PRELIMINARY REPORT:

2018 TAX PREFERENCE PERFORMANCE REVIEWS

Overview

July 2018

2018 Reviews

JLARC staff reviewed nine tax preferences in 2018, which are organized into seven reports below.

View a more detailed summary of all the preferences here.

The Citizen Commission for the Performance Measurement of Tax Preferences also considers preferences based on information provided by the Department of Revenue. View the 2018 expedited preference report here (PDF).

Preference Details	One Page Overview	Estimated Biennial Beneficiary Savings	Legislative Auditor's Recommendation	Commissioners' Recommendation *(Available October 2018)*
Aircraft for Air Ambulances		$0 - Preference not currently being used	Continue and clarify (structural purpose)	
Corporate Headquarters Investment Projects		$0 - Preference has not been used	Allow to expire and consider other strategies	
Custom Farming and Hauling Farm Products		$67,500 (Custom Farming) Unknown (Hauling Farm Products)	Continue and clarify (structural purpose)	
Government-Funded Behavioral Health Services		$10.9 Million	Determine whether to continue (policy decision)	

Preference Details	One Page Overview	Estimated Biennial Beneficiary Savings	Legislative Auditor's Recommendation	Commissioners' Recommendation *(Available October 2018)*
Investment Projects in High Unemployment Counties and Community Empowerment Zones		$5.8 Million	Review sufficiency of outcomes and add metrics	
Multifamily Housing in Mason County		$0 - Preference has not been used	Allow to expire and consider other strategies	
Nonprofit or Library Fundraising		Unknown - Beneficiaries not required to report savings	Continue and clarify	

Joint Legislative Audit & Review Committee

Study Process

What Is a Tax Preference?

Tax preferences are defined in statute (RCW 43.136.021) as exemptions, exclusions, or deductions from the base of a state tax; a credit against a state tax; a deferral of a state tax; or a preferential state tax rate. Washington has approximately 600 tax preferences.

Why a Review of Tax Preferences?

Legislature Creates a Process to Review Tax Preferences

In 2006, the Legislature stated that periodic reviews of tax preferences are needed to determine if their continued existence or modification serves the public interest. The Legislature enacted Engrossed House Bill 1069 to provide for an orderly process for the review of tax preferences (RCW 43.136).

Statute assigns specific roles in the process to two different entities.

- The Citizen Commission for Performance Measurement of Tax Preferences ("The Commission") creates a schedule for reviews, holds public hearings, and comments on the reviews.
- Staff to the Joint Legislative Audit and Review Committee (JLARC) conduct the reviews.

Citizen Commission Sets the Schedule

The Legislature directed the Commission to develop a schedule to accomplish an orderly review of most tax preferences over ten years. The Commission is directed to omit certain tax preferences from the schedule, such as those required by constitutional law. The Commission may also exclude preferences from review that the Commission determines are a critical part of the tax structure.

The Commission conducts its reviews based on analysis prepared by JLARC staff. In addition, the Commission may elect to rely on information supplied by the Department of Revenue.

In 2018, JLARC staff reviewed nine preferences compiled into seven reports (similar preferences may be combined into one report). The Commission's website includes analysis of preferences completed in previous years: See http://www.citizentaxpref.wa.gov/.

JLARC Staff's Approach to the Tax Preference Reviews

Statute guides the 11 questions typically covered in the reviews.

Public Policy Objectives:

1. What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference? (RCW 43.136.055(b))
2. What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives? (RCW 43.136.055(c))
3. To what extent will continuation of the tax preference contribute to these public policy objectives? (RCW 43.136.055(d))
4. If the public policy objectives are not being fulfilled, what is the feasibility of modifying the tax preference for adjustment of the tax benefits? (RCW 43.136.055(g))

Beneficiaries:

5. Who are the entities whose state tax liabilities are directly affected by the tax preference? (RCW 43.136.055(a))
6. To what extent is the tax preference providing unintended benefits to entities other than those the Legislature intended? (RCW 43.136.055(e))

Revenue and Economic Impacts:

7. What are the past and future tax revenue and economic impacts of the tax preference to the taxpayer and to the government if it is continued? (This includes an analysis of the general effects of the tax preference on the overall state economy, including the effects on consumption and expenditures of persons and businesses within the state.) (RCW 43.136.055(h))
8. If the tax preference were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preference and the extent to which the resulting higher taxes would have an effect on employment and the economy? (RCW 43.136.055(f))
9. If the tax preference were to be terminated, what would be the effect on the distribution of liability for payment of state taxes? (RCW 43.136.055(i))
10. For those preferences enacted for economic development purposes, what are the economic impacts of the tax preference compared to the economic impacts of government activities funded by the tax? (RCW 43.136.055(j))

Other States:

11. Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington? (RCW 43.136.055(k)

Depending on the tax preference, certain questions may be excluded. For instance, question #4 relates to modifying a preference if the public policy is not being fulfilled. If the preference is fulfilling its public policy, this question is skipped.

Analysis Process

JLARC Staff's Analysis Process

JLARC staff carefully analyze a variety of evidence in conducting these reviews:

- Legal and public policy history of the tax preferences.
- Beneficiaries of the tax preferences.
- Government and other relevant data pertaining to the utilization of these tax preferences.
- Economic and revenue impact of the tax preferences.
- Other states' laws to identify similar tax preferences.

Key: Understanding the Purpose

The Legislature now requires that any legislation creating a new preference, or expanding or extending an existing preference, must include a tax preference performance statement. The performance statement must contain a statement of legislative purpose as well as metrics to evaluate the effectiveness of the preference (RCW 82.32.808).

Some of the preferences included in this report were passed before the 2013 legislation requiring performance statements. When a preference's purpose or objective is identified in statute, staff are able to affirmatively state the public policy objective. Sometimes the objective may be found in intent statements or in other parts of statute if there is no tax preference performance statement..

When the Legislature did not state the public policy objective of a preference, JLARC staff may be able to infer what the implied public policy objective might be. To arrive at this inferred policy objective, staff review the following:

- Legislative history, including
    - Final bill reports for any statements on the intent or public policy objectives
    - Bills prior to the final version and legislative action on bills related to the same topic

    - Bill reports and testimony from various versions of the bill
    - Records of floor debate
- Relevant court cases that provide information on the objective.
- Department of Revenue information on the history of tax preferences, including rules, determinations, appeals, audits, and taxpayer communication.
- Press reports during the time of the passage of the bill which may indicate the intention of the preference.
- Other historic documents, such as stakeholder statements, that may address the issue addressed by the tax preference.

JLARC staff also interview the agencies that administer the tax preferences or are knowledgeable of the industries affected by the tax. Agencies may provide data on the value and usage of the tax preference and the beneficiaries. If the beneficiaries of the tax are required to report to other state or federal agencies, JLARC staff will also obtain data from those agencies.

If there is sufficient information in this evidence to infer a policy objective, JLARC staff state that in the reviews. In these instances, the purpose may be a more generalized statement than when there is explicit statutory language.

Joint Legislative Audit & Review Committee

More About 2018 Reviews

Audit Authority

The Joint Legislative Audit and Review Committee (JLARC) works to make state government operations more efficient and effective. The Committee is comprised of an equal number of House members and Senators, Democrats and Republicans.

JLARC's non-partisan staff auditors, under the direction of the Legislative Auditor, conduct performance audits, program evaluations, sunset reviews, and other analyses assigned by the Legislature and the Committee.

The statutory authority for JLARC, established in Chapter 44.28 RCW, requires the Legislative Auditor to ensure that JLARC studies are conducted in accordance with Generally Accepted Government Auditing Standards, as applicable to the scope of the audit. This study was conducted in accordance with those applicable standards. Those standards require auditors to plan and perform audits to obtain sufficient, appropriate evidence to provide a reasonable basis for findings and conclusions based on the audit objectives. The evidence obtained for this JLARC report provides a reasonable basis for the findings and conclusions, and any exceptions to the application of audit standards have been explicitly disclosed in the body of this report.

Scope & Objectives

Why a JLARC Study of Tax Preferences?

In 2006, the Legislature 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 Legislature directed the staff of the Joint Legislative Audit and Review Committee (JLARC) to conduct the periodic reviews. (Chapter 43.136 RCW).

Background

Tax preferences include exemptions, exclusions, or deductions from the base of a state tax; credits against a state tax; deferrals of a state tax; or preferential state tax rates.

Recognizing the need to assess the effectiveness of these tax preferences through an orderly process, the Legislature established the Citizen Commission for Performance Measurement of Tax Preferences. One of the Commission's roles is to develop a schedule for the orderly review of the state's 600+ tax preferences at least once every ten years. The Commission meets this requirement through the development of a ten-year review schedule, which can be revised annually if needed.

Omitted from review are several categories of tax preferences identified by statute (e.g., tax preferences required by constitutional law). Any tax preference the Commission determines is critical to the structure of the tax system may also be omitted. Additionally, the Commission may recommend an expedited process for any tax preference.

JLARC staff are to review tax preferences according to the schedule developed by the Commission. For each tax preference the Commission selects for a performance review, JLARC staff are to provide a recommendation to either: (1) continue; (2) allow to expire; (3) continue and modify the expiration date; (4) review and clarify; or (5) terminate the preference.

Study Scope

The Citizen Commission selected the following tax preferences for a performance review by JLARC staff in 2018:

Brief Description and Tax Type	RCW Citation	Year Enacted
1. Custom Farming (B&O Tax)	82.04.625	2007
2. Hauling Farm Products for Relatives (Public Utility Tax)	82.16.300	2007
3. Corporate Headquarters (Sales and Use Tax)	82.82.020	2008
4. Multi-Unit Urban Housing in Rural Counties (Property Tax)	Ch. 84.14 RCW; 84.14.040(1)	2014
5. Mental Health Services (B&O Tax)	82.04.4277	2011
6. Aircraft for Air Ambulances (Aircraft Excise Tax)	82.48.100(8)	2010
7. Aircraft for Air Ambulances (Property Tax)	84.36.575	2010
8. Nonprofit Fundraising (Use Tax)	82.12.225	2013
9. High-Unemployment County Investment Projects (Sales and Use Tax)	82.60.040; 82.60.049	1985

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

Brief Description and Tax Type	RCW Citation	Year Enacted
1. Seed Conditioning (B&O Tax)	82.04.120	1987
2. Conditioned Seed Wholesaling (B&O Tax)	82.04.331	1998
3. Shipping Farm Products to Port (Public Utility Tax)	82.16.050(10)	2007
4. Agricultural Fairs (B&O Tax)	82.04.335	1965

Brief Description and Tax Type	RCW Citation	Year Enacted
5. Hay Cubing (B&O Tax)	82.04.120	1997
6. Christmas Tree Producers (B&O Tax)	82.04.335	1987
7. Christmas Trees and Cottonwoods (Timber Tax)	84.33.170	1971
8. Christmas Tree Inputs (Sales and Use Tax)	82.04.213	1987
9. Hop Commission Services (B&O Tax)	82.04.338	1998
10. Farming Machinery and Equipment (Property Tax)	84.36.630	2001
11. Farm-Worker Housing (Sales and Use Tax)	82.08.02745; 82.12.02685	1996
12. Product Leases (Leasehold Excise Tax)	82.29A.120(2)	1976
13. Anaerobic Digesters for Dairies (Sales and Use Tax)	82.08.900; 82.12.900	2001
14. Crop Dusting (Aircraft Fuel Tax)	82.42.230(1)	1982
15. Conservation Futures (Property Tax)	84.36.500	1984
16. Agricultural Products	84.36.470	1984
17. Hops Processed and Exported (B&O Tax)	82.04.337	1987
18. Agricultural Products (Litter Tax)	82.19.050(2)	1971
19. Nursery Stock (Property Tax)	84.40.220	1971
20. Livestock Nutrient Management Equipment (Sales and Use Tax)	82.08.890; 82.12.890	2001
21. Horticultural Packing Materials (Sales and Use Tax)	82.08.0311; 82.12.0311	1988
22. Semen for Artificial Inseminations (Sales and Use Tax)	82.08.0272; 82.12.0267	1965
23. Aquaculture Feed (Sales and Use Tax)	82.08.0294; 82.12.0294	1985
24. Livestock Feed (Sales and Use Tax)	82.08.0296; 82.12.0296	1986
25. Conifer Seedlings Sold Out-of-State (Sales and Use Tax)	82.08.850; 82.12.850	2001
26. Pollen (Sales and Use Tax)	82.08.0277 82.08.0273	1967
27. Pollination Agents (Sales and Use Tax)	82.04.050(11)	1993
28. Farm Machinery Replacement Parts (Sales and Use Tax)	82.08.855; 82.12.855	2006
29. Fuel Used on Farms (Sales and Use Tax)	82.08.865; 82.12.865	2006
30. Farm Machinery Sold to Nonresidents (Sales Tax)	82.08.0268	1961
31. Warehouse and Grain Elevator Construction and Equipment (Sales and Use Tax)	82.08.820; 82.12.820	1997

Brief Description and Tax Type	RCW Citation	Year Enacted
32. Farm Auction Sales (Sales and Use Tax)	82.08.0257; 82.12.0258	1943
33. Leased Irrigation Equipment (Sales and Use Tax)	82.08.0288; 82.12.0283	1983
34. Farm Property (Estate Tax)	83.100.046	2005
35. Agricultural Products (B&O Tax)	82.04.330; 82.04.410	1935
36. Grain and Unprocessed Milk Wholesaling (B&O Tax)	82.04.332	1998
37. Livestock Medicine (Sales and Use Tax)	82.08.880; 82.12.880	2001
38. Gas Used to Heat Chicken Houses (Sales and Use Tax)	82.08.910; 82.12.910	2001
39. Irrigation Water (Public Utility Tax)	82.16.050(7)	1935
40. Chicken Bedding Materials (Sales and Use Tax)	82.08.920; 82.12.920	2001

Study Objectives

Public Policy Objectives:

1. What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference? (RCW 43.136.055(b))
2. What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives? (RCW 43.136.055(c))
3. To what extent will continuation of the tax preference contribute to these public policy objectives? (RCW 43.136.055(d))
4. If the public policy objectives are not being fulfilled, what is the feasibility of modifying the tax preference for adjustment of the tax benefits? (RCW 43.136.055(g))

Beneficiaries:

5. Who are the entities whose state tax liabilities are directly affected by the tax preference? (RCW 43.136.055(a))
6. To what extent is the tax preference providing unintended benefits to entities other than those the Legislature intended? (RCW 43.136.055(e))

Revenue and Economic Impacts:

7. What are the past and future tax revenue and economic impacts of the tax preference to the taxpayer and to the government if it is continued? (This includes an analysis of the general effects of the tax preference on the overall state economy, including the effects on consumption and expenditures of persons and businesses within the state.) (RCW 43.136.055(h))

8. If the tax preference were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preference and the extent to which the resulting higher taxes would have an effect on employment and the economy? (RCW 43.136.055(f))
9. If the tax preference were to be terminated, what would be the effect on the distribution of liability for payment of state taxes? (RCW 43.136.055(i))
10. For those preferences enacted for economic development purposes, what are the economic impacts of the tax preference compared to the economic impact of government activities funded by the tax? (This analysis involves conducting an economic impact study using OFM's input-output model.) (RCW 43.136.055(j))

Other States:

11. Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington? (RCW 43.136.055(k))

Timeframe for the Study

A preliminary audit report will be presented at the July 2018 JLARC meeting and at the August 2018 meeting of the Commission. A final report will be presented to JLARC in December 2018.

Joint Legislative Audit & Review Committee

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Aircraft for Air Ambulances

One Page Overview

Tax exemptions for nonprofits that own aircraft used exclusively for emergency medical transportation

An aircraft excise tax exemption and a property tax exemption are provided for nonprofit 501(c)(3) organizations that own aircraft used exclusively for emergency medical transportation.

The preferences are scheduled to expire January 1, 2020.

Estimated Biennial Beneficiary Savings

$0

Tax Type

Aircraft Excise Tax, Property Tax

RCW 82.48.100(8), 84.36.575

Applicable Statutes

Inferred public policy objective met

The Legislature did not state a public policy objective for either preference when they were passed in 2010. JLARC staff infer an objective based on testimony to the Legislature.

Objective (inferred)	Results
Provide tax relief to nonprofit organizations that own aircraft used exclusively for emergency medical transportation.	**Met.** The preferences provided tax relief to a nonprofit air ambulance service provider for six years. No organizations currently qualify for the preferences, but they could provide tax relief to qualifying nonprofits in the future.

Legislative Auditor's Recommendation: Continue and clarify (structural purpose)

The Legislature should clarify the two preferences to add performance statements, specify public policy objectives, and eliminate expiration dates.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2018

Corporate Headquarters Investment Projects

One Page Overview

Sales & use tax deferral for businesses locating in community empowerment zones

The preference provides a sales and use tax deferral on building expenses for businesses that establish corporate headquarters in a designated community empowerment zone (CEZ).

The deferred taxes are fully waived if:

- The Department of Revenue certifies the investment project meets all eligibility requirements.
- The completed project meets eligibility requirements for a total of eight years.

The company must pay back a portion of the waived taxes if it does not continue to meet eligibility requirements for a total of eight years.

The preference took effect July 1, 2009. The Legislature did not set an expiration date, but did establish that no new applications can be submitted after December 31, 2020.

Estimated Biennial Beneficiary Savings

$0 - Preference has not been used

Tax Type

Sales and Use Tax

RCW 82.82.020

Applicable Statutes

One of two inferred public policy objectives met

The Legislature did not state a public policy objective when it passed this preference in 2008. JLARC staff infer two public policy objectives based on the eligibility requirements, other related legislation, and testimony to the Legislature.

Inferred Objectives	Results
Encourage private sector investment and employment in community empowerment zones (CEZs) • CEZs are designated areas that have limited employment and educational services, a lack of affordable housing, and deteriorating infrastructure.	**Not currently met.** Department of Revenue tax records indicate the preference has never been used.
Better compete with Oregon and Idaho for private sector investment • Oregon has no sales tax, and Idaho had a similar incentive when the bill was passed.	**Met.** The preference makes Washington more competitive with Oregon for attracting corporate headquarters. Idaho repealed a similar preference in 2008 after this bill passed.

Many factors influence where businesses locate and invest

Evidence from corporate relocations and academic research suggest that tax incentives are one of many factors considered when businesses locate their headquarters. Many of these factors are not present in CEZs. Other states and local governments have used strategies beyond tax incentives to revitalize economically distressed areas.

Recommendations

Legislative Auditor's Recommendation: Allow to expire and consider other strategies

The Legislature should allow the preference to expire if no business has applied to use it by December 31, 2020. The Legislature may want to consider other strategies beyond tax incentives to encourage economic development in CEZs.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2018

Custom Farming and Hauling Farm Products

One Page Overview

B&O and public utility tax exemptions for those who provide services or haul goods for farmers

The Legislature enacted these preferences for farms in 2007:

1. **Custom farming** and specific farm services: A B&O tax exemption for farmers who provide custom farming services (e.g., planting or harvesting of agricultural products) to other farmers. The exemption also applies to those who provide specific farming services (e.g., farm management) to related farmers.
2. **Hauling farm products and equipment**: A public utility tax exemption for those who haul farm machinery, equipment, or agricultural products for a related farmer or person performing custom farming services.

"Related" farmer means a family member or a relationship established through a corporation or trust, as specified by the Internal Revenue Service.

Both preferences are scheduled to expire December 31, 2020.

Estimated Biennial Beneficiary Savings

$67,500 (Custom Farming)

Unknown (Hauling Farm Products)

Tax Type

B&O Tax
Public Utility Tax

RCW 82.04.625
RCW 82.16.300

Applicable Statutes

Inferred public policy objective met by one preference. Impact of second preference unknown.

Preference	Objectives (inferred)	Results
Custom farming and specific farm services (B&O tax preference)	Provide tax relief	**Met.** Preference is providing tax relief to six to seven businesses annually.
Hauling farm products and equipment for related farmers (Public utility tax preference)	Provide tax relief	**Unknown.** Structurally, the preference would provide tax relief. No data or information is available to determine if it is being used.

Some Washington farmers reorganized their farms in response to federal regulations. This had state tax consequences.

Under Bureau of Reclamation regulations, a farm owner can receive irrigation water from a federal reclamation project on no more than 960 acres. To remain eligible for federal irrigation water, some farm owners split their farm among multiple owners but continued to operate as one farming operation.

This created an unintended structural tax issue. **If one owner provided a service or hauled products/equipment for another owner on the same farm, these services could be subject to B&O or public utility tax.** The preferences eliminate potential taxation in these situations.

Farmers who meet all eligibility criteria but were not impacted by the federal regulations also qualify for these preferences.

Recommendations

Legislative Auditor's Recommendation: Continue and clarify (structural purpose)

The Legislature should continue and clarify the two preferences to add performance statements, specify public policy objectives, and eliminate the expiration dates.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2018

Government-Funded Behavioral Health Services

One Page Overview

B&O tax deduction for government-funded behavioral health care

The preference allows two types of entities to deduct the amount of government funding spent on behavioral health services:

1. **Health or social welfare organizations--**nonprofits that provide mental health and chemical dependency services to patients (i.e. behavioral health) can deduct the amount of government funding they receive.
2. **Behavioral Health Organizations (BHOs)**--regional health care entities that contract with providers for government-funded behavioral health services can deduct the amount they pay to health or social welfare organizations.

The preference is scheduled to expire January 1, 2020.

Estimated Biennial Beneficiary Savings

$10.9 Million

Tax Type

B&O Tax

RCW 82.04.4277

Applicable Statutes

Inferred public policy objectives met

The Legislature did not state a public policy objective when it passed this preference in 2011. JLARC staff infer two public policy objectives based on testimony to the Legislature when the legislation was passed.

Objectives (inferred)	Results
Increase the amount of funding available for behavioral health services.	**Met.** The preference reduces the amount of tax collected on government-funded behavioral health services so that more money goes directly to treatment.
Provide similar tax treatment for all entities that receive government funding for behavioral health services.	**Met**. The preference allows privately run BHOs to deduct from B&O taxes the amount of government funding they spend on behavioral health services. It also allows health or social welfare organizations to deduct from B&O taxes the amount of government funding they receive from privately run entities.

Changes in Washington's management of Medicaid funding will affect how health care providers are taxed

The state is currently in the process of integrating Medicaid-funding of behavioral health services with physical health services. This will change how health care entities and providers are taxed. As a result, more providers -- in Pierce County and other parts of the state -- are likely to use the preference until it expires in 2020.

When the preference expires, more government funding for behavioral health services will be taxed, so less money may go directly to behavioral health service treatment.

Recommendations

Legislative Auditor's Recommendation: Determine whether to continue (policy decision)

The Legislature should determine whether to continue the preference. If the Legislature wants to continue the tax deduction for government-funded behavioral health care, it will need to take action. Otherwise, behavioral health will be treated the same as physical health services and providers will pay B&O taxes beginning in 2020.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2018

Investment Projects in High Unemployment Counties and Community Empowerment Zones

One Page Overview

Sales and use tax deferral for qualifying businesses that invest in facilities, machinery, or equipment in certain distressed areas

Qualifying businesses located in economically distressed areas do not pay sales or use tax on the following investments:

- New construction, or expansion or renovation of existing facilities.
- New machinery or equipment.

The preference applies to two types of economically distressed areas:

1. A **high unemployment county** designated by the Employment Security Department based on recurring above average unemployment rates.
2. A **community empowerment zone (CEZ)** designated by the Department of Commerce. CEZs are located in cities or unincorporated areas and are characterized by limited employment opportunities and educational services, a lack of affordable housing, and deteriorating infrastructure.

The deferred taxes are waived if businesses continue to use the facilities, machinery, or equipment as intended for a total of eight years.

The preference has no expiration date, but the Department of Revenue cannot issue deferral certificates after July 1, 2020.

Estimated Biennial Beneficiary Savings

$5.8 Million

Tax Type

Sales and Use Tax

RCWs 82.60.040; 82.60.049

Applicable Statutes

Stated public policy objectives

The Legislature stated its objectives in 2010 when it restructured a previous deferral program to encourage investment in high unemployment counties and CEZs.

Objectives (stated)	Results
Stimulate economic development and job growth in distressed areas	**Mixed**. Businesses are using the preference in eight out of 22 high unemployment counties and four out of six CEZs. These beneficiaries have created new jobs, but fewer than they originally estimated. It is unclear if the job growth meets legislative expectations.
Reduce poverty in distressed areas	**Unclear, but likely nominal impact.** JLARC staff estimate the potential reduction to the poverty rate is at most 0.07 percent in qualifying areas.

Recommendations

Legislative Auditor's Recommendation: Review sufficiency of outcomes and add metrics

The Legislature should review the sufficiency of outcomes and add metrics for the preference. While businesses are using the preference in eight high unemployment counties and four CEZs, estimates vary on the extent to which the preference has impacted job growth. Businesses reported creating 87 percent fewer jobs than they originally estimated. It is unclear if the job growth meets legislative expectations.

It is also unclear whether the preference reduced poverty in distressed areas. At most, JLARC staff estimate the potential reduction in the poverty rate to be 0.07 percent in qualifying areas. The data necessary to determine a more precise impact on poverty rates does not exist.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2018

Multifamily Housing in Mason County

One Page Overview

Property tax exemption for Multifamily Housing in Mason County

The preference provides a property tax exemption to owners for new, expanded, or updated multifamily housing in targeted areas of rural counties. Mason County is the only rural county that qualifies under current law.

The housing must have at least four units and include affordable housing. The property remains exempt for eight to twelve years, depending on the percent of units that are affordable. Affordability and income limits are defined by Mason County.

The preference was created in 2014. Developers may not apply after January 1, 2020.

Estimated Biennial Beneficiary Savings

$0

Tax Type

Property Tax

Chapter 84.14 RCW

Applicable Statutes

The stated public policy objective is not being met

The Legislature stated a public policy objective in the tax preference performance statement for the preference when it was enacted in 2014.

Objective (stated)	Results
Stimulate construction of multifamily housing in target areas of rural counties where housing options, including affordable housing options, are severely limited.	**Not met**. No developers have built multifamily housing in Mason County since 2014.

Preference related to a broader exemption that JLARC staff will review in 2019

The preference is related to an exemption that is commonly referred to as the Multifamily Property Tax exemption (MFTE). Like this preference, the MFTE allows a larger number of local governments to provide a property tax exemption to stimulate the construction of multifamily housing within designated areas.

This preference for Mason County has more stringent income and project eligibility requirements than MFTE. For example, at least 20% of units must be affordable to qualify for the preference. An upcoming 2019 JLARC review of MFTE may identify factors that help multifamily housing preferences achieve their goals. That review may also be informative for the Mason County preference.

Recommendations

Legislative Auditor's Recommendation: Allow to expire and consider other strategies

The Legislature stated it intended to extend the preference if at least 20 percent of new housing units were occupied by low or moderate income households. However, there has been no new multifamily housing developed in Mason County since the preference was enacted.

The Legislature should allow the preference to expire and consider whether different strategies would be more successful for attracting new development.

While it has not achieved its objective to stimulate housing development, an upcoming 2019 JLARC review of a related preference may provide information to improve the incentive.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2018

Nonprofit or Library Fundraising

One Page Overview

Use tax exemption for items acquired at nonprofit or library fundraising events

The preference provides a use tax exemption for individuals who purchase or win items at qualifying nonprofit or library fundraising events or activities.

Items are exempt from use tax if they are:

- Valued at less than $12,000.
- Obtained at an event that is exempt from collecting sales tax.

Qualifying fundraising events must be exempt from B&O tax, time-limited, and intended to raise money to further the goals of the nonprofit or library.

Estimated Biennial Beneficiary Savings
Unknown - Beneficiaries not required to report savings.

Tax Type

Use Tax

RCW 82.12.225

Applicable Statutes

Stated public policy objective met

The Legislature stated a policy objective when it passed this preference in 2013.

Objective	Results
Provide use tax relief to individuals who purchase or win items at qualifying fundraising events.	**Met.**

Absent legislative action, the preference will expire on July 1, 2020.

Recommendation

Legislative Auditor's Recommendation: Continue and clarify (structural purpose)

The Legislature should continue and clarify the preference because it is achieving its objective of providing use tax relief to individuals who purchase or win items at qualifying nonprofit or library fundraising events.

If the Legislature does continue this preference, it should **consider making the preference permanent, adding a mechanism to allow the exempt value of items to increase with time, and recategorizing the preference as one intended to provide tax relief.**

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2018

Aircraft for Air Ambulances

Inferred objective: Give tax relief to nonprofit air ambulance providers

Nonprofit 501(c)(3) exempt organizations that own aircraft used exclusively for emergency medical transportation (air ambulances) are exempt from the aircraft excise tax and property tax.

Air ambulances are specially equipped to provide emergency medical services before and during transport.

Objective met: Preferences provided tax relief to one recipient for six years

The only qualifying nonprofit merged with a for-profit company in March 2016.

The five **air ambulance service providers now operating in WA do not qualify** because they are not nonprofit organizations.

Preferences expire January 1, 2020

Preferences provide the potential for tax exemption if a qualifying nonprofit were to own aircraft and provide air ambulance services.

Legislative Auditor's recommendation

Continue and clarify (structural purpose)

The Legislature should continue and clarify the two preferences to:

- Add performance statements that specify public policy objectives.
- Eliminate the expiration dates so they continue to offer potential tax relief if providers qualify in the future.

Preliminary Report:

2018 Tax Preference Performance Reviews

Aircraft for Air Ambulances

Legislative Auditor's Conclusion:

The Legislature should clarify whether the preferences are intended solely for tax relief. If so, the Legislature should remove the expiration dates.

July 2018

Tax exemptions for nonprofits that own aircraft used exclusively for emergency medical transportation

An aircraft excise tax exemption and a property tax exemption are provided for nonprofit 501(c)(3) organizations that own aircraft used exclusively for emergency medical transportation.

The preferences are scheduled to expire January 1, 2020.

Estimated Biennial Beneficiary Savings

$0

Tax Type

Aircraft Excise Tax, Property Tax

RCW 82.48.100(8), 84.36.575

Applicable Statutes

Inferred public policy objective met

The Legislature did not state a public policy objective for either preference when they were passed in 2010. JLARC staff infer an objective based on testimony to the Legislature.

Objective (inferred)	Results
Provide tax relief to nonprofit organizations that own aircraft used exclusively for emergency medical transportation.	**Met.** The preferences provided tax relief to a nonprofit air ambulance service provider for six years. No organizations currently qualify for the preferences, but they could provide tax relief to qualifying nonprofits in the future.

Legislative Auditor's Recommendation: Continue and clarify (structural purpose)

The Legislature should clarify the two preferences to add performance statements, specify public policy objectives, and eliminate expiration dates.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2018

REVIEW DETAILS

1. What are the preferences?

Nonprofit air ambulance service providers are exempt from aircraft excise tax and property tax

JLARC staff infer the public policy objective for these preferences is to provide tax relief

The Legislature did not state a public policy objective for either of the preferences. The preferences were passed before the Legislature required a performance statement for new preferences.

Based on testimony to the Legislature, JLARC staff infer the preferences were enacted to provide tax relief to nonprofit organizations that own aircraft used exclusively to provide emergency medical transportation services.

Nonprofit air ambulance service providers qualify

Nonprofit 501(c)(3) exempt organizations that **own** aircraft **used exclusively for emergency medical transportation** are exempt from the aircraft excise tax and property tax. These air ambulances are specially equipped to provide emergency medical services before and during transport.

The property tax exemption must benefit the nonprofit organization that owns the aircraft.

Qualifying nonprofits must:

- Report use of the aircraft excise tax exemption annually to the Washington State Department of Transportation's Aviation Division.
- Apply annually to the Department of Revenue for the property tax exemption.

Preferences scheduled to expire January 1, 2020

Both preferences took effect July 13, 2010, and are scheduled to expire January 1, 2020.

REVIEW DETAILS

2. Other relevant background

Aircraft used in Washington generally subject to either aircraft excise tax or property tax

Most aircraft owners are required to register with the Washington State Department of Transportation's (WSDOT) Aviation Division each calendar year an aircraft operates or is based in the state.

Aircraft are subject annually to either **aircraft excise tax** or **property tax**, but not both.

Aircraft excise tax

Owners of general aviation aircraft must register with WSDOT's Aviation Division and pay aircraft excise tax. General aviation aircraft do not include any aircraft owned by the government or by commercial airlines. If aircraft excise tax is paid, the aircraft is exempt from property tax.

The aircraft excise tax is collected annually by WSDOT and the amount due is determined by the aircraft type.

Exhibit 2.1: Aircraft excise tax registration fees determined by aircraft type

Type of Aircraft	Fee
Home built	$ 20
Lighter than air	$ 20
Sailplane	$ 20
Single engine fixed wing	$ 50
Small multi-engine fixed wing	$ 65
Helicopter	$ 75
Large multi-engine fixed wing	$ 80
Turboprop multi-engine fixed wing	$100
Turbojet multi-engine fixed wing	$125

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

Property tax

To be subject to property tax, aircraft must be:

- Exempt from aircraft excise tax.
- Operated by an airplane company that transports people or property for compensation.

Property tax rates are expressed in dollars per $1,000 of assessed value and vary depending on the locality. Local county assessors set the levy rate based on the taxing district's budget request, the total assessed value of the taxing district, and any applicable levy limits. The tax rates for personal property and real property are the same in each taxing district.

Five air ambulance service providers currently operate in Washington, but none qualify for the preferences

The Department of Health certifies and licenses air ambulance service providers in Washington. As of January 2018, there were five licensed providers in the state. None of the current providers qualify for the preferences because they are not nonprofit organizations. Current providers include:

- Airlift Northwest
- Island Air Ambulance
- Life Flight Network
- MedFlight One
- REACH Air Medical Services

REVIEW DETAILS

3. Inferred objective met, but preferences not currently used

Preferences provided tax relief until 2016, but no current beneficiaries or revenue impacts.

The Legislature did not state a public policy objective for either preference. The preferences were enacted before the Legislature required a performance statement for new preferences.

Inferred objective: provide tax relief to nonprofit air ambulance service providers

JLARC staff infer the objective for both preferences was to provide tax relief to nonprofit organizations that own aircraft used exclusively for emergency medical transportation.

The prime sponsor of the preferences testified that the aircraft excise tax and property tax exemptions addressed a specific situation with a nonprofit air ambulance provider. In 2007, the Department of Revenue began assessing property tax on aircraft owned by Inland Northwest Medical Services (INHS) and its subsidiary, Northwest Medstar. This nonprofit emergency air ambulance provider had not previously been assessed property tax.

JLARC staff infer that the objective of the preferences was to provide immediate aircraft excise and property tax relief for nonprofits that owned aircraft used exclusively for medical transport, and to continue to provide tax relief for any similar situations in the future.

Inferred objective met, but preferences not currently used

The preferences achieve the inferred objective by eliminating aircraft excise and property taxation for nonprofits that own aircraft used exclusively for emergency medical transportation.

INHS/Northwest Medstar is the only nonprofit organization to apply for the property tax exemption since the preferences were established in 2010.

According to the Washington State Department of Transportation's Aviation Division, no nonprofit has reported using the aircraft excise tax exemption.

In March 2016, INHS/Northwest Medstar was acquired by Life Flight Network, a for-profit business. Neither preference has been used since then. However, the preferences continue to provide the potential for tax relief if a qualifying nonprofit air ambulance service provider begins operating in Washington.

No beneficiaries or revenue impacts for preferences

There are currently no qualifying nonprofit air ambulance service providers licensed in Washington. The preferences have no revenue impact at this time.

REVIEW DETAILS

4. No similar preferences in neighboring states

Idaho and Oregon do not have similar aircraft tax preferences

JLARC staff reviewed laws in Idaho and Oregon to determine if similar tax preferences are provided in neighboring states.

Idaho

In Idaho, aircraft owners must register annually with the Idaho Transportation Department Division of Aeronautics. The registration fees are assessed at a rate of 3 cents per pound of maximum certified weight. Fees range from $20 to $600.

Aircraft owners who do not pay the registration fee are subject to personal property tax in lieu of the fee. There are no exemptions for aircraft used for medical transportation in general, or specifically for nonprofits that own aircraft used for emergency medical transportation.

Oregon

In Oregon, aircraft owners must register annually with the Oregon Department of Aviation. Similar to Washington, the registration fee is fixed and based on the type of aircraft. Fees range from $55 to $700. There is no exemption for nonprofits that own aircraft used for emergency medical transportation.

Oregon does not impose property tax on aircraft.

REVIEW DETAILS

5. Applicable statutes

RCW 82.48.100, RCW 84.36.575

Aircraft Excise Tax

RCW 82.48.100

Exempt aircraft. (Effective until January 1, 2020.)

This chapter does not apply to:

(1) Aircraft owned by and used exclusively in the service of any government or any political subdivision thereof, including the government of the United States, any state, territory, or possession of the United States, or the District of Columbia, which are not engaged in carrying persons or property for commercial purposes;

(2) Aircraft registered under the laws of a foreign country;

(3) Aircraft that are owned by a nonresident and registered in another state, if the aircraft remains in this state or is based in this state, or both, for a period less than ninety days;

(4)(a) Aircraft engaged principally in commercial flying that constitutes interstate or foreign commerce, except as provided in (b) of this subsection.

(b) The exemption provided by (a) of this subsection does not apply to aircraft engaged principally in commercial flying that constitutes interstate or foreign commerce when such aircraft will be in this state exclusively for the purpose of continual storage of not less than one full calendar year;

(5) Aircraft owned by the manufacturer thereof while being operated for test or experimental purposes, or for the purpose of training crews for purchasers of the aircraft;

(6) Aircraft being held for sale, exchange, delivery, test, or demonstration purposes solely as stock in trade of an aircraft dealer licensed under Title 14 RCW;

(7) Aircraft owned by a nonresident of this state if the aircraft is kept at an airport in this state and that airport is jointly owned or operated by a municipal corporation or other governmental entity of this state and a municipal corporation or other governmental entity of another state, and the owner or operator of the aircraft provides the department with proof that the owner or operator has paid all taxes, license fees, and registration fees required by the state in which the owner or operator resides; and

(8) Aircraft that are: (a) Owned by a nonprofit organization that is exempt from federal income taxation under 26 U.S.C. Sec. 501(c)(3) of the federal internal revenue code; and (b) exclusively used to provide emergency medical transportation services.

Property tax

RCW 84.36.575

Nonprofit organizations - Aircraft. (Expires January 1, 2020.)

An aircraft is exempt from taxation, if:

(1) The aircraft is owned by a nonprofit organization that is exempt from federal income taxation under 26 U.S.C. Sec. 501(c)(3);

(2) The aircraft is used to provide emergency medical transportation services; and

(3) The exemption inures to the benefit of the nonprofit organization that owns the aircraft.

RECOMMENDATIONS & AGENCY RESPONSE

Legislative Auditor's Recommendation

Legislative Auditor recommends continuing and clarifying the two preferences (structural purpose)

The Legislature should continue and clarify the two preferences to:

- **Add performance statements that specify public policy objectives.** The preferences were passed before the Legislature required a performance statement for new preferences. JLARC staff infer the preferences were intended to provide tax relief to nonprofit air ambulance service providers.

- **Eliminate expiration dates.** Consider exempting the preferences from the statutory requirement for an expiration date. While no air ambulance service providers currently qualify to use the preferences, they continue to provide the potential for tax relief if qualifying nonprofit air ambulance service providers begin operating in Washington.

Legislation Required: Yes.

Fiscal Impact: None.

RECOMMENDATIONS & AGENCY RESPONSE

Letter from Commission Chair

Available October 2018

RECOMMENDATIONS & AGENCY RESPONSE

Commissioners' Recommendation

Available October 2018

RECOMMENDATIONS & AGENCY RESPONSE

Agency Response

If applicable, available October 2018

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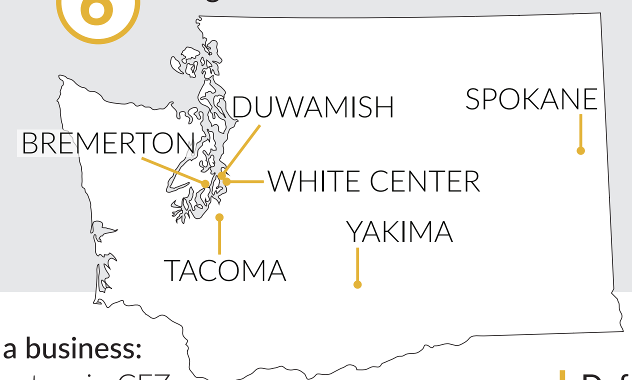
Corporate Headquarters Investment Projects

Sales and use tax deferral for corporate headquarters in a Community Empowerment Zone

Community Empowerment Zones (CEZs):

6 designated areas



Areas are characterized by:

- Limited employment.
- Few educational services.
- Poor infrastructure.
- Lack of affordable housing.
- Low wages.

Sales and use tax is deferred if a business:

- Operates corporate headquarters in CEZ.
- Invests at least $30 million in qualifying construction expenses.
- Provides at least 300 permanent full-time jobs after construction.

Deferred taxes will be waived if the business stays eligible for 8 years.

Inferred objectives:

Encourage investment

Objective not currently met: **No businesses have applied** since preference was enacted in 2009. New applications cannot be submitted after 2020.

&

Compete with neighboring states

Objective met: The preference makes Washington more competitive with Oregon for attracting corporate headquarters. Idaho repealed a similar preference in 2008 after this bill passed.

Research suggests other factors influence location of headquarters

- Ability to attract and retain workforce talent.
- Corporate brand/culture.
- Good airport and transportation infrastructure.
- Research and higher ed. facilities nearby.
- Amenities that appeal to employees.

Legislative Auditor's recommendation

Allow to expire and consider other strategies

The Legislature should allow the preference to expire if no business has applied for the incentive by December 31, 2020. The Legislature may want to consider other strategies beyond tax incentives if it wants to attract businesses to CEZs.

For more information, contact: **Keenan Konopaski,** Washington State Legislative Auditor
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Preliminary Report:

2018 Tax Preference Performance Reviews

Corporate Headquarters Investment Projects

Legislative Auditor's Conclusion:

Businesses have not used the tax preference to locate headquarters in community empowerment zones. The Legislature may want to consider other strategies to revitalize these areas.

July 2018

Sales & use tax deferral for businesses locating in community empowerment zones

The preference provides a sales and use tax deferral on building expenses for businesses that establish corporate headquarters in a designated community empowerment zone (CEZ).

The deferred taxes are fully waived if:

- The Department of Revenue certifies the investment project meets all eligibility requirements.
- The completed project meets eligibility requirements for a total of eight years.

The company must pay back a portion of the waived taxes if it does not continue to meet eligibility requirements for a total of eight years.

The preference took effect July 1, 2009. The Legislature did not set an expiration date, but did establish that no new applications can be submitted after December 31, 2020.

Estimated Biennial Beneficiary Savings

$0 - Preference has not been used

Tax Type

Sales and Use Tax

RCW 82.82.020

Applicable Statutes

One of two inferred public policy objectives met

The Legislature did not state a public policy objective when it passed this preference in 2008. JLARC staff infer two public policy objectives based on the eligibility requirements, other related legislation, and testimony to the Legislature.

Inferred Objectives	Results
Encourage private sector investment and employment in community empowerment zones (CEZs) • CEZs are designated areas that have limited employment and educational services, a lack of affordable housing, and deteriorating infrastructure.	**Not currently met.** Department of Revenue tax records indicate the preference has never been used.
Better compete with Oregon and Idaho for private sector investment • Oregon has no sales tax, and Idaho had a similar incentive when the bill was passed.	**Met.** The preference makes Washington more competitive with Oregon for attracting corporate headquarters. Idaho repealed a similar preference in 2008 after this bill passed.

Many factors influence where businesses locate and invest

Evidence from corporate relocations and academic research suggest that tax incentives are one of many factors considered when businesses locate their headquarters. Many of these factors are not present in CEZs. Other states and local governments have used strategies beyond tax incentives to revitalize economically distressed areas.

Recommendations

Legislative Auditor's Recommendation: Allow to expire and consider other strategies

The Legislature should allow the preference to expire if no business has applied to use it by December 31, 2020. The Legislature may want to consider other strategies beyond tax incentives to encourage economic development in CEZs.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2018

REVIEW DETAILS

1. What is the preference?

Sales and use tax preference on building expenses for businesses that establish corporate headquarters in a community empowerment zone

Preference has two inferred objectives

The Legislature did not state a public policy objective when it passed this preference.

JLARC staff infer two public policy objectives based on the preference's eligibility requirements, the legislative purpose of community empowerment zones (CEZs), and the prime sponsor's testimony to the Legislature:

1. Encourage private sector investment and employment in CEZs.
2. Better compete with Oregon and Idaho for private sector investment.

Qualifying projects must meet specific requirements

Businesses may apply for the deferral at any time before headquarters construction is completed. However, tax liabilities incurred before a business applies do not qualify for the deferral.

To be eligible, the project must meet all of the following requirements:

- **Locate within a CEZ.** See What are CEZs for more information.
- **Operate as a "corporate headquarters,"** meaning a facility where corporate staff are physically employed and handle most of the company's regional or national management services. "Company management services" include accounting, information technology, insurance, legal, payroll, personnel, research and development, and tax. Manufacturing, wholesaling, or warehousing facilities do not qualify.
- **Invest at least $30 million** in qualified building expenses, such as construction or expansion, tangible personal property, and fixtures. Qualifying expenses include planning, installation, and construction labor and services.
- **Provide at least 300 permanent, full-time positions after construction.** Each qualified employment position must earn at least the state's annual average wage for that year, as determined by the Employment Security Department. The qualified employment positions must be filled by the end of the calendar year following the year in which the project is certified as operationally complete. If a recipient does not meet the requirements for qualified employment positions by the end of the second calendar year following the year in which the project is certified operationally complete, all deferred taxes are immediately due. Washington's average annual wage for calendar year 2016 was $59,073.
- **File an annual tax performance report** with DOR.

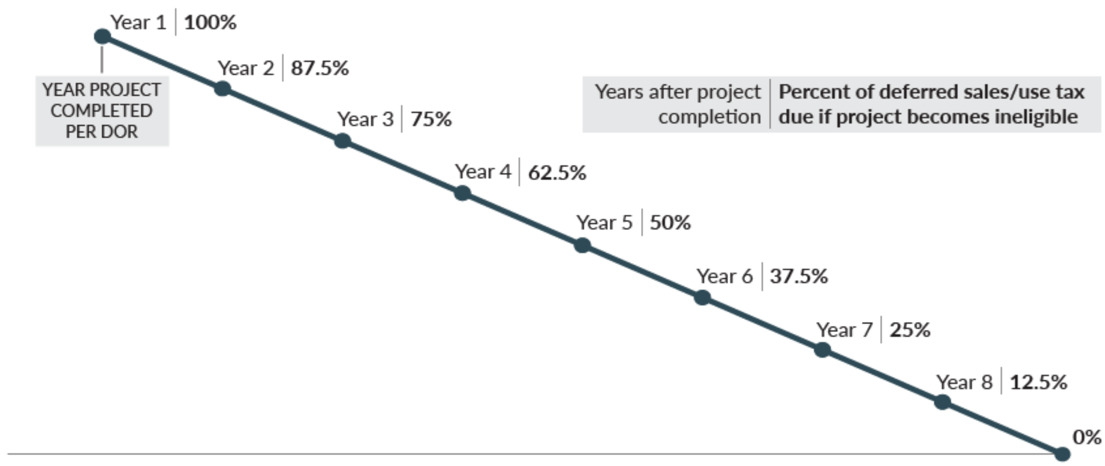
The number of eligible investment projects is limited to two statewide per biennium. Additionally, a CEZ can have only one eligible investment project per biennium.

Projects must meet program requirements for eight years to receive full tax waiver

To receive the full waiver, the project must remain eligible for eight years: the year the project is complete, and for seven succeeding years. Deferred taxes are incrementally waived each year that the project remains eligible at a rate of 12.5 percent per year.

If DOR determines the investment project is no longer eligible at any time during the eight years, a percentage of the deferred tax amount is immediately due, along with interest retroactive to the date of deferral.

Exhibit 1.1: Deferred taxes immediately due based on repayment schedule if DOR determines a project is no longer eligible



Source: JLARC staff analysis of RCW 82.82.040(2)(a).

Preference is time limited, but has no expiration date

The preference took effect July 1, 2009. The Legislature did not set an expiration date, but did establish that no new applications can be submitted after December 31, 2020.

REVIEW DETAILS

2. What are CEZs?

Community empowerment zones designated as high unemployment, low-income geographic areas

Six community empowerment zones designated across the state

The Legislature created a targeted approach for community revitalization — now called the Community Empowerment Zone (CEZ) Act — in 1993. The Act is intended to encourage reinvestment in areas with limited employment opportunities, low incomes, a lack of affordable housing, deteriorating infrastructure, and limited community service, job training, or education facilities.

State law allows up to six CEZs statewide.

As required by statute, the Department of Commerce director designated the CEZs before 2004.

Exhibit 2.1: Washington's CEZs are located within six cities or unincorporated areas

Source: JLARC staff map of CEZs listed on DOR website viewed March 30, 2018.

Other tax preferences for CEZs

The Legislature has established other tax preferences to assist with development in community empowerment zones.

Exhibit 2.2: Other Washington tax preferences encourage investment in CEZs

Tax Preference	Description	JLARC Review
Rural County and CEZ B&O Tax Credit for New Employees **RCW 82.62.030, RCW 82.62.045**	Provides B&O tax credit for each new employment position filled and maintained by a qualified business in a rural county or CEZ. In CEZs, only positions filled by persons who are residents of the CEZ at the time of hire are eligible for the credit. Businesses must increase employment by 15 percent over four quarters from when the employees are hired. Limited to manufacturing, research and development, and commercial testing facilities.	Full review in 2013. Legislative Auditor recommended review and clarify.
Investment Projects in High Unemployment Counties and CEZs Sales and Use Tax Deferral	Provides a sales and use tax deferral and eventual waiver for qualifying machinery, equipment, and construction of buildings for new or expanding businesses located in a qualifying high unemployment county or CEZ.	Full review in 2018. Legislative Auditor recommended review sufficiency of

Tax Preference	Description	JLARC Review
RCW 82.60.040, RCW 82.60.049	Limited to manufacturers, vegetable seed conditioning, research and development labs, and commercial testing facilities. Businesses in a CEZ must meet these hiring requirements: • At least one permanent full-time employee for each $750,000 of investment. • The employee must live in the CEZ or the county containing the CEZ when hired. • The position(s) must be filled within a certain timeframe after the project is certified operationally complete.	outcomes and add metrics.

Source: JLARC staff analysis of chapter 82.60 RCW and chapter 82.62 RCW.

REVIEW DETAILS

3. One of two inferred objectives met

One of two inferred public policy objectives currently met. No qualifying headquarters have located in a CEZ.

The Legislature did not state a public policy objective when it passed this preference in 2008. This preference was passed before the Legislature required a performance statement for new preferences.

JLARC staff infer two public policy objectives based on the preference's eligibility requirements, the legislative purpose of community empowerment zones (CEZs), and the prime sponsor's testimony to the Legislature. One of the two inferred objectives has been met.

One of two inferred objectives has been met

Inferred Objectives	Results
Encourage private sector investment and employment in community empowerment zones (CEZs) • CEZs are designated areas that have limited employment and educational services, a lack of affordable housing, and deteriorating infrastructure.	**Not currently met.** Department of Revenue tax records indicate the preference has never been used.
Better compete with Oregon and Idaho for private sector investment • Oregon has no sales tax, and Idaho had a similar incentive when the bill was passed.	**Met. T**he preference makes Washington more competitive with Oregon for attracting corporate headquarters. Idaho repealed a similar preference in 2008 after this bill passed.

Inferred objective 1: Encourage private sector investment and employment in community empowerment zones

In committee testimony, the prime sponsor noted that existing incentives for CEZs focused on manufacturing and research and development facilities. He stated that this preference for new or expanding corporate headquarters would be a tool to attract private sector investments with high paying jobs. Others who testified in favor of the preference supported development in the Tacoma and Spokane CEZs.

Department of Revenue tax records indicate the preference has never been used. Since July 1, 2009, only one application has been submitted. The application was withdrawn and the project was not pursued.

The Department of Commerce reports it has provided 10 companies with information about the preference since 2011. Eight of the companies would have been new to the state and two would have been expansions or relocations for companies already in Washington. None applied to use the preference.

Inferred objective 2: Better compete with Oregon and Idaho

In testimony, the prime sponsor noted that Washington was competing in a global economy for large, private sector investment. He stated this preference was a "tool in the toolbox" that "leveled the playing field" with Oregon, which does not have a sales tax, and Idaho, which had a similar preference in law.

The prime sponsor and others indicated that the original bill (which had a $50 million investment threshold and 500 jobs requirement) was nearly an exact replica of an Idaho tax incentive designed to encourage corporate headquarters to locate or remain there. The Idaho incentive, however, had no restrictions on where a qualifying investment could locate.

The Idaho Legislature repealed its Corporate Headquarters Incentive Act in 2008. Staff with Idaho's Commerce Department report that the legislation was aimed to encourage one specific company to maintain and expand its corporate headquarters in the state. According to Idaho's Commerce staff, the company did not use the incentive, but remained and expanded its operations in Idaho.

No beneficiaries, revenue, or economic impacts from preference

Because the preference has never been used, there are no beneficiaries, revenue, or economic impacts to report.

REVIEW DETAILS

4. Many factors influence where businesses invest

Research suggests many factors impact decisions for locating headquarters or investing in distressed areas

Businesses consider many issues when deciding where to locate headquarters

JLARC staff analyzed current national data and academic literature on corporate headquarter relocations. Key issues that businesses consider when selecting locations for new corporate headquarters include:

- The ability to attract and retain current and future workforce talent.
- Reestablishing or building the corporate brand/culture.

- Availability of business services and same industry clusters/specializations.
- Good airport and transportation infrastructure.
- Cutting edge research and higher education facilities nearby.
- Qualitative and cultural amenities that appeal to current and potential employees.

Community empowerment zones (CEZs) are characterized by limited employment opportunities, lower incomes, lack of affordable housing, deteriorating infrastructure, and limited educational and other community services. These locations do not appear to meet many of the criteria corporations value when siting headquarter facilities.

Other states and local governments have used strategies in addition to tax preferences to encourage economic development in distressed areas

Academic researchers have identified several strategies that have been used successfully by other states and local governments to revitalize economically distressed areas. Some of these strategies were used in combination with tax preferences to encourage economic development.

- **Invest in training**. Both Kentucky and Michigan have offered incentives or grants to businesses to fund customized training programs for their employees. The two states have found the programs to be cost effective in terms of increasing employment and productivity.

  Similarly, South Carolina involved its community and technical colleges in offering specialized training and apprenticeship programs for new businesses that moved into distressed areas. The state's workforce training programs expanded to include 82 participating companies in aerospace, energy, healthcare, information technology, tourism, and transportation.

- **Improve infrastructure**. South Carolina and the city of Chatanooga, Tennessee, have both used infrastructure improvements as a method to attract new business investments. South Carolina expanded its marine terminal capacity and strengthened its inland infrastructure to handle larger shipping vessels at the Port of Charleston.

  The city of Chatanooga invested in fiber optics to turn a formerly distressed area into an innovation zone with the fastest internet in the country. A University of Tennessee study found this investment in infrastructure resulted in 2,800 new jobs in the area between 2011-2015.

- **Provide business and technical assistance**. The federal government partners with public and private entities in every state to provide assistance to small and medium-sized manufacturing businesses. This is known as the Manufacturing Extension Partnership (MEP) network. The network includes manufacturing experts who provide advice and technical expertise to about 7,000 mostly small manufacturers every year. Research suggests that MEP clients benefit from increased productivity, reduced costs, higher output, and greater employment.
- **Offer additional public services**. Combining tax credits with social service grants has increased the likelihood for job and productivity improvements in some distressed areas. Research from the original 1993 federal funding for community empowerment zones (CEZs) found that employment in designated zone areas increased by 15 percent by the year 2000. Businesses in these designated areas received employment tax credits (20 percent employment tax credit for the first $15,000 of wages paid to Zone residents) at the same time that the CEZ received social service block grants. The grants were used to fund business assistance programs, youth services, emergency housing, infrastructure investments, and other public services.

If the Legislature wants to encourage economic development in CEZs, it may want to consider using other strategies beyond tax incentives to attract businesses to these areas.

REVIEW DETAILS

5. Applicable statutes

Chapter 82.82 RCW, RCW 82.82.020, RCW 43.31C.005

RCW 82.82.010.

Definitions.

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

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

(2) "Corporate headquarters" means a facility or facilities where corporate staff employees are physically employed, and where the majority of the company's management services are handled either on a regional or a national basis. Company management services may include: Accounts

receivable and payable, accounting, data processing, distribution management, employee benefit plan, financial and securities accounting, information technology, insurance, legal, merchandising, payroll, personnel, purchasing procurement, planning, reporting and compliance, research and development, tax, treasury, or other headquarters-related services. "Corporate headquarters" does not include a facility or facilities used for manufacturing, wholesaling, or warehousing.

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

(4) "Eligible area" means a designated community empowerment zone approved under RCW 43.31C.020. (5)(a) "Eligible investment project" means an investment project in a qualified building or buildings in an eligible area, as defined in subsection (4) of this section, which will have employment at the qualified building or buildings of at least three hundred employees in qualified employment positions, each of whom must earn for the year reported at least the average annual wage for the state for that year as determined by the employment security department.

(b) The lessor or owner of a qualified building or buildings is not eligible for a deferral unless:

(i) The underlying ownership of the building or buildings vests exclusively in the same person; or

(ii)(A) The lessor by written contract agrees to pass the economic benefit of the deferral to the lessee;

(B) The lessee that receives the economic benefit of the deferral agrees in writing with the department to complete the annual survey required under RCW 82.82.020; and

(C) The economic benefit of the deferral passed to the lessee is no less than the amount of tax deferred by the lessor and is evidenced by written documentation of any type of payment, credit, or other financial arrangement between the lessor or owner of the qualified building and the lessee.

(6) "Investment project" means a capital investment of at least thirty million dollars in a qualified building or buildings including tangible personal property and fixtures that will be incorporated as an ingredient or component of such buildings during the course of their construction, and including labor and services rendered in the planning, installation, and construction of the project.

(7) "Manufacture" has the same meaning as provided in RCW 82.04.120.

(8) "Operationally complete" means a date no later than one year from the date the project is issued an occupancy permit by the local permit issuing authority.

(9) "Person" has the same meaning as provided in RCW 82.04.030.

(10) "Qualified building or buildings" means construction of a new structure or structures or expansion of an existing structure or structures to be used for corporate headquarters. If a building

is used partly for corporate headquarters and partly for other purposes, the applicable tax deferral is determined by apportionment of the costs of construction under rules adopted by the department.

(11) "Qualified employment position" means a permanent full-time employee employed in the eligible investment project during the entire tax year. The term "entire tax year" means a full-time position that is filled for a period of twelve consecutive months. The term "full-time" means at least thirty-five hours a week, four hundred fifty-five hours a quarter, or one thousand eight hundred twenty hours a year.

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

(13) "Warehouse" means a building or structure, or any part thereof, in which goods, wares, or merchandise are received for storage for compensation.

(14) "Wholesale sale" has the same meaning as provided in RCW 82.04.060. [2008 c 15 § 1.]

[2008 c 15 § 1.]
NOTES:
***Reviser's note:** RCW 82.82.020 was amended by 2017 c 135 § 43, changing "annual survey" to "annual tax performance report," effective January 1, 2018. **Effective date—2008 c 15:** "This act takes effect July 1, 2009." [2008 c 15 § 10.]

RCW 82.82.020

Application for deferral - Annual tax performance report. (Effective January 1, 2018.)

(1) Application for deferral of taxes under this chapter can be made at any time prior to completion of construction of a qualified building or buildings, but tax liability incurred prior to the department's receipt of an application may not be deferred. The application must be made to the department in a form and manner prescribed by the department. The application must 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. The department must rule on the application within sixty days.

(2) Applications for deferral of taxes under this section may not be made after December 31, 2020.

(3) Each recipient of a deferral of taxes under this chapter must file a complete annual tax performance report with the department under RCW 82.32.534. If the economic benefits of the

deferral are passed to a lessee as provided in RCW 82.82.010(5), the lessee must file a complete annual tax performance report, and the applicant is not required to file the annual tax performance report.

(4) A recipient who must repay deferred taxes under RCW 82.82.040 because the department has found that an investment project is no longer an eligible investment project is no longer required to file annual tax performance reports under RCW 82.32.534 beginning on the date an investment project is used for nonqualifying purposes.

[2017 c 135 § 43;2010 c 114 § 148;2008 c 15 § 2.]
NOTES:

Effective date - 2017 c 135: See note following RCW 82.32.534.

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

Effective date- 2008 c 15: See noted following RCW 82.82.010.

RCW 82.82.030

Deferral certificate.

(1) The department must issue a sales and use tax deferral certificate for state and local sales and use taxes due under chapters 82.08, 82.12, and 82.14 RCW on each eligible investment project meeting the requirements of this chapter.

(2) No certificate may be issued for an investment project that has already received a deferral under chapter 82.60 or 82.63 RCW or this chapter, except that an investment project for qualified research and development that has already received a deferral may also receive an additional deferral certificate for adapting the investment project for use in pilot scale manufacturing.

(3) The department must keep a running total of all deferrals granted under this chapter during each fiscal biennium.

(4) The number of eligible investment projects for which the benefits of this chapter will be allowed is limited to two per biennium. The department must approve deferral certificates for completed applications on a first in-time basis. During any biennium, only one deferral certificate may be issued per community empowerment zone.

[2008 c 15 § 3.]

NOTES:

Effective date—2008 c 15: See note following RCW 82.82.010.

RCW 82.82.040

Repayment of deferred taxes. (*Effective January 1, 2018.)*

(1) Except as provided in subsection (2) of this section and RCW 82.32.534, taxes deferred under this chapter need not be repaid.

(2)(a) If, on the basis of the tax performance report under RCW 82.32.534 or other information, the department finds that an investment project is no longer an "eligible investment project" under RCW 82.82.010 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 are immediately due according to the following schedule:

Year in which 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 82.82.010(5), the lessee is responsible for payment to the extent the lessee has received the economic benefit.

(3) The department must assess interest at the rate provided for delinquent taxes under chapter 82.32 RCW, but not penalties, retroactively to the date of deferral. 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.

[2017 c 135 § 44; 2010 c 114 § 149; 2008 c 15 § 5.]

NOTES:

Effective date—2017 c 135: See note following RCW 82.32.534.

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

Effective date—2008 c 15: See note following RCW 82.82.010.

RCW 82.82.050

Qualified employment positions - Requirements.

The qualified employment positions must be filled by the end of the calendar year following the year in which the project is certified as operationally complete. If a recipient does not meet the requirements for qualified employment positions by the end of the second calendar year following the year in which the project is certified as operationally complete, all deferred taxes are immediately due.

[2008 c 15 § 6.]

NOTES:

Effective date—2008 c 15: See note following RCW 82.82.010.

RCW 43.31C.005

Findings - Declaration.

(1) The legislature finds that:

(a) There are geographic areas within communities that are characterized by a lack of employment opportunities, an average income level that is below the median income level for the surrounding community, a lack of affordable housing, deteriorating infrastructure, and a lack of facilities for community services, job training, and education;

(b) Strategies to encourage reinvestment in these areas by assisting local businesses to become stronger and area residents to gain economic power involve a variety of activities and partnerships;

(c) Reinvestment in these areas cannot be accomplished with only governmental resources and require a comprehensive approach that integrates various incentives, programs, and initiatives to meet the economic, physical, and social needs of the area;

(d) Successful reinvestment depends on a local government's ability to coordinate public resources in a cohesive, comprehensive strategy that is designed to leverage long-term private investment in an area;

(e) Reinvestment can strengthen the overall tax base through increased tax revenue from expanded and new business activities and physical property improvement;

(f) Local governments, in cooperation with area residents, can provide leadership as well as planning and coordination of resources and necessary supportive services to address reinvestment in the area; and

(g) It is in the public interest to adopt a targeted approach to revitalization and enlist the resources of all levels of government, the private sector, community-based organizations, and community residents to revitalize an area.

(2) The legislature declares that the purposes of the community empowerment zone act are to:

(a) Encourage reinvestment through strong partnerships and cooperation between all levels of government, community-based organizations, area residents, and the private sector;

(b) Involve the private sector and stimulate private reinvestment through the judicious use of public resources;

(c) Target governmental resources to those areas of greatest need; and

(d) Include all levels of government, community individuals, organizations, and the private sector in the policy-making process.

[**2000 c 212 § 1.**]

RECOMMENDATIONS & AGENCY RESPONSE

Legislative Auditor's Recommendation

Legislative Auditor recommends allowing the preference to expire if no business has applied to use it by 2020, and considering other strategies.

The preference has been in effect since 2009 and no businesses have used it to date. Businesses have until December 31, 2020, to apply for the incentive. If no business has applied by then, the Legislature should allow the preference to expire.

If the Legislature wants to revitalize CEZs, it may want to consider other strategies beyond tax incentives to attract businesses to these areas.

Legislation Required: Yes.

Fiscal Impact: None.

RECOMMENDATIONS & AGENCY RESPONSE

Letter from Commission Chair

Available October 2018

RECOMMENDATIONS & AGENCY RESPONSE

Commissioners' Recommendation

Available October 2018

RECOMMENDATIONS & AGENCY RESPONSE

Agency Response

If applicable, available October 2018

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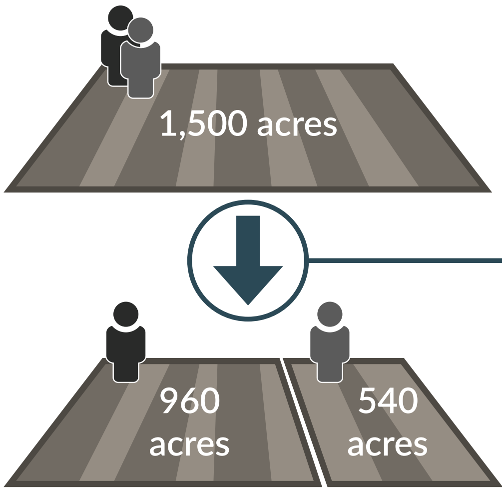
Custom Farming & Hauling Farm Products

JLARC Staff 2018 Tax Preference Performance Review

Custom Farming, Specific Farming Services (B&O Tax)
Hauling Farm Products/Equipment (Public Utility Tax)

Some Washington farmers reorganized their farms in response to federal regulations. This had state tax consequences.



Some owners split their farms among multiple owners.

Often responding to federal regulations that limit irrigation water to **no more than 960 acres.**

They may continue to operate as one farming operation.

If one owner provides a service or hauling for another owner, **these services could be subject to B&O or public utility tax.**

Preferences eliminate potential taxation for these farmers and others who have split ownership

An eligible farmer **does not pay B&O tax when performing custom farming services (e.g., harvesting agricultural products)** for another farmer.

A person who performs **specific farming services (e.g., farm management) does not pay B&O tax** if they are related to the farmer.

A person who **hauls agricultural products or machinery for a farmer does not pay public utility tax (PUT)** if they are related to the farmer.

(RCW 82.04.625, 82.16.300)

Related farmer means a family member or an organizational relationship specified by the Internal Revenue Service.

Preferences expire December 31, 2020

Objective met for one preference:
The B&O tax preference is providing tax relief as intended: 5-7 businesses benefit.

Unclear if objective met for the other:
PUT preference is structured to provide tax relief. No data about use is available.

Legislative Auditor's recommendation

Continue and clarify (structural purpose)

The Legislature should continue and clarify the two preferences to:

- Eliminate the expiration date -- preferences appear to address a structural tax issue.
- Add performance statements that specify public policy objectives.

The complete report is on the JLARC web site.

For more information, contact: **Keenan Konopaski,** Washington State Legislative Auditor
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Preliminary Report:

2018 Tax Preference Performance Reviews

Custom Farming and Hauling Farm Products

Legislative Auditor's Conclusion:

The tax preference for custom farming is providing tax relief to eligible farmers. However, there is no data to determine if farmers use the second tax preference for hauling farm products and equipment.

July 2018

B&O and public utility tax exemptions for those who provide services or haul goods for farmers

The Legislature enacted these preferences for farms in 2007:

1. **Custom farming** and specific farm services: A B&O tax exemption for farmers who provide custom farming services (e.g., planting or harvesting of agricultural products) to other farmers. The exemption also applies to those who provide specific farming services (e.g., farm management) to related farmers.
2. **Hauling farm products and equipment**: A public utility tax exemption for those who haul farm machinery, equipment, or agricultural products for a related farmer or person performing custom farming services.

"Related" farmer means a family member or a relationship established through a corporation or trust, as specified by the Internal Revenue Service.

Both preferences are scheduled to expire December 31, 2020.

Estimated Biennial Beneficiary Savings

$67,500 (Custom Farming)

Unknown (Hauling Farm Products)

Tax Type

B&O Tax
Public Utility Tax

RCW 82.04.625
RCW 82.16.300

Applicable Statutes

Inferred public policy objective met by one preference. Impact of second preference unknown.

Preference	Objectives (inferred)	Results
Custom farming and specific farm services (B&O tax preference)	Provide tax relief	**Met.** Preference is providing tax relief to six to seven businesses annually.
Hauling farm products and equipment for related farmers (Public utility tax preference)	Provide tax relief	**Unknown.** Structurally, the preference would provide tax relief. No data or information is available to determine if it is being used.

Some Washington farmers reorganized their farms in response to federal regulations. This had state tax consequences.

Under Bureau of Reclamation regulations, a farm owner can receive irrigation water from a federal reclamation project on no more than 960 acres. To remain eligible for federal irrigation water, some farm owners split their farm among multiple owners but continued to operate as one farming operation.

This created an unintended structural tax issue. **If one owner provided a service or hauled products/equipment for another owner on the same farm, these services could be subject to B&O or public utility tax.** The preferences eliminate potential taxation in these situations.

Farmers who meet all eligibility criteria but were not impacted by the federal regulations also qualify for these preferences.

Recommendations

Legislative Auditor's Recommendation: Continue and clarify (structural purpose)

The Legislature should continue and clarify the two preferences to add performance statements, specify public policy objectives, and eliminate the expiration dates.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2018

REVIEW DETAILS

1. What are the preferences?

Two preferences for those who provide services or haul goods for farmers

JLARC staff infer the public policy objectives are to provide tax relief

The Legislature did not state public policy objectives for either of the preferences. Based on testimony when the preferences passed, JLARC staff infer the preferences were enacted to provide tax relief to farmers, including those who changed their farm structure in response to federal regulations regarding irrigated water.

B&O and public utility tax exemptions for providing services and hauling farm products or equipment

1. **Custom farming and specific farming services** (B&O tax exemptions)
    - *Custom farming services* must be performed by an eligible farmer or an entity that is at least 50 percent owned by a farmer. Custom farming generally means bringing machinery or draft animals to a farm for operations such as planting or harvesting agricultural products.
    - *Specific farming services* include farm management, contract labor, and services for animals considered agricultural products. Services must be performed by a person related to the farmer who receives the service.
2. **Hauling farm machinery, equipment, or agricultural products for a farmer** (public utility tax exemption)
    - The person who does the hauling must be related to the farmer who receives the service.

In 2014, the Legislature clarified that custom farming services did not include any services involved with growing, raising, or producing marijuana. Otherwise, the preferences have not substantively changed since enacted.

"Related" is defined in federal income tax law

To qualify for the preferences, specific farming services and hauling services must be provided by someone who is related to the farmer who receives the service.

"Related" is defined as a family member or a relationship established through an organizational relationship, such as a corporation or trust, as specified by the Internal Revenue Service.

Preferences scheduled to expire December 31, 2020

The preferences took effect August 1, 2007 and are set to expire December 31, 2020.

REVIEW DETAILS

2. Preferences have detailed requirements

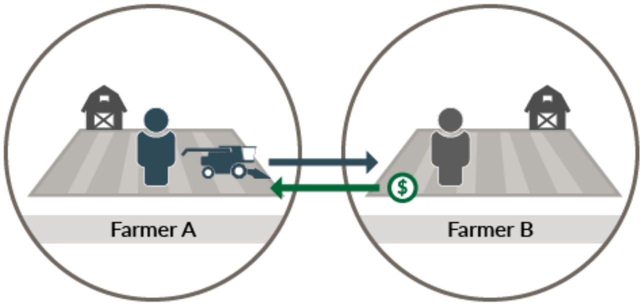
Statute specifies the services that qualify, as well as eligibility requirements

Custom farming services (B&O tax exemption) must be performed by eligible farmers or farming entities. Qualifying services are defined in statute.

Eligible farmers do not pay B&O tax when performing custom farming services. Entities that are majority-owned by an eligible farmer also qualify for the preference.

- **Eligible farmer:** Person that grows, raises, or produces an agricultural product to sell, using land they own or have a legal right to use. The person must have produced agricultural products during the previous year that grossed $10,000 or more, or would have grossed that amount if the products had been sold.
- **Custom farming:** Specific farming operations such as planting, cultivating, or harvesting that require farm machinery or a draft animal and an operator. The law excludes services such as veterinary or farrier services, boarding, appraisals or agricultural consulting, packing or processing, and waste disposal.
- **Additional requirements:** The custom farming must be directly tied to producing an agricultural product to be sold or used by a farmer. The work must be done under contract with a farmer or under the farmer's supervision.

Exhibit 2.1: Eligible farmers exempt from B&O tax on custom farming services performed for other farmers



Eligible **Farmer A** provides custom farming services to **Farmer B.**

Farmer A does not pay B&O tax on income received for that service.

Source: JLARC staff analysis of RCW 82.04.625(1)(a).

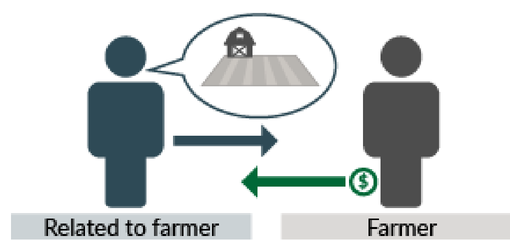
Specific farming services (B&O tax exemption) must be performed by someone related to the farmer. Qualifying services must meet specific criteria.

A person who performs specific farming services does not pay B&O tax if they are related to the person who receives the service. The recipient may be either a farmer or a person who performs custom farming services.

Three specific farming services qualify:

- Farm management services (e.g., professional advice about which crops to plant, fertilizer application, marketing).
- Contract labor services.
- Services provided to animals that are considered agricultural products.

Exhibit 2.2: Persons exempt from B&O tax on specific farm services provided to a related farmer



A person who provides specific farming services to a related farmer (e.g., consultation) does not pay B&O tax on income received for that service.

Source: JLARC staff analysis of RCW 82.04.625(1)(b).

Hauling services (public utility tax exemption) must be performed by a person related to the farmer

Persons who haul agricultural products, farm machinery, or farm equipment do not pay public utility tax on income earned from such hauls if they are related to the person receiving the service. The recipient may be either a farmer or a person who performs custom farming services.

REVIEW DETAILS

3. Inferred objective: provide tax relief

Some Washington farmers reorganized their farms in response to federal regulations. This had unintended state tax consequences. JLARC staff infer that the preferences were enacted to provide tax relief.

Inferred objective: provide tax relief for those affected by unintended state tax consequences

The Legislature did not state public policy objectives when it enacted these preferences. The preferences were passed before the Legislature required a performance statement for new preferences.

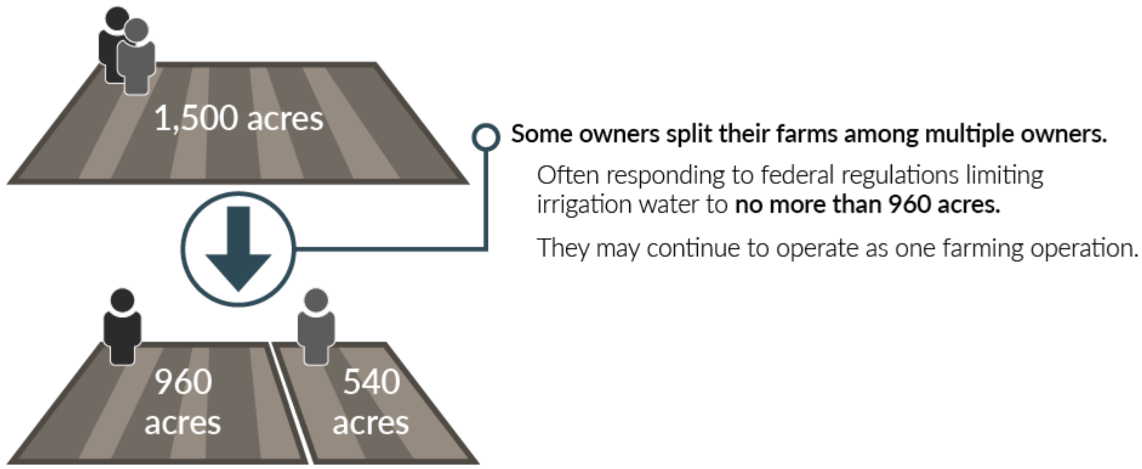
JLARC staff infer the public policy objective for the preferences was to provide tax relief to farmers and entities owned by farmers, including those that were affected by a structural tax issue related to federal regulations.

Federal Reclamation regulations limit the number of acres that can receive irrigation water from federal reclamation projects

Under Bureau of Reclamation (Reclamation) regulations, a farm owner can receive irrigation water from a federal reclamation project on no more than 960 acres. The limit is adjusted for quality of land.

Testimony provided to legislators by farm industry proponents indicated that this limitation led some farm owners to split the farm among multiple owners. Following a split, the land is legally owned by different persons or entities. But, the proponents noted that in these situations the land continues to be run as one farming operation.

Exhibit 3.1: Federal irrigation limits can lead farm owners to split farms among multiple owners



Source: JLARC staff analysis of 43 USC 426.5(b), archival documentation and testimony submitted to Legislature.

Changes in farm ownership created an unintended structural tax issue: Services provided on a farm that is run as one operation, but with multiple landowners, may be subject to B&O or public utility tax

For state tax purposes, a farmer is any person who grows, raises, or produces agricultural products **on land they own or have a legal right to use.** The products must be produced for sale.

Farm services or hauling of farm products/equipment that farmers do for themselves on land they own or lease is not taxable. However, if a person or business other than the farmer/landowner performs services or hauls goods for the farmer, those activities may be taxable.

On farms with split ownership, farmers may concentrate certain activities. For example, one owner may maintain equipment while another maintains materials. As a result, if one owner provides a service to another owner on the same farm, the income could be subject to B&O or public utility tax. The preferences eliminate potential taxation in these situations.

Farmers who meet all eligibility criteria but were not impacted by changes to Reclamation regulations also qualify for these preferences.

Neighboring states impose different tax structures with no similar preferences

JLARC staff found no similar preferential tax treatment for these activities in Oregon or Idaho. Neither Idaho nor Oregon imposes a tax similar to Washington's B&O tax or public utility tax.

REVIEW DETAILS

4. Custom farming preference provides tax relief

The preference for custom farming and specific farming services (B&O tax) is providing tax relief as intended

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

Exhibit 4.1: Farmers, and entities owned by farmers, are the beneficiaries

	Direct Beneficiaries	Indirect Beneficiaries
Description	Farmers, and entities that are majority-owned by a farmer, that perform custom farming for any other farmer. Farmers that provide specific farming services to a related farmer.	Farmers receiving the services, if the tax savings are passed on to them.
Number	Six to seven businesses (fiscal years 2015 through 2017)	Unknown. No tax return data is collected on this detail.

There may be more beneficiaries. But, in response to a JLARC staff inquiry, agriculture industry representatives stated that they had no additional information or data on use of the preference.

Estimated direct beneficiary savings for the 2019-2021 Biennium is $67,500

JLARC staff estimate the direct beneficiary savings for fiscal year 2017 was $45,000. The estimated beneficiary savings for the 2019-2021 Biennium is $67,500.

JLARC staff used Department of Revenue tax return deduction detail for fiscal years 2016 and 2017 to prepare the estimate.

Exhibit 4.2: Estimated direct beneficiary savings for custom farming (B&O) preference

Biennium	Fiscal Year	Estimated Taxable Income	Estimated Beneficiary Savings
2015-17 *7/1/15-6/30/17*	2016	$3,079,000	$46,000
	2017	$2,995,000	$45,000
2017-2019 *7/1/17 - 6/30/19*	2018	$3,000,000	$45,000
	2019	$3,000,000	$45,000
2019-21 *7/1/19-12/31/20*	2020	$3,000,000	$45,000
	2021	$1,500,000	$22,500
	2019-21 Biennium	$4,500,000	$67,500

Source: JLARC staff analysis of Department of Revenue tax return deduction detail for 2016, 2017. No growth estimated in future years.

Absent the preferences, farmers and related entities would owe tax

Absent the tax preference, farmers who perform custom farming and persons who perform specific farming services for related farmers would be subject to B&O tax. The current rate for income earned from performing a service is 1.5 percent.

REVIEW DETAILS

5. Unknown if preference for hauling products/equipment meets objective

Tax preference for hauling farm products or equipment is structured to provide tax relief. But, there is no data to indicate that it has been used.

The tax preference applies to income earned from hauling farm machinery, equipment, or agricultural products for a related farmer (public utility tax).

Direct beneficiaries would be people who haul agricultural products or equipment for farmers, if the two parties are related. If savings were passed on to customers, farmers receiving the services would be **indirect beneficiaries.**

The extent to which the preference is used is unknown

The Department of Revenue's most recent tax exemption study notes that situations where the preference would apply are "believed to be quite rare" and that while the impact cannot be quantified, it is "likely minimal."

- No businesses have reported using the preference on tax returns in the last three fiscal years.
- There are no reporting requirements or other methods of identifying direct or indirect beneficiaries of the preference.
- JLARC staff asked agriculture industry representatives if they knew, or could estimate, how many farmers might be receiving these tax-exempt services. They responded that they had no relevant information.

Absent information about the preference's use, its economic and revenue impact is unclear. However, when the preference was enacted in 2007, the fiscal note assumed the revenue loss associated with the preference would be minimal.

Without data about use, the impact of allowing the preference to expire is unclear

The preference is set to expire December 31, 2020. Without the preference, those who haul equipment or goods for related farmers would owe public utility tax under the motor transportation rate. The rate is currently 1.926 percent.

REVIEW DETAILS

6. Applicable statutes

RCW 82.04.625 and RCW 82.16.300

Custom Farming

82.04.625

Exemptions—Custom farming services. (Expires December 31, 2020)

(1) This chapter does not apply to any:

(a) Person performing custom farming services for a farmer, when the person performing the custom farming services is: (i) An eligible farmer; or (ii) at least fifty percent owned by an eligible farmer; or

(b) Person performing farm management services, contract labor services, services provided with respect to animals that are agricultural products, or any combination of these services, for a farmer or for a person performing custom farming services, when the person performing the farm management services, contract labor services, services with respect to animals, or any combination of these services, and the farmer or person performing custom farming services are related.

(2) The definitions in this subsection apply throughout this section.

(a)(i) "Custom farming services" means the performance of specific farming operations through the use of any farm machinery or equipment, farm implement, or draft animal, together with an operator, when: (i) [(A)] The specific farming operation consists of activities directly related to the growing, raising, or producing of any agricultural product to be sold or consumed by a farmer; and (ii) [(B)] the performance of the specific farming operation is for, and under a contract with, or the direction or supervision of, a farmer. "Custom farming services" does not include the custom application of fertilizers, chemicals, or biologicals, or any services related to the growing, raising, or producing of marijuana.

(ii) For the purposes of this subsection (2)(a), "specific farming operation" includes specific planting, cultivating, or harvesting activities, or similar specific farming operations. The term does not include veterinary services as defined in RCW 18.92.010; farrier, boarding, training, or appraisal services; artificial insemination or stud services, agricultural consulting services; packing or processing of agricultural products; or pumping or other waste disposal services.

(b) "Eligible farmer" means a person who is eligible for an exemption certificate under RCW 82.08.855 at the time that the custom farming services are rendered, regardless of whether the person has applied for an exemption certificate under RCW 82.08.855.

(c) "Farm management services" means the consultative decisions made for the operations of the farm including, but not limited to, determining which crops to plant, the choice and timing of application of fertilizers and chemicals, the horticultural practices to apply, the marketing of crops and livestock, and the care and feeding of animals. "Farm management services" does not include any services related to the growing, raising, or producing of marijuana.

(d) "Related" means having any of the relationships specifically described in section 267(b) (1), (2), and (4) through (13) of the internal revenue code, as amended or renumbered as of January 1, 2007.

2014 c 140 § 10;2007 c 334 § 1.

Hauling agricultural products or machinery

RCW 82.16.300

Exemptions—Custom farming services. (Expires December 31, 2020)

(1) This chapter shall not apply to any person hauling agricultural products or farm machinery or equipment for a farmer or for a person performing custom farming services, when the person providing the hauling and the farmer or person performing custom farming services are related.

(2) The exemption provided by this section shall not apply to the hauling of any substances or articles manufactured from agricultural products. For the purposes of this subsection, "manufactured" has the same meaning as "to manufacture" in RCW 82.04.120.

(3) The definitions in RCW 82.04.213 and 82.04.625 apply to this section.

2007 c 334 § 2.]

RECOMMENDATIONS & AGENCY RESPONSE

Legislative Auditor's Recommendation

Legislative Auditor recommends continuing and clarifying the preferences (structural purpose)

The Legislature should continue and clarify the two preferences to:

- **Add performance statements that specify public policy objectives.** The preferences were passed before the Legislature required a performance statement for new preferences. Based on testimony provided at the time the preferences passed, JLARC staff infer that the preferences are intended to provide tax relief to those affected by a structural tax issue.
- **Eliminate expiration dates.** Consider exempting the preferences from the statutory requirement for an expiration date. The inferred objectives appear to address a structural tax issue that arose after some farmers reorganized their farms in response to federal regulations. At this time, the federal regulations are not scheduled to expire. If the Legislature confirms the inferred objective of the preferences, it is unclear why an expiration date is needed.

Legislation Required: Yes (preferences expire on December 31, 2020).

Fiscal Impact: Depends on legislative action.

RECOMMENDATIONS & AGENCY RESPONSE

Letter from Commission Chair

Available October 2018

RECOMMENDATIONS & AGENCY RESPONSE

Commissioners' Recommendation

Available October 2018

RECOMMENDATIONS & AGENCY RESPONSE

Agency Response

If applicable, available October 2018

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Government-Funded Behavioral Health Services

The preference reduces taxes, so more money can go directly to behavioral health treatment.

Who can claim the preference?

Behavioral health organizations (BHO) and health/social welfare organizations (qualifying providers).

A BHO is a regional entity designated by the state to manage funding for mental health and substance use treatment in its area. There are ten regions, and BHOs can be a government entity (such as a county or group of counties) or a private entity.

With recent changes in the state's management of Medicaid, more providers are likely to use the preference before it expires in 2020

State is integrating Medicaid funding for behavioral health services and physical health services.

Integration will change how health care entities and providers are taxed.

More providers are likely to use the preference until it expires in 2020.

When the preference expires, more government funding for behavioral health services will be taxed, so less money may go directly to behavioral health treatment.

Legislative Auditor's recommendation

Determine whether to continue (policy decision)

If the Legislature wants to continue the tax deduction for government-funded behavioral health care, it will need to take action. Otherwise, behavioral health will be treated the same as physical health services and providers will pay B&O taxes beginning in 2020.

For more information, contact: **Keenan Konopaski,** Washington State Legislative Auditor
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Preliminary Report:

2018 Tax Preference Performance Reviews

Government-Funded Behavioral Health Services

Legislative Auditor's Conclusion:

The preference increases the amount of funding available directly for behavioral health treatment. With recent changes in the state's management of Medicaid, more providers are likely to use the preference before it expires in 2020.

July 2018

B&O tax deduction for government-funded behavioral health care

The preference allows two types of entities to deduct the amount of government funding spent on behavioral health services:

1. **Health or social welfare organizations--**nonprofits that provide mental health and chemical dependency services to patients (i.e. behavioral health) can deduct the amount of government funding they receive.
2. **Behavioral Health Organizations (BHOs)**--regional health care entities that contract with providers for government-funded behavioral health services can deduct the amount they pay to health or social welfare organizations.

The preference is scheduled to expire January 1, 2020.

Estimated Biennial Beneficiary Savings

$10.9 Million

Tax Type

B&O Tax

RCW 82.04.4277

Applicable Statutes

Inferred public policy objectives met

The Legislature did not state a public policy objective when it passed this preference in 2011. JLARC staff infer two public policy objectives based on testimony to the Legislature when the legislation was passed.

Objectives (inferred)	Results
Increase the amount of funding available for behavioral health services.	**Met.** The preference reduces the amount of tax collected on government-funded behavioral health services so that more money goes directly to treatment.
Provide similar tax treatment for all entities that receive government funding for behavioral health services.	**Met**. The preference allows privately run BHOs to deduct from B&O taxes the amount of government funding they spend on behavioral health services. It also allows health or social welfare organizations to deduct from B&O taxes the amount of government funding they receive from privately run entities.

Changes in Washington's management of Medicaid funding will affect how health care providers are taxed

The state is currently in the process of integrating Medicaid-funding of behavioral health services with physical health services. This will change how health care entities and providers are taxed. As a result, more providers -- in Pierce County and other parts of the state -- are likely to use the preference until it expires in 2020.

When the preference expires, more government funding for behavioral health services will be taxed, so less money may go directly to behavioral health service treatment.

Recommendations

Legislative Auditor's Recommendation: Determine whether to continue (policy decision)

The Legislature should determine whether to continue the preference. If the Legislature wants to continue the tax deduction for government-funded behavioral health care, it will need to take action. Otherwise, behavioral health will be treated the same as physical health services and providers will pay B&O taxes beginning in 2020.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2018

REVIEW DETAILS

1. Government funding for behavioral health

Preference is for two types of entities involved in government-funded behavioral health services

What is behavioral health and who pays for it?

Behavioral health services are treatments for mental health and substance use disorders. These include 24-hour crisis services, residential treatment services, in-patient and out-patient services, group treatment, and medication management and monitoring.

About 85 percent of government funding for behavioral health care in Washington State is from Medicaid. This is a health program paid for by the state and federal government, and is available to those who meet income and other eligibility requirements.

The remaining 15 percent of government funding pays for behavioral health services that are not covered by Medicaid. These include crisis hotlines and services provided while people are in jail, which are available for both Medicaid and non-Medicaid patients.

Behavioral Health Organizations (BHOs) subcontract with providers who treat patients

In most regions, Washington currently distributes state and federal funding for behavioral health services through Behavioral Health Organizations (BHOs). These entities are located in designated geographic areas around the state to manage funding for mental health and substance use treatment.

The state provides each BHO a fixed amount of public money and the BHOs must provide access to the following:

- A full-range of behavioral health services for all Medicaid-eligible individuals.
- Crisis services for any person, regardless of whether they are eligible for Medicaid.
- Additional services to non-Medicaid eligible individuals if other funding, such as federal grants or local revenue, is available.

Health or social welfare organizations provide behavioral health services

BHOs subcontract with mental health and substance use disorder treatment providers in their local areas to provide these services. These include health or social welfare organizations.

Statute defines a health or social welfare organization as either a nonprofit entity with eight or more board members who are not paid employees, or a corporation sole. The organization must provide specific health or social welfare services, such as:

- Mental health, drug, and alcohol counseling and treatment
- Family counseling
- Health care services
- Day care for children
- Employment development
- Legal services for the indigent

These organizations must follow other legal requirements in addition to providing certain services.

Exhibit 1.1: Preference applies to money flowing through BHO to health or social welfare organizations

Source: JLARC staff analysis of RCW 82.04.4277.

REVIEW DETAILS

2. Preference meets objectives

Preference enacted to increase the amount of funding available directly for behavioral health treatment, and provide consistent tax treatment to those receiving government funds

B&O tax preference for entities involved with government-funded behavioral health services

This preference provides a business & occupation (B&O) tax deduction for government-funded behavioral health services (i.e., mental health or chemical dependency services) that are provided by a health or social welfare organization.

Two different types of entities may claim the deduction:

1. A Behavioral Health Organization (BHO) may deduct the amount it pays to the health or social welfare organization for providing behavioral health services to patients.
2. The health or social welfare organization may deduct the amount it receives for providing the services.

Two inferred objectives met

The Legislature did not state a public policy objective when it passed this preference in 2011.

JLARC staff infer two public policy objectives based on testimony to the Legislature when the legislation was passed.

Inferred objective met: Preference provides similar tax treatment for all BHOs and providers of government-funded behavioral health services

Before 2008, all BHOs were government entities and were not subject to B&O tax. In 2008, Pierce County stopped serving as the BHO for its region and DSHS selected a private, for-profit entity to take its place. Unlike the governmental BHOs, this entity (Optum Pierce) and its contracted providers were subject to B&O tax.

With the preference, privately run BHOs are able to deduct some of their expenses and are taxed similarly to government-run BHOs, which do not pay tax.

Further, all health or social welfare organizations may deduct B&O taxes for the amount of government funding they receive for behavioral health services, regardless of whether the money comes from a government or private entity. Prior to this preference, only health and social welfare organizations that received money directly from a government entity (RCW 82.04.4297) could deduct B&O taxes.

This results in similar tax treatment for any entity that distributes or receives government-funding for behavioral health.

Inferred objective met: Preference increases the amount of government funding available directly for behavioral health treatment by reducing the tax

As of May 2018, Optum Pierce was the only privately-run BHO in Washington, and the only BHO that claimed the deduction. Health or social welfare entities that receive government funding from Optum Pierce can claim the deduction as well. The deduction reduces B&O tax thereby increasing the amount of government funding available for patient services.

Circumstances are unique to Washington's tax structure

The objectives for this preference are unique to Washington and the B&O tax. In states with an income tax, nonprofit providers are generally exempt from paying income tax. Further, when entities receive funding that they distribute to others, that funding is typically not considered income.

REVIEW DETAILS

3. Changes in Medicaid management impact taxes

Recent changes in Washington's management of Medicaid funding will affect how entities are taxed

Until 2016, Washington financed and delivered its Medicaid-funded behavioral health services separately from its physical health services. Now the state is in the process of integrating both behavioral and physical health. Under the new model, all Medicaid funding will be distributed from the Health Care Authority to privately run Managed Care Organizations (MCOs) for both physical and behavioral health services. About 85 percent of government funding for behavioral health comes from Medicaid.

New entities will manage government funding for behavioral health

Before integration, government funding for physical and behavioral health care was managed separately by the following types of entities:

- MCOs managed Medicaid funding for **physical health** services. These entities are privately run for-profit and nonprofit organizations.
- Behavioral Health Organizations (BHOs) managed Medicaid and non-Medicaid funding for **behavioral health** services. They contracted with local providers to deliver services to patients.

After integration is completed, Medicaid funding for physical and behavioral health will be managed together:

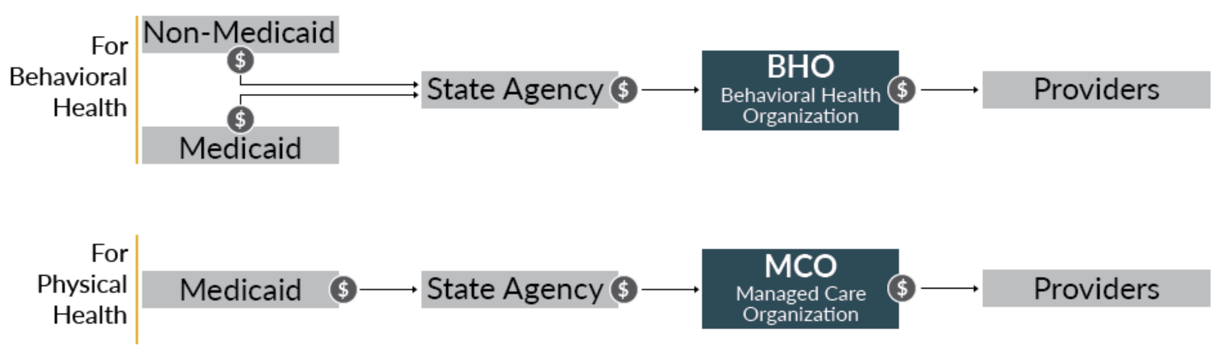
- **MCOs** will be responsible for managing **Medicaid funding for physical and behavioral health**. They will contract with local providers to deliver services to patients.
- **Behavioral Health-Administrative Service Organizations (BH-ASOs)** will manage **non-Medicaid funding for behavioral health services** instead of BHOs. These services are available to all individuals, regardless of insurance status or income level. They include crisis hotlines and services provided while people are in jail.

Integration will impact how health care entities and providers are taxed

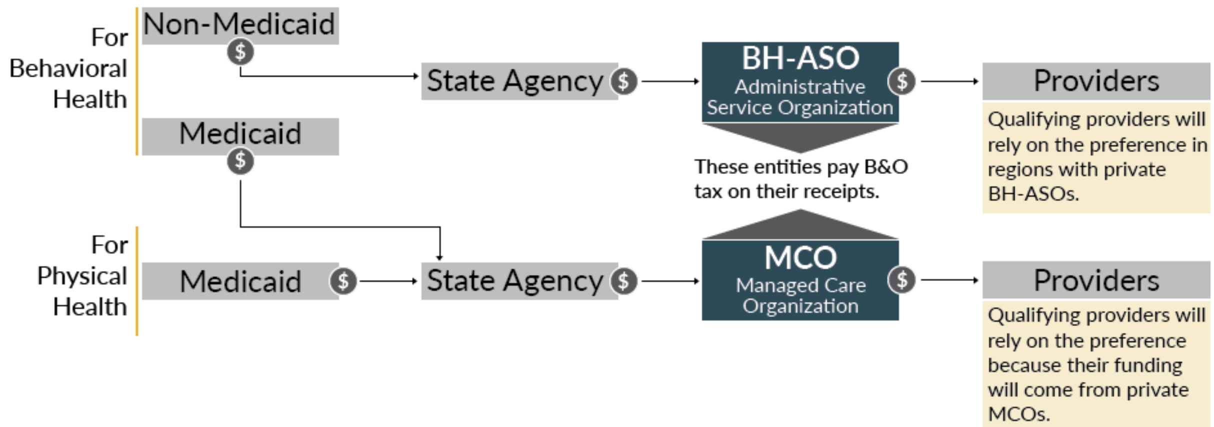
This tax preference currently applies to BHOs and health or social welfare organizations that provide behavioral health services. The integration of behavioral and physical health management will change how health care entities are taxed.

- **MCOs** are responsible for managing Medicaid funding for health care services. They are not eligible for this preference because they do not meet the current definition of a BHO. Unless they qualify for other tax preferences, MCOs must pay B&O tax on the funding they receive for behavioral health services.
- **BH-ASOs** are a new type of entity not included in the current definition of a BHO. These organizations owe tax on the funding they receive unless they are government entities and already tax-exempt, or they qualify for other preferences.
- **Health or social welfare organizations** that receive money from MCOs or BH-ASOs continue to be eligible for this preference. More of these providers are likely to claim the preference because more of them will receive money from privately run entities (MCOs or BH-ASOs).

Exhibit 3.1: Integration will change how government funding for behavioral health is managed



Before integration, BHOs distribute Medicaid and Non-Medicaid Funding for Behavioral Health.



After integration, funding will flow through for-profit MCOs and BH-ASOs, which may be for-profit or government entities.

Medicaid funding for physical health is taxed

Entities that manage or receive Medicaid funding for physical health services must pay B&O tax on the money they receive. Other deductions exist for some specific types of providers, such as public and nonprofit hospitals and community health centers, but there is no general deduction for physical health care services.

REVIEW DETAILS

4. Number of beneficiaries will likely increase

More providers likely to use the preference as the state integrates Medicaid-funded behavioral and physical health care

Direct beneficiaries include one BHO and health or social welfare organizations

The preference is available to Behavioral Health Organizations (BHOs) and to health or social welfare organizations providing behavioral health services to patients. The direct beneficiaries are:

BHOs that receive government funds for behavioral health:

- As of May 2018, Optum Pierce in Pierce County is the only privately run BHO in Washington, and the only one that claimed the deduction.

- The other seven BHOs are government entities and do not owe income tax under existing law.

Health or social welfare organizations that provide behavioral health services:

- Providers that receive government money from Optum Pierce would pay tax without this preference.
- Providers in the North Central and Southwest regions have already transitioned to an integrated managed care system and would pay tax without this preference. As more regions integrate, more providers are likely to claim the preference when they receive funding from privately-run Managed Care Organizations (MCOs) or Behavioral Health-Administrative Service Organizations (BH-ASOs).
- Providers that receive payments directly from a government-run entity are already eligible to deduct B&O tax under existing law (see RCW 82.04.4297).

JLARC staff estimate beneficiaries saved $3.6 million in 2018

JLARC staff estimate $3.6 million in beneficiary savings in fiscal year 2018 and $10.9 million in the 2017-19 biennium. This estimate is based on data available in Pierce County. It assumes the same proportion of funding goes to qualified providers in each region. It also assumes every qualified provider claims the deduction. The estimate may include providers who are eligible for other deductions on the same income, such as the deduction for hospitals and community health centers (see RCW 82.04.4311).

Exhibit 4.1 Estimated Beneficiary Savings

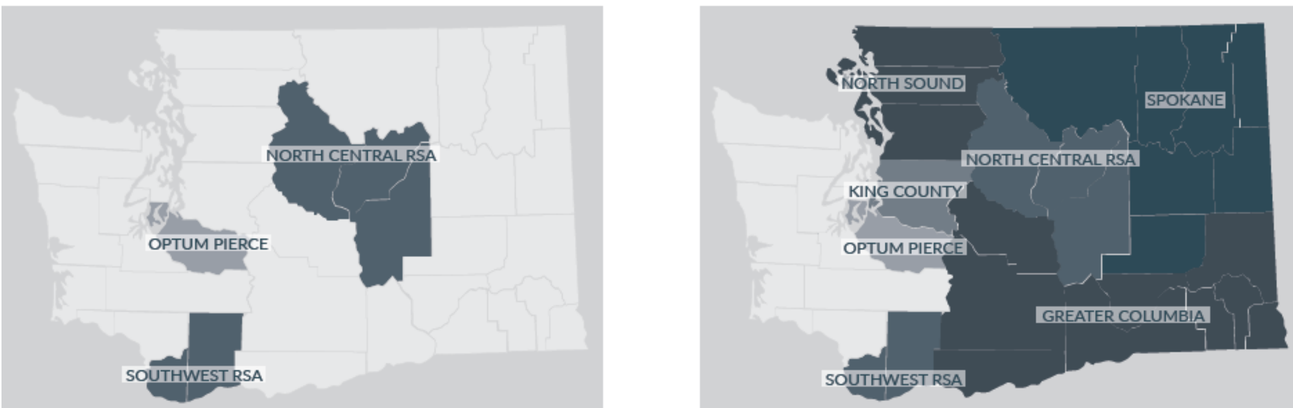
Fiscal Year	Beneficiary Savings
2016	$2,800,000
2017	$3,400,000
2018	$3,600,000
2019	$7,300,000
2017 -2019 Biennium	$10,900,000

Source: JLARC staff analysis of taxpayer deduction data and BHO expenditure data from DSHS.

By 2019, most health or social welfare organizations will be in integrated regions working with privately run health care entities

As more regions integrate Medicaid-funded behavioral and physical health care, qualified providers in integrated regions will be more likely to receive funding through private entities such as Managed Care Organizations and BH-ASOs. As a result, more providers will rely on this preference. BHOs will no longer exist so there will be no BHOs using the preference.

Exhibit 4.2: As regions integrate, more providers will receive funding through private entities



2018
Providers in three regions receive funding from private entities

2019
Providers in most regions receive funding from private entities

Source: JLARC staff analysis of Health Care Authority Data.

Indirect beneficiaries

Medicaid patients who receive behavioral health treatment are indirect beneficiaries of the preference. Since providers and BHOs can deduct B&O tax from the funds they receive, more money is available directly for behavioral health treatment. The preference also benefits some non-Medicaid patients who receive government-funded behavioral health services.

REVIEW DETAILS

5. Preference scheduled to expire in 2020

The expiration of the preference may reduce government funding for behavioral health services

The preference is currently scheduled to expire on January 1, 2020.

When this preference expires, some of the funding for behavioral health services will be taxed.

- Health or social welfare organizations will be subject to tax on the Medicaid funds they receive from privately-run Managed Care Organizations (MCOs). They will also be taxed on the non-Medicaid funding they receive from privately-run Behavioral Health-Administrative Service Organization (BH-ASO).
- MCOs and privately-run BH-ASOs will be taxed on the government funding they receive to manage behavioral health services.

Some providers may qualify for other deductions on the income they receive for behavioral health. For example, health or social welfare organizations that meet the definition of Community Health Centers may claim a deduction under RCW 82.04.431.

Without the preference, health or social welfare organizations, MCOs and non-government BH-ASOs will be taxed the same way as those that receive government funding for physical health services.

REVIEW DETAILS

6. Applicable statutes

RCW 82.04.4277

Deductions—Health and social welfare organizations—Mental health or chemical dependency services. (Effective January 1, 2018, until January 1, 2020.)

(1) A health or social welfare organization may deduct from the measure of tax amounts received as compensation for providing mental health services or chemical dependency services under a government-funded program.

(2) A behavioral health organization may deduct from the measure of tax amounts received from the state of Washington for distribution to a health or social welfare organization that is eligible to deduct the distribution under subsection (1) of this section.

(3) A person claiming a deduction under this section must file a complete annual tax performance report with the department under RCW 82.32.534.

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

(a) "Chemical dependency" has the same meaning as provided in *RCW 70.96A.020 through March 31, 2018, and the same meaning as provided in RCW 71.05.020 beginning April 1, 2018.

(b) "Health or social welfare organization" has the meaning provided in RCW 82.04.431.

(c) "Mental health services" and "behavioral health organization" have the meanings provided in RCW 71.24.025.

(5) This section expires January 1, 2020.

[2017 c 323 § 528; 2017 c 135 § 14; 2016 sp.s. c 29 § 532; 2014 c 225 § 104; 2011 1st sp.s. c 19 § 1.]

NOTES:

Reviser's note: *(1) RCW 70.96A.020 was repealed by 2016 sp.s. c 29 § 301, effective April 1, 2018.

(2) This section was amended by 2017 c 135 § 14 and by 2017 c 323 § 528, each without reference to the other. Both amendments are incorporated in the publication of this section under RCW 1.12.025(2). For rule of construction, see RCW 1.12.025(1).

Tax preference performance statement exemption—Automatic expiration date exemption—2017 c 323: See note following RCW 82.04.040.

Effective date—2017 c 135: See note following RCW 82.32.534.

Effective dates—2016 sp.s. c 29: See note following RCW 71.05.760.

Short title—Right of action—2016 sp.s. c 29: See notes following RCW 71.05.010.

Effective date—2014 c 225: See note following RCW 71.24.016.

Application—2011 1st sp.s. c 19: "This act applies to amounts received by a taxpayer on or after August 1, 2011." [2011 1st sp.s. c 19 § 4.]

RCW 82.04.431

"Health or social welfare organization" defined—Conditions for exemption—"Health or social welfare services" defined.

(1) The term "health or social welfare organization" means an organization, including any community action council, which renders health or social welfare services as defined in subsection (2) of this section, which is a domestic or foreign not-for-profit corporation under chapter 24.03 RCW and which is managed by a governing board of not less than eight individuals none of whom is a paid employee of the organization or which is a corporation sole under chapter 24.12 RCW. Health or social welfare organization does not include a corporation providing professional services as authorized in chapter 18.100 RCW. In addition a corporation in order to be exempt under RCW 82.04.4297 must satisfy the following conditions:

(a) No part of its income may be paid directly or indirectly to its members, stockholders, officers, directors, or trustees except in the form of services rendered by the corporation in accordance with its purposes and bylaws;

(b) Salary or compensation paid to its officers and executives must be only for actual services rendered, and at levels comparable to the salary or compensation of like positions within the public service of the state;

(c) Assets of the corporation must be irrevocably dedicated to the activities for which the exemption is granted and, on the liquidation, dissolution, or abandonment by the corporation, may not inure directly or indirectly to the benefit of any member or individual except a nonprofit organization, association, or corporation which also would be entitled to the exemption;

(d) The corporation must be duly licensed or certified where licensing or certification is required by law or regulation;

(e) The amounts received qualifying for exemption must be used for the activities for which the exemption is granted;

(f) Services must be available regardless of race, color, national origin, or ancestry; and

(g) The director of revenue must have access to its books in order to determine whether the corporation is exempt from taxes within the intent of RCW 82.04.4297 and this section.

(2) The term "health or social welfare services" includes and is limited to:

(a) Mental health, drug, or alcoholism counseling or treatment;

(b) Family counseling;

(c) Health care services;

(d) Therapeutic, diagnostic, rehabilitative, or restorative services for the care of the sick, aged, or physically, developmentally, or emotionally-disabled individuals;

(e) Activities which are for the purpose of preventing or ameliorating juvenile delinquency or child abuse, including recreational activities for those purposes;

(f) Care of orphans or foster children;

(g) Day care of children;

(h) Employment development, training, and placement;

(i) Legal services to the indigent;

(j) Weatherization assistance or minor home repair for low-income homeowners or renters;

(k) Assistance to low-income homeowners and renters to offset the cost of home heating energy, through direct benefits to eligible households or to fuel vendors on behalf of eligible households;

(l) Community services to low-income individuals, families, and groups, which are designed to have a measurable and potentially major impact on causes of poverty in communities of the state; and

(m) Temporary medical housing, as defined in RCW 82.08.997, if the housing is provided only:

(i) While the patient is receiving medical treatment at a hospital required to be licensed under RCW 70.41.090 or at an outpatient clinic associated with such hospital, including any period of recuperation or observation immediately following such medical treatment; and

(ii) By a person that does not furnish lodging or related services to the general public.

[2011 1st sp.s. c 19 § 3; 2008 c 137 § 1; 1986 c 261 § 6; 1985 c 431 § 3; 1983 1st ex.s. c 66 § 1; 1980 c 37 § 80; 1979 ex.s. c 196 § 6.]

NOTES:

Application—2011 1st sp.s. c 19: See note following RCW 82.04.4277.

Effective date—2008 c 137: See note following RCW 82.08.997.

Intent—1980 c 37: See note following RCW 82.04.4281.

Effective date—1979 ex.s. c 196: See note following RCW 82.04.240.

RCW 71.24.025 (as amended by 2018 2ESHB 1388, effective July 1, 2018)

Definitions.

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

(1) "Acutely mentally ill" means a condition which is limited to a short-term severe crisis episode of:

(a) A mental disorder as defined in RCW 71.05.020 or, in the case of a child, as defined in RCW 71.34.020;

(b) Being gravely disabled as defined in RCW 71.05.020 or, in the case of a child, a gravely disabled minor as defined in RCW 71.34.020; or

(c) Presenting a likelihood of serious harm as defined in RCW 71.05.020 or, in the case of a child, as defined in RCW 71.34.020.

(2) "Alcoholism" means a disease, characterized by a dependency on alcoholic beverages, loss of control over the amount and circumstances of use, symptoms of tolerance, physiological or psychological withdrawal, or both, if use is reduced or discontinued, and impairment of health or disruption of social or economic functioning.

(3) "Approved substance use disorder treatment program" means a program for persons with a substance use disorder provided by a treatment program licensed or certified by the department as meeting standards adopted under this chapter.

(4) "Authority" means the Washington state health care authority.

(5) "Available resources" means funds appropriated for the purpose of providing community mental health programs, federal funds, except those provided according to Title XIX of the Social Security Act, and state funds appropriated under this chapter or chapter 71.05 RCW by the legislature during any biennium for the purpose of providing residential services, resource management services, community support services, and other mental health services. This does not include funds appropriated for the purpose of operating and administering the state psychiatric hospitals.

(6) "Behavioral health organization" means any county authority or group of county authorities or other entity recognized by the director in contract in a defined region.

(7) "Behavioral health program" means all expenditures, services, activities, or programs, including reasonable administration and overhead, designed and conducted to prevent or treat chemical dependency and mental illness.

(8) "Behavioral health services" means mental health services as described in this chapter and chapter 71.36 RCW and substance use disorder treatment services as described in this chapter.

(9) "Child" means a person under the age of eighteen years.

(10) "Chronically mentally ill adult" or "adult who is chronically mentally ill" means an adult who has a mental disorder and meets at least one of the following criteria:

(a) Has undergone two or more episodes of hospital care for a mental disorder within the preceding two years; or

(b) Has experienced a continuous psychiatric hospitalization or residential treatment exceeding six months' duration within the preceding year; or

(c) Has been unable to engage in any substantial gainful activity by reason of any mental disorder which has lasted for a continuous period of not less than twelve months. "Substantial gainful activity" shall be defined by the authority by rule consistent with Public Law 92-603, as amended.

(11) "Clubhouse" means a community-based program that provides rehabilitation services and is licensed or certified by the department.

(12) "Community mental health service delivery system" means public, private, or tribal agencies that provide services specifically to persons with mental disorders as defined under RCW 71.05.020 and receive funding from public sources.

(13) "Community support services" means services authorized, planned, and coordinated through resource management services including, at a minimum, assessment, diagnosis, emergency crisis intervention available twenty-four hours, seven days a week, prescreening determinations for persons who are mentally ill being considered for placement in nursing homes as required by federal law, screening for patients being considered for admission to residential services, diagnosis and treatment for children who are acutely mentally ill or severely emotionally disturbed discovered under screening through the federal Title XIX early and periodic screening, diagnosis, and treatment program, investigation, legal, and other nonresidential services under chapter 71.05 RCW, case management services, psychiatric treatment including medication supervision, counseling, psychotherapy, assuring transfer of relevant patient information between service providers, recovery services, and other services determined by behavioral health organizations.

(14) "Consensus-based" means a program or practice that has general support among treatment providers and experts, based on experience or professional literature, and may have anecdotal or case study support, or that is agreed but not possible to perform studies with random assignment and controlled groups.

(15) "County authority" means the board of county commissioners, county council, or county executive having authority to establish a community mental health program, or two or more of the county authorities specified in this subsection which have entered into an agreement to provide a community mental health program.

(16) "Department" means the department of health.

(17) "Designated crisis responder" means a mental health professional designated by the county or other authority authorized in rule to perform the duties specified in this chapter.

(18) "Director" means the director of the authority.

(19) "Drug addiction" means a disease characterized by a dependency on psychoactive chemicals, loss of control over the amount and circumstances of use, symptoms of tolerance, physiological or psychological withdrawal, or both, if use is reduced or discontinued, and impairment of health or disruption of social or economic functioning.

(20) "Early adopter" means a regional service area for which all of the county authorities have requested that the authority purchase medical and behavioral health services through a managed care health system as defined under RCW 71.24.380(6).

(21 "Emerging best practice" or "promising practice" means a program or practice that, based on statistical analyses or a well established theory of change, shows potential for meeting the evidence-based or research-based criteria, which may include the use of a program that is evidence-based for outcomes other than those listed in subsection (20) of this section.

(22) "Evidence-based" means a program or practice that has been tested in heterogeneous or intended populations with multiple randomized, or statistically controlled evaluations, or both; or one large multiple site randomized, or statistically controlled evaluation, or both, where the weight of the evidence from a systemic review demonstrates sustained improvements in at least one outcome. "Evidence-based" also means a program or practice that can be implemented with a set of procedures to allow successful replication in Washington and, when possible, is determined to be cost-beneficial.

(23) "Licensed physician" means a person licensed to practice medicine or osteopathic medicine and surgery in the state of Washington.

(24) "Licensed or certified service provider" means an entity licensed or certified according to this chapter or chapter 71.05 RCW or an entity deemed to meet state minimum standards as a result of accreditation by a recognized behavioral health accrediting body recognized and having a current agreement with the department, or tribal attestation that meets state minimum standards, or

persons licensed under chapter 18.57, 18.57A, 18.71, 18.71A, 18.83, or 18.79 RCW, as it applies to registered nurses and advanced registered nurse practitioners.

(25) "Long-term inpatient care" means inpatient services for persons committed for, or voluntarily receiving intensive treatment for, periods of ninety days or greater under chapter 71.05 RCW. "Long-term inpatient care" as used in this chapter does not include: (a) Services for individuals committed under chapter 71.05 RCW who are receiving services pursuant to a conditional release or a court-ordered less restrictive alternative to detention; or (b) services for individuals voluntarily receiving less restrictive alternative treatment on the grounds of the state hospital.

(26) "Mental health services" means all services provided by behavioral health organizations and other services provided by the state for persons who are mentally ill.

(27) Mental health "treatment records" include registration and all other records concerning persons who are receiving or who at any time have received services for mental illness, which are maintained by the department of social and health services or the authority, by behavioral health organizations and their staffs, or by treatment facilities. "Treatment records" do not include notes or records maintained for personal use by a person providing treatment services for the department of social and health services, behavioral health organizations, or a treatment facility if the notes or records are not available to others.

(28) "Mentally ill persons," "persons who are mentally ill," and "the mentally ill" mean persons and conditions defined in subsections (1), (10), (36), and (37) of this section.

(29) "Recovery" means the process in which people are able to live, work, learn, and participate fully in their communities.

(30) "Registration records" include all the records of the department of social and health services, the authority, behavioral health organizations, treatment facilities, and other persons providing services for the department of social and health services, the authority, county departments, or facilities which identify persons who are receiving or who at any time have received services for mental illness.

(31) "Research-based" means a program or practice that has been tested with a single randomized, or statistically controlled evaluation, or both, demonstrating sustained desirable outcomes; or where the weight of the evidence from a systemic review supports sustained outcomes as described in subsection (20) of this section but does not meet the full criteria for evidence-based.

(32) "Residential services" means a complete range of residences and supports authorized by resource management services and which may involve a facility, a distinct part thereof, or services which support community living, for persons who are acutely mentally ill, adults who are chronically mentally ill, children who are severely emotionally disturbed, or adults who are seriously disturbed

and determined by the behavioral health organization to be at risk of becoming acutely or chronically mentally ill. The services shall include at least evaluation and treatment services as defined in chapter 71.05 RCW, acute crisis respite care, long-term adaptive and rehabilitative care, and supervised and supported living services, and shall also include any residential services developed to service persons who are mentally ill in nursing homes, residential treatment facilities, assisted living facilities, and adult family homes, and may include outpatient services provided as an element in a package of services in a supported housing model. Residential services for children in out-of-home placements related to their mental disorder shall not include the costs of food and shelter, except for children's long-term residential facilities existing prior to January 1, 1991.

(33) "Resilience" means the personal and community qualities that enable individuals to rebound from adversity, trauma, tragedy, threats, or other stresses, and to live productive lives.

(34) "Resource management services" mean the planning, coordination, and authorization of residential services and community support services administered pursuant to an individual service plan for: (a) Adults and children who are acutely mentally ill; (b) adults who are chronically mentally ill; (c) children who are severely emotionally disturbed; or (d) adults who are seriously disturbed and determined solely by a behavioral health organization to be at risk of becoming acutely or chronically mentally ill. Such planning, coordination, and authorization shall include mental health screening for children eligible under the federal Title XIX early and periodic screening, diagnosis, and treatment program. Resource management services include seven day a week, twenty-four hour a day availability of information regarding enrollment of adults and children who are mentally ill in services and their individual service plan to designated crisis responders, evaluation and treatment facilities, and others as determined by the behavioral health organization.

(35) "Secretary" means the secretary of the department of health.

(36) "Seriously disturbed person" means a person who:

(a) Is gravely disabled or presents a likelihood of serious harm to himself or herself or others, or to the property of others, as a result of a mental disorder as defined in chapter 71.05 RCW;

(b) Has been on conditional release status, or under a less restrictive alternative order, at some time during the preceding two years from an evaluation and treatment facility or a state mental health hospital;

(c) Has a mental disorder which causes major impairment in several areas of daily living;

(d) Exhibits suicidal preoccupation or attempts; or

(e) Is a child diagnosed by a mental health professional, as defined in chapter 71.34 RCW, as experiencing a mental disorder which is clearly interfering with the child's functioning in family or school or with peers or is clearly interfering with the child's personality development and learning.

(37) "Severely emotionally disturbed child" or "child who is severely emotionally disturbed" means a child who has been determined by the behavioral health organization to be experiencing a mental disorder as defined in chapter 71.34 RCW, including those mental disorders that result in a behavioral or conduct disorder, that is clearly interfering with the child's functioning in family or school or with peers and who meets at least one of the following criteria:

(a) Has undergone inpatient treatment or placement outside of the home related to a mental disorder within the last two years;

(b) Has undergone involuntary treatment under chapter 71.34 RCW within the last two years;

(c) Is currently served by at least one of the following child-serving systems: Juvenile justice, child-protection/welfare, special education, or developmental disabilities;

(d) Is at risk of escalating maladjustment due to:

(i) Chronic family dysfunction involving a caretaker who is mentally ill or inadequate;

(ii) Changes in custodial adult;

(iii) Going to, residing in, or returning from any placement outside of the home, for example, psychiatric hospital, short-term inpatient, residential treatment, group or foster home, or a correctional facility;

(iv) Subject to repeated physical abuse or neglect;

(v) Drug or alcohol abuse; or

(vi) Homelessness.

(38) "State minimum standards" means minimum requirements established by rules adopted and necessary to implement this chapter by:

(a) The authority for:

(i)Delivery of mental health and substance use disorder services; and

(ii) Community support services and resource management services;

(b) The department of health for:

(i) Licensed or certified services providers for the provision of mental health and subtance use disorder services; and

(ii) Residential services.

(39) "Substance use disorder" means a cluster of cognitive, behavioral, and physiological symptoms indicating that an individual continues using the substance despite significant substance-related problems. The diagnosis of a substance use disorder is based on a pathological pattern of behaviors related to the use of the substances.

(40) "Tribal authority," for the purposes of this section and RCW 71.24.300 only, means: The federally recognized Indian tribes and the major Indian organizations recognized by the director insofar as these organizations do not have a financial relationship with any behavioral health organization that would present a conflict of interest.

[2016 sp.s. c 29 § 502; 2016 sp.s. c 29 § 501; 2016 c 155 § 12. Prior: 2014 c 225 § 10; 2013 c 338 § 5; 2012 c 10 § 59; 2008 c 261 § 2; 2007 c 414 § 1; 2006 c 333 § 104; prior: 2005 c 504 § 105; 2005 c 503 § 2; 2001 c 323 § 8; 1999 c 10 § 2; 1997 c 112 § 38; 1995 c 96 § 4; prior: 1994 sp.s. c 9 § 748; 1994 c 204 § 1; 1991 c 306 § 2; 1989 c 205 § 2; 1986 c 274 § 2; 1982 c 204 § 3.]

NOTES:

Reviser's note: The definitions in this section have been alphabetized pursuant to RCW 1.08.015(2)(k).

Effective dates—2016 sp.s. c 29: See note following RCW 71.05.760.

Short title—Right of action—2016 sp.s. c 29: See notes following RCW 71.05.010.

Effective date—2014 c 225: See note following RCW 71.24.016.

Application—2012 c 10: See note following RCW 18.20.010.

Intent—Findings—2008 c 261: See note following RCW 71.24.320.

Finding—Purpose—Intent—Severability—Part headings not law—Effective dates—2006 c 333: See notes following RCW 71.24.016.

Findings—Intent—Severability—Application—Construction—Captions, part headings, subheadings not law—Adoption of rules—Effective dates—2005 c 504: See notes following RCW 71.05.027.

Alphabetization—Correction of references—2005 c 504: See note following RCW 71.05.020.

Correction of references—Savings—Severability—2005 c 503: See notes following RCW 71.24.015.

Purpose—Intent—1999 c 10: "The purpose of this act is to eliminate dates and provisions in chapter 71.24 RCW which are no longer needed. The legislature does not intend this act to make, and no provision of this act shall be construed as, a substantive change in the service delivery system or funding of the community mental health services law." [1999 c 10 § 1.]

Alphabetization of section—1999 c 10 § 2: "The code reviser shall alphabetize the definitions in RCW 71.24.025 and correct any cross-references." [1999 c 10 § 14.]

Effective date—1995 c 96: See note following RCW 71.24.400.

Severability—Headings and captions not law—Effective date—1994 sp.s. c 9: See RCW 18.79.900 through 18.79.902.

Conflict with federal requirements—1991 c 306: See note following RCW 71.24.015.

Effective date—1986 c 274 §§ 1, 2, 3, 5, and 9: See note following RCW 71.24.015.

RECOMMENDATIONS & AGENCY RESPONSE

Legislative Auditor's Recommendation

Legislative Auditor recommends determining whether to continue the preference (policy decision)

The Legislature should determine whether to continue this preference. If the Legislature wants to continue the tax deduction for government-funded behavioral health care, it will need to take action. Otherwise, behavioral health will be treated the same as physical health and providers will pay B&O taxes beginning in 2020.

Legislation Required: Yes.

Fiscal Impact: Depends on legislative action.

RECOMMENDATIONS & AGENCY RESPONSE

Letter from Commission Chair

Available October 2018

RECOMMENDATIONS & AGENCY RESPONSE

Commissioners' Recommendation

Available October 2018

RECOMMENDATIONS & AGENCY RESPONSE

Agency Response

If applicable, available October 2018

Washington Joint Legislative Audit and Review Committee

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Investment Projects

in High Unemployment Counties & Community Empowerment Zones

Preference defers sales & use tax for qualifying businesses in economically distressed areas

Must be in a **high unemployment county** OR **community empowerment zone (CEZ).**

- Must invest in facilities, machinery, or equipment. Projects in CEZs must meet hiring requirements.
- Deferred taxes are waived if a project meets eligibility requirements for 8 years.
- No deferral certificates issued after July 1, 2020.

Businesses reported creating 87% fewer jobs than they estimated in applications

Stated policy objective: Promote and stimulate economic and new employment opportunities in economically distressed areas.

- Businesses used the preference in 8 of 22 qualifying counties.
- Businesses used the preference in 4 of 6 CEZs.
- Businesses added a net of 131 jobs. This is 87% less than the 989 jobs they estimated creating.
- It is unclear if the job growth meets legislative expectations.

Preference likely had nominal impact on reducing poverty in distressed areas

Stated policy objective: Reduce poverty in distressed areas.

- Poverty rate in qualifying counties and CEZs in 2016: **16 percent.**
- Potential reduction in poverty rate: **0.07 percent** (using most optimistic scenario).

EXAMPLE

Best possible preference effect:

1 out of 1,000
residents no longer in poverty in eligible areas

Legislative Auditor's recommendation

Review sufficiency of outcomes and add metrics

- While businesses are using the preference in a few distressed areas, it is unclear if the amount of new jobs created or potential impact on poverty rates meets legislative expectations.
- The Legislature should consider adding metrics to reflect its expectations for job creation and poverty reduction.

For more information, contact: **Keenan Konopaski,** Washington State Legislative Auditor
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Preliminary Report:

2018 Tax Preference Performance Reviews

Investment Projects in High Unemployment Counties and Community Empowerment Zones

Legislative Auditor's Conclusion:

Businesses reported creating 87 percent fewer jobs than they originally estimated. The preference likely had a nominal impact on poverty rates. The Legislature should consider adding targets to help determine whether the preference is meeting expectations.

July 2018

Sales and use tax deferral for qualifying businesses that invest in facilities, machinery, or equipment in certain distressed areas

Qualifying businesses located in economically distressed areas do not pay sales or use tax on the following investments:

- New construction, or expansion or renovation of existing facilities.
- New machinery or equipment.

The preference applies to two types of economically distressed areas:

1. A **high unemployment county** designated by the Employment Security Department based on recurring above average unemployment rates.
2. A **community empowerment zone (CEZ)** designated by the Department of Commerce. CEZs are located in cities or unincorporated areas and are characterized by limited employment opportunities and educational services, a lack of affordable housing, and deteriorating infrastructure.

The deferred taxes are waived if businesses continue to use the facilities, machinery, or equipment as intended for a total of eight years.

The preference has no expiration date, but the Department of Revenue cannot issue deferral certificates after July 1, 2020.

Estimated Biennial Beneficiary Savings

$5.8 Million

Tax Type

Sales and Use Tax

RCWs 82.60.040; 82.60.049

Applicable Statutes

Stated public policy objectives

The Legislature stated its objectives in 2010 when it restructured a previous deferral program to encourage investment in high unemployment counties and CEZs.

Objectives (stated)	Results
Stimulate economic development and job growth in distressed areas	**Mixed**. Businesses are using the preference in eight out of 22 high unemployment counties and four out of six CEZs. These beneficiaries have created new jobs, but fewer than they originally estimated. It is unclear if the job growth meets legislative expectations.
Reduce poverty in distressed areas	**Unclear, but likely nominal impact.** JLARC staff estimate the potential reduction to the poverty rate is at most 0.07 percent in qualifying areas.

Recommendations

Legislative Auditor's Recommendation: Review sufficiency of outcomes and add metrics

The Legislature should review the sufficiency of outcomes and add metrics for the preference. While businesses are using the preference in eight high unemployment counties and four CEZs, estimates vary on the extent to which the preference has impacted job growth. Businesses reported creating 87 percent fewer jobs than they originally estimated. It is unclear if the job growth meets legislative expectations.

It is also unclear whether the preference reduced poverty in distressed areas. At most, JLARC staff estimate the potential reduction in the poverty rate to be 0.07 percent in qualifying areas. The data necessary to determine a more precise impact on poverty rates does not exist.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2018

REVIEW DETAILS

1. What is the preference?

Sales and use tax deferral for qualifying businesses that invest in facilities, machinery, or equipment in distressed areas

Legislature stated two public policy objectives

The Legislature passed this preference in 2010 with two stated objectives:

- Promote and stimulate economic and new employment opportunities in distressed areas.
- Reduce poverty in distressed areas.

Sales and use tax deferral for construction, new machinery and equipment

Qualifying businesses do not pay sales or use tax on the following investments:

- Building, expanding, or renovating facilities to increase floor space or production capacity.
- Purchasing new machinery or equipment.

The deferral covers materials, labor, and services to plan and construct facilities, and to install machinery or equipment.

Businesses must apply to the Department of Revenue (DOR) for the deferral before they begin construction, take possession of machinery or equipment, or hire employees.

Manufacturing and several other business activities qualify

The preference is limited to businesses performing any of the following activities:

- Manufacturing
- Research and development laboratories
- Commercial testing laboratories
- Conditioning vegetable seeds

Investment projects must be located in a distressed area

For this report, distressed area means one of the following:

- A **high unemployment county**, which is defined as a county with an unemployment rate at least 20 percent higher than the state average for the preceding three consecutive calendar years. The Employment Security Department establishes a list of qualifying counties and updates it every two years.
- A designated **community empowerment zone (CEZ)**. CEZs are located in cities or unincorporated areas. They are characterized by limited employment and educational services, a lack of affordable housing, and deteriorating infrastructure. The Department of Commerce has designated six CEZs in Washington.

Specific hiring requirements for projects in CEZs, none for projects in high unemployment counties

Investment projects in a CEZ must meet the following requirements:

- Hire one permanent full-time employee for each $750,000 of investment for which a deferral is requested.
- The employee(s) must live in the CEZ or in the county containing the CEZ when hired.
- Hiring must occur after DOR has received the deferral application.
- The position(s) must be filled by the end of the calendar year after the year in which DOR certifies that the project is complete. The business must retain the positions for the entire tax year.

DOR must verify that businesses have satisfied the hiring requirements initially. However, there is no statutory requirement that the new positions be maintained after the date that DOR verifies they were filled.

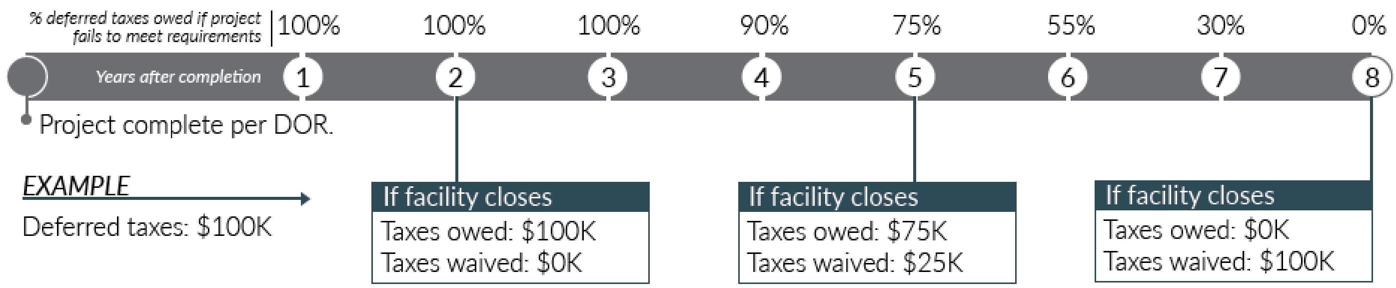
Businesses with investment projects located in high unemployment counties have no statutory hiring requirements.

Deferred taxes are waived if a project meets eligibility requirements for 8 years

If DOR determines a project meets eligibility requirements for eight consecutive years, all deferred taxes are waived. However, if a project no longer meets eligibility requirements within eight years after completion, **all or a portion of the remaining deferred taxes** are **immediately due**. The amount of taxes owed, and the amount waived, depends on how many years the project remains eligible.

A project becomes ineligible when a business no longer performs one of the qualifying activities. For example, if a business stops manufacturing at the facility, or closes the facility, the project is no longer eligible for a deferral.

Exhibit 1.1: A portion of deferred taxes is waived starting the 4th year after the project is operationally complete



Source: JLARC staff analysis of RCWs 82.60.060(1), 82.60.065(2).

Beneficiaries must file annual tax performance report

Businesses must file an annual tax performance report (annual report) for eight consecutive years after the project is operationally complete to remain eligible for the preference. If a business does not file an annual report or request an extension by the reporting deadline, DOR must bill the business for 12.5 percent (one-eighth) of the total amount of deferred taxes.

Preference is time limited, but has no expiration date

The preference took effect July 1, 2010. The Legislature did not set an expiration date, but did establish that DOR cannot issue deferral certificates after July 1, 2020.

REVIEW DETAILS

2. Legal history

The Legislature has tried different ways to encourage investment in rural, distressed, and high unemployment counties for over 30 years

1972-1982: Early attempts to target sales and use tax deferrals to specific areas were unsuccessful

The Legislature first enacted a sales and use tax deferral program in 1972 for investments in new buildings, machinery, and equipment. The deferral was in response to numerous job reductions in the aerospace industry.

Although initially targeted to certain distressed areas, the deferral was expanded to more areas over time. By 1982, the deferral was available in 37 of Washington's 39 counties. The Legislature repealed the deferral program that year after legislative studies found it to be costly and ineffective in attracting new businesses or increasing production.

1985-2009: Legislature enacted new tax deferral program for distressed areas. Program was expanded and extended over the next 24 years.

In 1985, the Legislature enacted a new sales and use tax deferral program to provide tax relief and incentives for small business development or expansion in certain distressed areas. The program was initially set to expire in 1991 and only applied to manufacturers and certain other business activities in counties with high unemployment rates. The program also initially had project-specific and statewide spending caps. Businesses were required to:

- Create a job for each $200,000 invested.
- Increase the site's value by 25 percent.

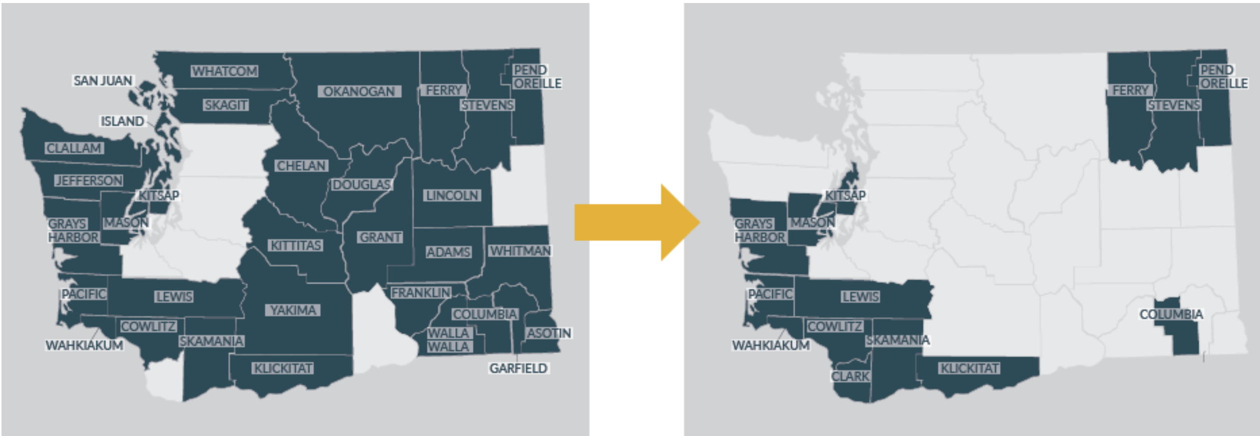
Over time, the Legislature removed the caps, extended the program, and expanded the areas where qualifying businesses could locate. Eventually, 32 out of 39 counties were eligible for the program as well as the state's six community empowerment zones (CEZs). The program closed for new applicants on July 1, 2010.

2010: Legislature restructured deferral program to encourage investment in high unemployment counties and CEZs

Beginning July 1, 2010, the Legislature restructured the deferral program to focus on businesses making investments in high unemployment counties and CEZs.

In 2010, 13 counties and all of Washington's CEZs met the qualifications.

Exhibit 2.1: Legislature restructured deferral program to focus on a smaller number of counties



July 1, 2009 - June 30, 2010 | **32 of 39 counties**

July 1, 2010 - June 30, 2012 | **13 of 39 counties**

Source: JLARC staff analysis of Office of Financial Management classification of qualifying distressed and rural counties, 2008-2010 and Department of Revenue Special Notice, May 16, 2016.

The preference has not been substantively changed since 2010. The number of qualifying counties has increased from 13 in July 2010 to 21 as of July 1, 2018. Under current law, the Department of Revenue cannot issue deferral certificates for this program after July 1, 2020.

REVIEW DETAILS

3. What locations qualify for the preference?

High unemployment counties and CEZs qualify for deferral

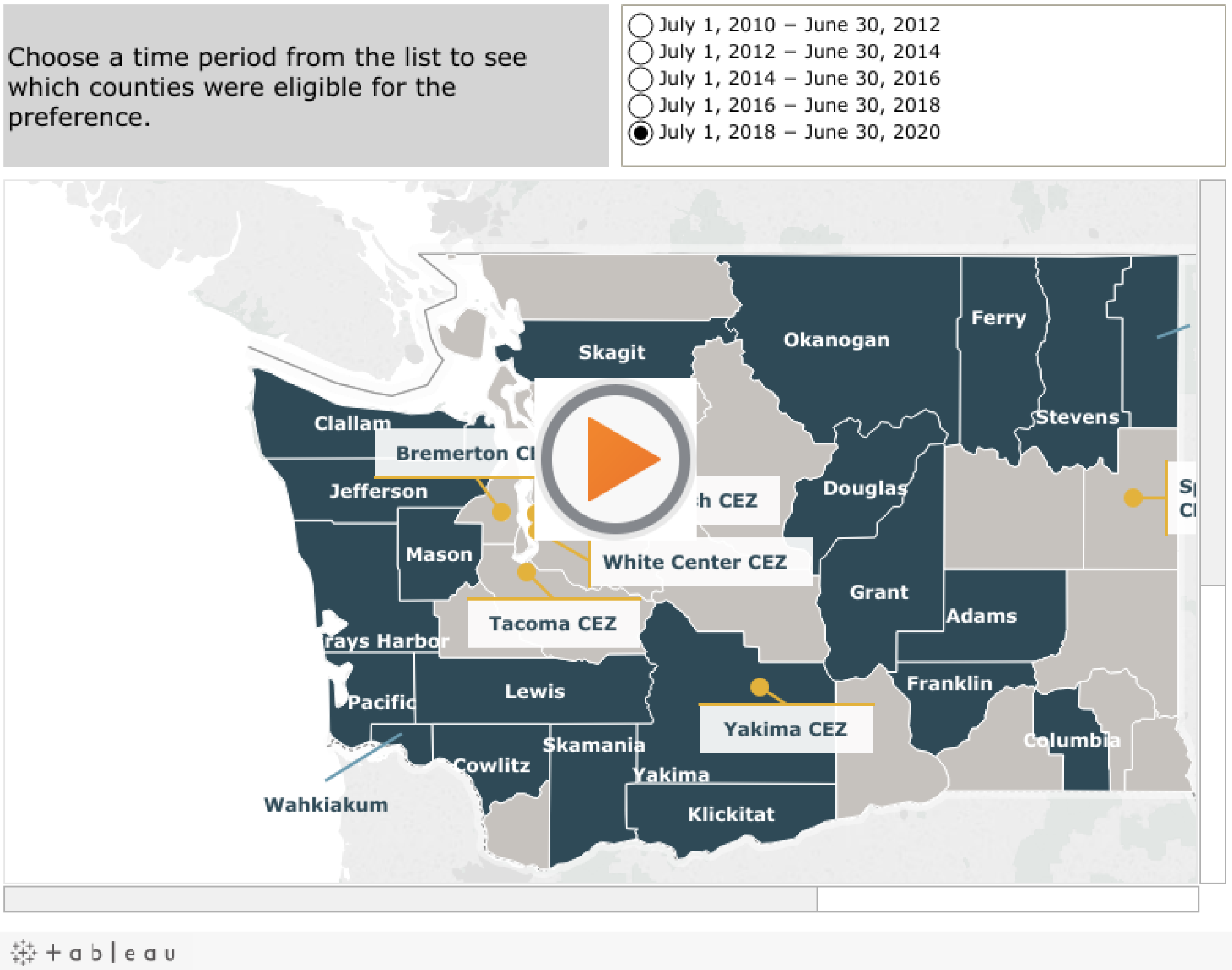
Qualifying businesses must make facility, machinery, or equipment investments in high unemployment counties or CEZs to qualify for a tax deferral.

High unemployment counties determined every two years

Eligible counties must have an unemployment rate at least 20 percent higher than the state average for the preceding three consecutive calendar years. The Employment Security Department (ESD) establishes a list of qualifying counties based on this criteria and updates the list every two years.

The maps below allow you to view the counties that have qualified for each two-year period from July 1, 2010, through June 30, 2020.

Exhibit 3.1: Qualifying high unemployment counties have changed every two years. Twenty-one of Washington's 39 counties will qualify through June 2020.



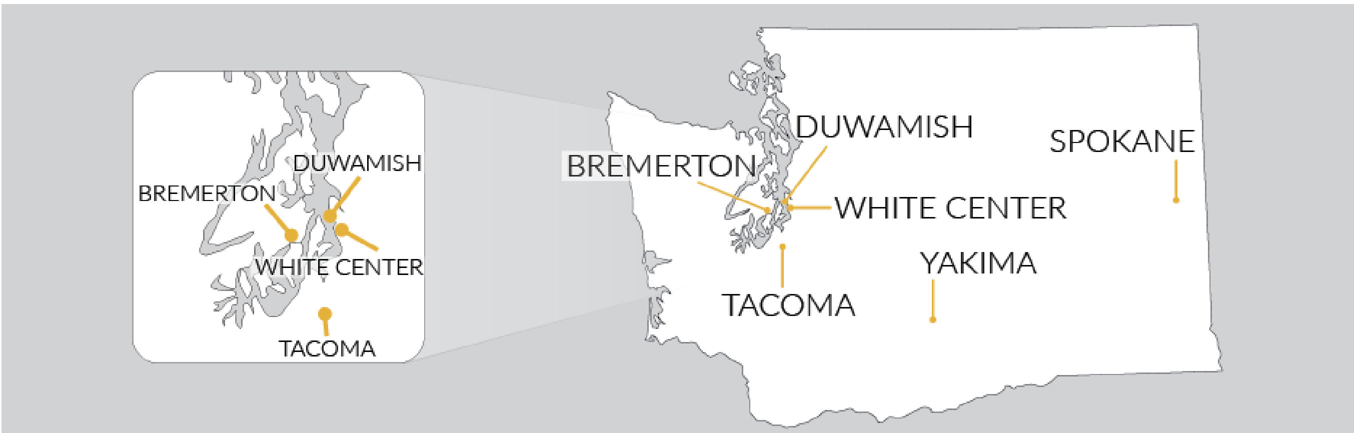
Source: JLARC staff review of Department of Revenue Special Notice dated May 16, 2016, and analysis of detail provided by Employment Security Department on qualifying high unemployment counties for the period July 1, 2018 through June 30, 2020.

Six CEZs designated as high unemployment, low-income areas

In 1993, the Legislature passed the Community Empowerment Zone (CEZ) Act to encourage community revitalization and reinvestment in certain distressed areas of the state. CEZs are located in cities or unincorporated areas. They are characterized by limited employment opportunities, a lack of affordable housing, low incomes, deteriorating infrastructure, and limited services such as job training and education.

State law directed the Department of Commerce to identify up to six CEZs statewide before 2004. It identified six, and there have been no changes to the list or their geographic boundaries. At this time, Spokane is working with the Department of Commerce to change its CEZ boundaries to more closely align with its current industrial area.

Exhibit 3.2: Washington's CEZs are located within six cities or unincorporated areas



Source: JLARC staff analysis of CEZ locations obtained from Department of Revenue website, viewed March 30, 2018.

REVIEW DETAILS

4. Unclear whether the preference is meeting objectives

Businesses reported creating fewer jobs than they estimated. Preference likely had nominal impact on reducing poverty.

Legislature stated its objectives when it restructured the deferral program

In 2010, the Legislature stated two objectives for the deferral program:

1. Promote and stimulate economic and new employment opportunities in distressed areas.
2. Reduce poverty in distressed areas.

The Legislature noted several areas in the state that were characterized by "very high levels of unemployment and poverty." It indicated that the state needed new policies to promote economic stimulation and new employment opportunities in these distressed areas.

The deferral program is limited to high unemployment counties as identified by the Employment Security Department and community empowerment zones (CEZs) designated by the Department of Commerce.

Objective 1: Stimulate economic development and create jobs in distressed areas

Businesses estimated they would create more new jobs than they actually did

Businesses are required to estimate the number of new jobs that will be created at their qualifying facilities when they apply for the preference. The current beneficiaries estimated they would create 989 new full-time jobs. The actual number of net new jobs these same beneficiaries reported in 2016 was 87 percent lower than estimated. There is variation in job changes reported by beneficiaries, with some reporting increases and others reporting decreases compared to their applications. However, businesses overall reported a net total increase of 131 jobs at qualifying facilities.

Forty-four businesses reported using the preference in 2016

The preference was used by 44 businesses in 2016, the latest data available at the time of this report. Most of these businesses are in the manufacturing industry. Since 2010, the preference has been used in eight of 22 counties that have qualified as a high unemployment county, and in four of six CEZs.

The Legislature did not state clear expectations or targets for the level of economic development or number of jobs it hoped to stimulate with the preference. It is unclear if the Legislature's expectations have been met by the number of businesses claiming the preference or the number of jobs reported by beneficiaries.

Economic model shows potential range of net employment changes resulting from preference

Beneficiary data reported to the Department of Revenue (DOR) in 2016 indicates employment at qualifying sites increased by 131 jobs between the year the beneficiaries applied for the preference and 2016.

It is difficult to objectively determine how many of the new jobs were a direct result of the preference (i.e., how many of these new jobs would not exist without the preference). However, it is possible to estimate a range of net employment changes based on different assumptions about how the preference impacted employment. These analyses of net employment changes include estimates of potential jobs gained at project sites minus potential jobs lost due to reduced tax revenues for public sector spending. When beneficiaries claim the tax deferral, there is a loss in state revenue with an assumed corresponding reduction in state spending.

The table below shows the estimated net employment change (including direct, indirect, and induced jobs) under three different scenarios:

Exhibit 4.1: Net gain or loss in employment depends on how many new jobs were created as a direct result of the preference

	Number of new jobs assumed to be a direct result of the preference*	Net employment change statewide **
Scenario 1	If none (0 jobs)	Then net loss of 29 jobs
Scenario 2	If all (131 jobs)	Then net gain of 429 jobs
Scenario 3	If break-even point (8.5 jobs)	Then net change is 0 jobs. Net gain is offset by net loss.

Source: JLARC staff analysis of Department of Revenue high unemployment county application and 2016 annual report data. JLARC staff estimated impact on job loss or creation using REMI economic modeling tool.

***Beneficiaries reported 131 new jobs as of 2016. This column indicates an assumption about how many of those jobs exist solely because of the preference.**

**** Net employment change is the assumed number of jobs that are a direct result of the preference less the number of job losses due to the loss in state revenue when beneficiaries claim the tax deferral.**

Average wages paid by beneficiaries fall between statewide and manufacturing industry averages

For 2016, the current 44 beneficiaries paid an average annual wage of $62,042. This is slightly above the average annual statewide employee wage but below the statewide average manufacturing industry wage for 2016.

Average Annual Wage (2016)	
All Beneficiaries	**$62,042**
All Manufacturers	**$74,632**
Statewide, All Employers	**$59,090**

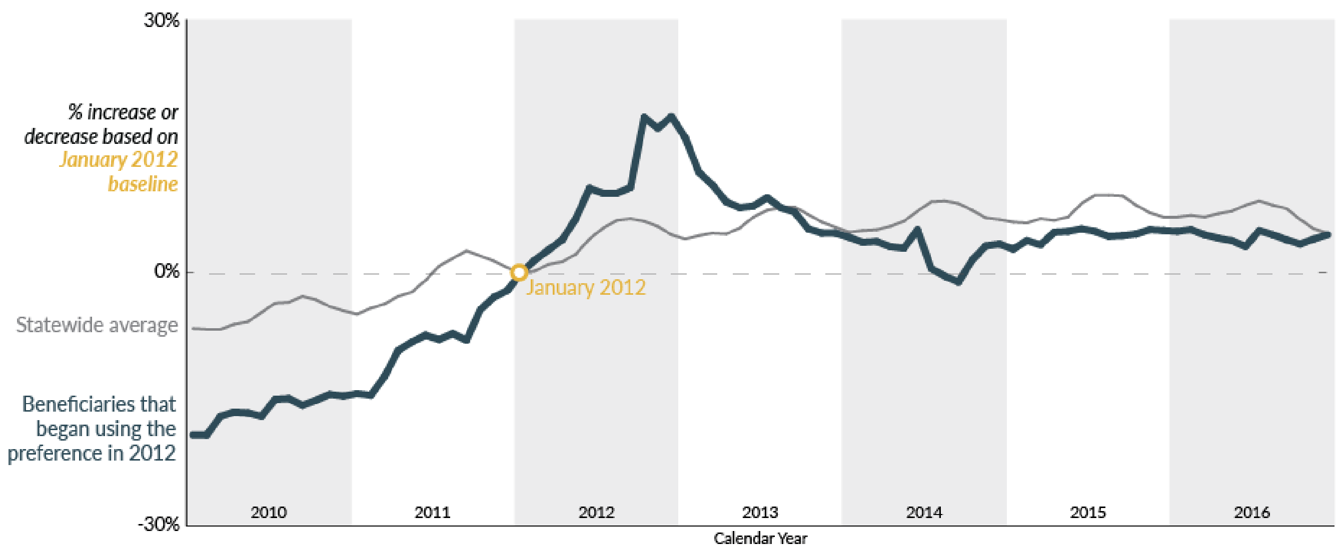
Source: JLARC staff analysis of 2016 Employment Security Department employee wage data for: tax preference beneficiaries filing annual report in 2016, statewide manufacturing industry, and statewide, all industries.

Beneficiaries' employment changes similar to all manufacturers statewide

To determine whether the beneficiaries' employment growth outperformed businesses that did not claim the preference, JLARC staff divided the current beneficiaries into cohorts based on the first year they filed an annual tax performance report (annual report) with DOR. For each cohort, JLARC staff examined the change in employment starting two years before the businesses filed their first annual report through 2016, and compared the change to statewide manufacturing sector employment data for the same time period.

Beneficiaries that filed their first annual report with DOR between 2012 and 2014 had employment changes that were very similar to all manufacturing businesses statewide. The chart below shows the 2012 cohort. The 2013 and 2014 cohort groups also had similar trends in employment changes compared to all manufacturing businesses.

Exhibit 4.2: After 4 years, employment for the 2012 beneficiary cohort increased by 4.5% and manufacturing employment statewide increased by 4.7%



Source: JLARC staff analysis of changes in employment using Employment Security Department wage data for 2012 cohorts and all manufacturers, statewide from January 2010 through December 2016.

Objective 2: Reduce poverty in distressed areas

The preference had a nominal impact on reducing poverty in distressed areas

Using U.S. Census data, JLARC staff estimated the potential impact that the new jobs may have had on poverty rates in qualifying counties and CEZs. These are likely high-end estimates, based on assumptions that allow for the maximum impact on poverty rates, including the following:

- The net gain in employment is 429 new jobs based on scenario 2 in Exhibit 4.1, above.
- Each of these new jobs is filled by a person living in an average-sized family whose members all earned income below the poverty level before the employee began the job.
- Each of these jobs moved the employee and their family out of poverty.

Based on these assumptions, the most optimistic potential reduction in the poverty rate in distressed areas was 0.07 percent. The poverty rate in the distressed areas in 2016 was 16.3 percent.

It is difficult to objectively determine how successful the preference was in reducing poverty in distressed areas for two reasons.

- First, the statute creating the preference does not include a target for reducing poverty.
- Second, and perhaps more importantly, there is little information available about the family incomes of employees who fill the jobs created by beneficiaries.

Exhibit 4.3: Even with the most optimistic assumptions, the preference has a nominal impact on reducing poverty rates in distressed areas

Qualifying Distressed Areas	2016 Population	Population in Poverty	Total Jobs Created by Preference (See Exhibit 4.1 above)	Reduction in People Below Poverty Level (Family)	Reduction in Poverty Rate (Family)
All CEZs and Qualifying Counties	2,045,800	334,400	429	1,360	0.07%

Source: JLARC staff analysis of Department of Revenue High Unemployment County and CEZ deferral applications and 2016 annual report data, as well as U.S. Census data on poverty rates in qualifying locations.

Legislature may want to consider adding job creation or retention and wage targets to better assess performance of preference

If the Legislature wants to extend the preference for new applicants beyond July 1, 2020, it may want to consider adding metrics that will allow for an objective assessment of whether the preference is meeting legislative expectations. These may include:

- Job creation targets for beneficiaries located in high unemployment counties. Currently the only job creation requirement is for beneficiaries located in CEZs. They must create one job per $750,000 investment.
- Job retention targets for all beneficiaries. Beneficiaries in CEZs must create jobs, but there is no requirement to maintain the job after the tax year in which the employee is hired.

JLARC staff researched economic development and job creation tax incentives offered in other states. We found several programs that require participants to meet targets for job creation and job retention. Additionally, many tax incentive programs in other states require participants to meet certain employee wage levels. See Other States with Similar Preferences tab.

REVIEW DETAILS

5. Beneficiaries

Through 2016, most of the 44 direct beneficiaries were manufacturers expanding their existing operations. Additional qualifying businesses will be completing their projects soon.

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

Through 2016, 44 businesses have reported they directly benefited from the preference

Forty-four businesses currently benefit from the preference and have filed annual reports with the Department of Revenue (DOR) for calendar year 2016. Of those 44 businesses:

- 37 of the 44 reported using the preference for business expansion. The remaining seven used it for new business facilities.

- Most of the 2016 beneficiaries noted they were conducting manufacturing activities.
- The average **annual amount** of sales and use tax deferred was $27,622 per beneficiary.
- The average **total amount** of sales and use tax owed on the project was $220,980 (deferred and potentially waived, if business remains eligible).

Additional projects currently in progress

Additional investment projects have been approved and are moving toward project completion. DOR expects 15 new businesses to file their first annual report for calendar year 2017 by the end of May 2018.

Between July 2010 and May 2018, businesses submitted 130 certificate applications to DOR to use the preference. A certificate application is for a specific new construction or expansion project at a facility, or a purchase of new equipment or machinery. Some businesses have submitted multiple certificate applications through the years, so the number of certificates does not match the number of beneficiary businesses.

Of the 130 certificate applications received by DOR:

93 approved applications

- **54** are held by the 44 businesses that filed 2016 annual reports.
- **16** (one business has two certificates) will file their first annual report in 2017.
- **1** will file its first annual report in 2018.
- **22** have been approved but are not yet complete.

37 not participating

- **32** were withdrawn by the business or denied by DOR.
- **4** were determined to have no qualifying purchases.
- **1** closed the facility after becoming operationally complete and was billed for the full amount of deferred tax.

Beneficiaries are concentrated in a few distressed areas

Eighteen of the 44 businesses using the preference in 2016 were located in Clark County. The next largest concentration of beneficiaries was in Spokane's community empowerment zone (CEZ), with nine businesses. Five businesses were located in either Yakima's CEZ or in Yakima County. The remainder of the beneficiaries are located in other counties or CEZs throughout the state, with no more than two in the same location.

Counties and communities where projects are located may receive indirect benefits

While qualifying businesses directly benefit from the preference, the high unemployment counties and CEZs where they are located also may receive benefits. The economic activity generated by new or expanding businesses can boost economic development and growth in the broader community and create jobs for local residents.

REVIEW DETAILS

6. Revenue and economic impact

Estimated direct revenue impact $5.8 million in 2019-2021 Biennium

JLARC staff estimate the direct beneficiary savings for fiscal year 2017 is $1.6 million. The estimated beneficiary savings for the 2019-2021 Biennium is $5.8 million.

The biennial estimate is based on the following assumptions:

- Several businesses with approved projects in progress will complete their projects in the coming years.
- Additional businesses will submit applications to DOR before the cutoff date of July 1, 2020, and will receive benefits after that date.
- Businesses that began receiving deferrals in 2011 and 2012 will pass the 8-year time period and receive a full waiver of their deferred taxes.

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

Biennium	Fiscal Year	Estimated Beneficiary Businesses	Estimated Beneficiary Savings
2015-17 *7/1/15-6/30/17*	2016	44	$1.2 Million
	2017	59	$1.6 Million
2017-2019 *7/1/17 - 6/30/19*	2018	74	$2.0 Million
	2019	89	$2.4 Million
2019-21 *7/1/19-6/30/21*	2020	104	$2.9 Million
	No deferral certificates issued after July 1, 2020		
	2021	104	$2.9 Million
	2019-21 Biennium	104	$5.8 Million

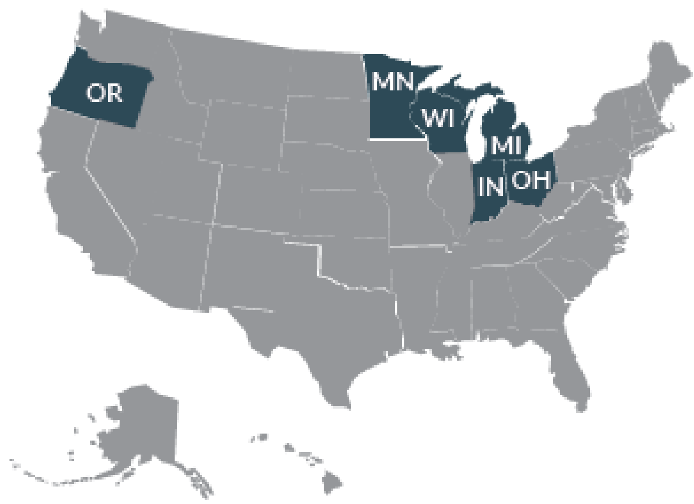
Source: JLARC staff analysis of annual tax preference performance reports and consultation with Department of Revenue staff on estimated future use.

REVIEW DETAILS

7. Other states with similar preferences

Other top manufacturing states often include job creation and wage requirements in similar tax incentives

JLARC staff reviewed economic development tax incentive programs offered in top manufacturing states as well as Idaho and Oregon, two neighboring states. Staff focused on leading manufacturing states because the majority of beneficiaries of this preference are manufacturers. In 2016, the five states with the greatest concentration of manufacturing jobs were Michigan, Wisconsin, Ohio, Indiana, and Minnesota.



The economic development tax incentives identified in the following table are similar to Washington's high unemployment county and CEZ investment preference in two ways:

- They require a capital investment in facilities, machinery, or equipment.
- They provide incentives to projects located in distressed, high unemployment, or rural areas.

JLARC staff did not find any programs that met the above criteria in Idaho.

Unlike Washington's preference, the other states are different in several areas as well:

- Of the six states, all have programs that include requirements for job creation, retention, and wage levels. Washington's preference only has job creation requirements for projects located in CEZs.
- Of the six states, only Minnesota has a program that offers partial rebates or refunds on purchases rather than a full sales and use tax deferral and waiver.

Exhibit 7.1: Other states offer incentives to encourage development in economically distressed areas

Select an incentive to view its description below

Full State	Type	Incentive	Certain industries targeted	Distressed/ rural areas targeted or gi..	Job and/or wage requirements
Indiana	Income Tax	Community Revitalization Enhancement..	✗	✓	✗
		Enterprise Zone Incentives	✓	✓	✓
Michigan	Grants or l..	Michigan Community Revitalization Pro..	✗	✓	✗
	Property Tax	Distressed County Property Tax Relief	✓	✓	✗
	Sales and ..	Michigan Business Development Program	✗	✓	✓
Minneso..	Property Tax	Border Cities Enterprise Zones Incentiv..	✗	✓	✓
	Sales and ..	Greater Minnesota Job Expansion Refu..	✗	✗	✓
Ohio	Property Tax	Community Reinvestment Area Program	✗	✓	✗
		Ohio Enterprise Zone Prog	✗	✓	✓
Oregon	Property Tax	E-Commerce Zones	✓	✓	✗
		Enterprise Zone – Standar	✓	✓	✓
		Strategic Investment Prog	✓	✓	✗
	Sales and ..	Long-Term Rural Enterpris	✗	✓	✓
Wiscons..	Income Tax	Development Opportunity Zone Program	✓	✓	✓
		Enterprise Zone Jobs Tax Credit	✗	✓	✓
		Wisconsin Business Development Credit	✗	✓	✓

Incentive: All

Description: All

+ a b | e a u

Source: JLARC staff analysis of state economic development and tax incentive programs as detailed in online resources for Oregon, Michigan, Wisconsin, Ohio, Indiana, and Minnesota.

REVIEW DETAILS

8. Applicable statutes

Chapter 82.60 RCW provides statutory authority for investment project deferral program

RCW 82.60.010

Legislative findings and declaration.

The legislature finds that there are several areas in the state that are characterized by very high levels of unemployment and poverty. The legislature further finds that economic stagnation is the primary cause of this high unemployment rate and poverty; that new state policies are necessary in order to promote economic stimulation and new employment opportunities in these distressed areas; and that policies providing incentives for economic growth in these distressed areas are essential. For these reasons, the legislature reestablishes a tax deferral program to be effective solely in distressed counties. The legislature declares that this limited program serves the vital public purpose of creating employment opportunities and reducing poverty in the distressed counties of the state.

[2010 1st sp.s. c 16 § 1;1985 c 232 § 1.]

RCW 82.60.040

Issuance of tax deferral certificate. (Expires July 1, 2020.)

(1) The department must issue a sales and use tax deferral certificate for state and local sales and use taxes due under chapters 82.08, 82.12, and 82.14 RCW on each eligible investment project.

(2) The department must keep a running total of all deferrals granted under this chapter during each fiscal biennium.

(3) This section expires July 1, 2020.

[2010 1st sp.s. c 16 § 6;2004 c 25 § 4;1999 c 164 § 302;1997 c 156 § 5;1995 1st sp.s. c 3 § 6;1994 sp.s. c 1 § 3;1986 c 116 § 13;1985 c 232 § 4.]

RCW 82.60.049

Additional eligible projects.

(1) For the purposes of this section:

(a) "Eligible area" also means a designated community empowerment zone approved under RCW 43.31C.020.

(b) "Eligible investment project" also means an investment project in an eligible area as defined in this section.

(2) In addition to the provisions of RCW 82.60.040, the department shall issue a sales and use tax deferral certificate for state and local sales and use taxes due under chapters 82.08, 82.12, and 82.14 RCW, on each eligible investment project that is located in an eligible area, if the applicant establishes that at the time the project is operationally complete:

(a) The applicant will hire at least one qualified employment position for each seven hundred fifty thousand dollars of investment for which a deferral is requested; and

(b) The positions will be filled by persons who at the time of hire are residents of the community empowerment zone. As used in this subsection, "resident" means the person makes his or her home in the community empowerment zone or the county in which the zone is located. A mailing address alone is insufficient to establish that a person is a resident for the purposes of this section. The persons must be hired after the date the application is filed with the department.

(3) All other provisions and eligibility requirements of this chapter apply to applicants eligible under this section.

(4) The qualified employment position must be filled by the end of the calendar year following the year in which the project is certified as operationally complete. If a person does not meet the requirements for qualified employment positions by the end of the second calendar year following the year in which the project is certified as operationally complete, all deferred taxes are immediately due.

[2010 1st sp.s. c 16 § 7;2004 c 25 § 5;2000 c 106 § 8;1999 c 164 § 304.]

REVIEW DETAILS

Technical Appendix 1: REMI Overview

REMI Overview

JLARC staff used Regional Economic Models, Inc.'s (REMI) Tax-PI software (v.2.1) to model the economic impacts for one tax preference review in the 2018 report: Investment Projects in High Unemployment Counties and Community Empowerment Zones Sales and Use Tax Deferral.

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

Model is Tailored to Washington and Includes Government Sector

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

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

Results the Model Provides

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

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

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

What the Model Includes

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

- The supply side of the model includes many economic variables representing labor supply, consumer prices, and capital and energy costs with elasticities for both the consumer and business sectors.
- Regional competitiveness is modeled via imports, exports, and output.
- Demographics are modeled using population dynamics (births, deaths, and economic and retirement migration) and includes cohorts for age, sex, race, and retirement.
- Demographic information informs the model's estimates for economic consumption and labor supply.
- The dynamic aspect comes from the ability to adjust variables over time as forecasted economic conditions change.

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

REVIEW DETAILS

Technical Appendix 2: REMI Analysis

Analysis of employment impacts associated with the sales and use tax deferral for investment projects in high unemployment counties and CEZs

This technical appendix provides background detail and supporting information for the JLARC staff analysis of the employment impacts associated with Washington's sales and use tax deferral for investment projects in high unemployment counties and CEZs. The appendix is divided into three sections:

- Section One titled **REMI Methodology** details how JLARC staff set up and calibrated the Tax-PI program prior to using the model.
- Section Two titled **Jobs for the Manufacturing Industries in REMI** discusses baseline manufacturing employment in the REMI model of the Washington economy, and the observed increase in employment at business sites where beneficiaries have used the preference.
- Section Three titled **Modeling the Impact of the Sales and Use Tax Deferral for the Manufacturing Industry in REMI** describes the scenarios used to estimate the range of potential employment effects of the sales and use tax deferral on statewide employment. The results of this analysis are presented in the "Are Objectives Being Met?" tab.

1) REMI Methodology

User Inputs in REMI

REMI's Tax-PI model allows users to model policy changes and analyze the estimated impacts to the Washington economy, both in terms of economic activity and government finances. (See Technical Appendix 1 for an overview of the REMI model.)

Prior to running modeling scenarios, users must make a series of choices about how to set up the modeling environment by building a state budget and calibrating the model accordingly. JLARC staff used the November 2017 revenue estimates produced by the Economic and Revenue Forecast Council (ERFC) and budgeted expenditures for fiscal years 2016 and 2017, as reported by the Legislative Evaluation and Accountability Program (LEAP) Committee. This data represents the budget and revenue data in the model and serves as the "jump off" point for Tax-PI's economic and fiscal estimates. Because Tax-PI is a forecasting tool, JLARC staff was unable to model the economic impact of the tax preference beginning in 2010.

In addition to establishing a budget and inputting expected revenue values, users must specify whether government expenditures are determined by demand or revenue. "By demand" imposes a level of government spending in future years that is necessary to maintain the same level of service as the final year in which budget data is entered. "By revenue" ties government expenditures to estimated changes in revenue collections.

Users may also elect to impose a balanced budget restriction or leave the model unconstrained. The balanced budget feedback forces revenue and expenditures to be equivalent and thus may impose some limitations on economic activity.

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

JLARC staff ran the reported scenarios with expenditures set to be determined by demand and with the balanced budget feedback option turned on.

Data for the REMI Model

The REMI model comes with historical economic and demographic data back to 1990. The data comes from federal government agencies such as the U.S. Census Bureau, U.S. Energy Information Administration, the Bureau of Labor Statistics, and the Bureau of Economic Analysis. As described above, current revenue and expenditure data for Washington comes from ERFC and LEAP, respectively. The data to build the modeling scenario described in section three is from JLARC staff estimations of beneficiary savings, based on Department of Revenue tax records.

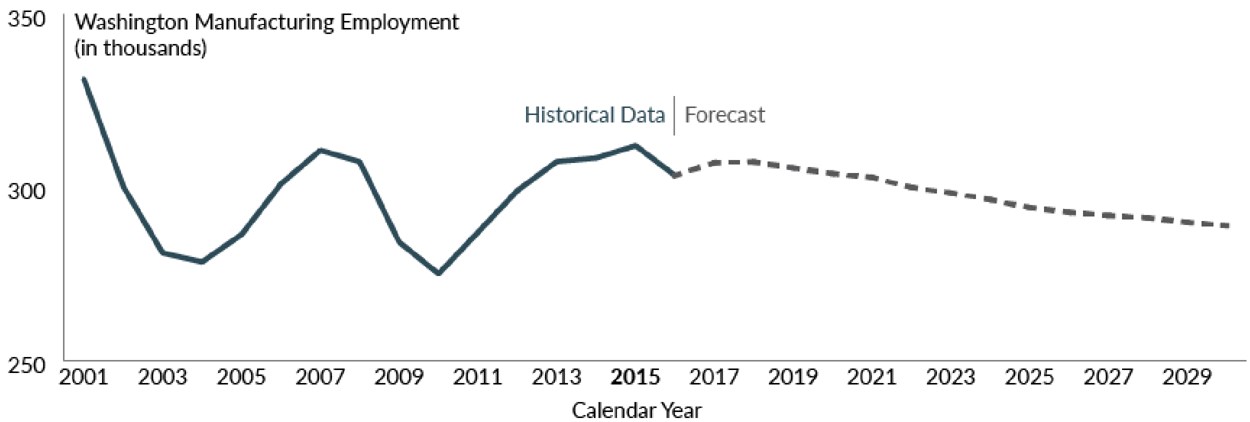
2) Jobs for the Manufacturing Industries in REMI

The majority of businesses that claim the deferral report North American Industry Classification System (NAICS) numbers identifying them as primarily manufacturing businesses. Therefore, JLARC staff modeled the potential employment effects of the preference on baseline employment of businesses in the manufacturing industry (NAICS 31 - 33).

Manufacturing Industry Jobs Fluctuated in Washington between 2001 and 2015

REMI's historical baseline forecast employment data for the manufacturing industry fluctuated from a high of 331,000 in 2001 to a low of 275,000 in 2010. Employment is projected to decline steadily from 312,000 in 2015 to 289,000 in 2030.

Exhibit: REMI Baseline and Forecast Data Shows Statewide Manufacturing Jobs Decline after 2015



Source: JLARC staff analysis of REMI data for jobs using NAICS codes for manufacturing (31 - 33).

Beneficiaries of the Tax Preference Report 131 New Jobs at Qualifying Sites

Data reported to the Department of Revenue shows the 44 businesses that claimed the preference in 2016 increased employment by 131 during 2010-2016, the years the tax preference has been in effect.

3) Modeling the Impact of the Sales and Use Tax Deferral for Investment Projects in High Unemployment Counties and CEZs

JLARC staff followed a two-step approach to modeling the employment impacts of the tax preference:

- Increased employment in all manufacturing sectors included in the REMI model.
- Reduced government spending by an amount equivalent to the taxpayer savings.

JLARC staff modeled three scenarios that illustrate the range of potential employment effects that result from the tax preference. JLARC staff are unable to determine how many of the 131 jobs created at the manufacturing sites of beneficiary businesses were created directly as a result of the preference. Instead, JLARC staff attempted to illustrate lower and upper bounds of potential employment effects based on two assumptions for the share of reported jobs that were directly created as a result of the preference, as well as the point at which the positive employment effects of additional manufacturing employment offset the negative employment effects of reduced government spending.

For each scenario modeled, JLARC staff modeled a change in nominal state government spending in the amount of the estimated beneficiary savings for FY 2016-2030.These amounts are shown below:

Fiscal Year	Estimated Beneficiary Savings
2016	1,203,669
2017	1,631,488
2018	2,046,273
2019	2,461,059
2020	2,875,844
2021	2,875,844
2022	2,876,000
2023	2,876,000
2024	2,876,000
2025	2,876,000
2026	2,461,000
2027	2,046,000
2028	1,632,000
2029	1,217,000
2030	802,000

Scenario 1: Beneficiary Savings Induce No Change in Manufacturing Sector

In the first scenario, JLARC staff assumed **none** of the 131 new jobs were created directly due to the preference. This scenario assumes no manufacturing employment change from the baseline, and includes only the direct, indirect, and induced employment effects of the change in state government spending.

Scenario 2: Beneficiary Savings Induce Reported Job Increases at Manufacturing Sites

In the second scenario, JLARC staff assumed **all** of the 131 new jobs were created directly due to the preference. This scenario assumes the manufacturing employment change from the baseline of 131 jobs, distributed among the 75 manufacturing subsectors in the REMI model, weighted by each subsector's relative output level. The employment changes are applied at the firm (competes locally) level.

Scenario 3: Beneficiary Savings Induce Some Job Increases at Manufacturing Sites, No Net Employment Change in 2016

In the third scenario, JLARC staff assumed **just enough** of the 131 new jobs were created directly due to the preference to offset the employment losses resulting from the reduction in government spending. This scenario involved running REMI scenarios with incrementally increasing manufacturing employment changes until the 2016 employment change from the baseline was zero. In each case, the manufacturing employment change from the baseline was distributed among the 75 manufacturing subsectors in the REMI model, weighted by each subsector's relative output level. The employment changes are applied at the firm (competes locally) level.

JLARC staff used REMI to model how this direct employment change and its indirect and induced effects offset the direct, indirect, and induced employment effects of the change in state government spending.

Exhibit:Three Scenarios Illustrate Range of Possible Statewide Employment Effects of Tax Preference

Scenario #	Description	2016	2017	2018	2019	2020	2021
1	Beneficiary Savings Induce No Change in Manufacturing Sector	-29	-40	-51	-59	-65	-62
2	Beneficiary Savings Induce Reported Job Increases at Manufacturing Sites	429	455	539	532	516	503
3	Beneficiary Savings Induce Some Job Increases at Manufacturing Sites, No Net Employment Change in 2016	0	-8	-12	-20	-28	-26

Source: JLARC staff analysis on future year possible employment changes using REMI economic modeling tool.

Two Employment Data Sources

Different Approaches in Reporting Employment

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

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

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

RECOMMENDATIONS & AGENCY RESPONSE

Legislative Auditor's Recommendation

Legislative Auditor recommends reviewing the sufficiency of outcomes and adding metrics

The Legislature should review the sufficiency of outcomes and add metrics for this tax preference prior to July 1, 2020. While businesses are using the preference in a few distressed areas, it is unclear whether the amount of new jobs created or the potential impact on poverty rates meets legislative expectations.

- Beneficiaries reported 131 new jobs created. The reported jobs are 87% lower than what the businesses originally estimated when they applied for the preference. There is variation in job changes reported by beneficiaries, with some reporting increases and others reporting decreases compared to their applications.
- Estimates vary on the extent to which the preference has impacted job growth.
- JLARC staff estimate the most optimistic potential reduction in the poverty rate in qualifying areas was 0.07 percent.

The Legislature should consider adding metrics that reflect its expectations for job creation and poverty reduction.

Legislation Required: Yes

Fiscal Impact: Depends on legislative action.

RECOMMENDATIONS & AGENCY RESPONSE

Letter from Commission Chair

Available October 2018

RECOMMENDATIONS & AGENCY RESPONSE

Commissioners' Recommendation

Available October 2018

RECOMMENDATIONS & AGENCY RESPONSE

Agency Response

If applicable, available October 2018

Washington Joint Legislative Audit and Review Committee
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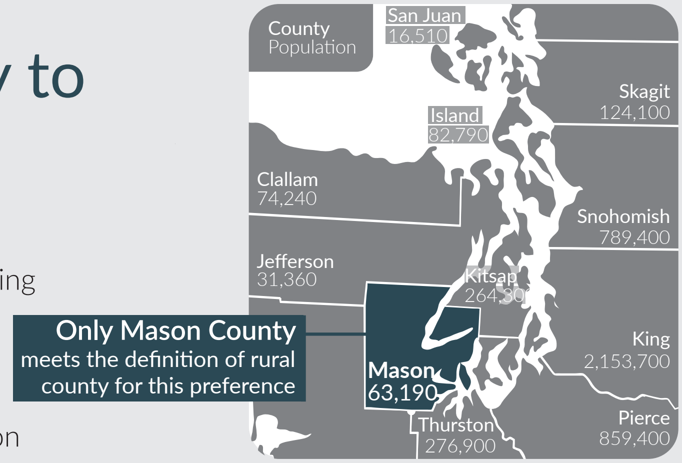
Multifamily Housing in Mason County

Property tax exemption available in Mason County to stimulate construction of multifamily housing



- Owners of new, expanded, or updated multifamily housing in targeted areas of rural counties are eligible.
- The housing must have at least four units and include affordable housing.
- Property remains exempt for 8 or 12 years, depending on the percent of units that are affordable.
- Rural county: must border Puget sound and have a population between 50,000 and 71,000

The preference has not stimulated multifamily housing construction in Mason County as intended

No developers have built multifamily housing in Mason County since the Legislature approved the preference in 2014

Applications cannot be accepted after January 1, 2020.

The Legislature stated its intent to extend the deadline if at least 20 percent of new housing units were occupied by low or moderate income households. This has not occurred.

Upcoming 2019 review of a similar preference used in other locations may identify successful practices for attracting multifamily housing

- The Multifamily Property Tax Exemption (MFTE) allows local governments to provide a property tax exemption to stimulate the construction of multifamily housing within designated areas.
- The review may identify factors that help multifamily housing preferences achieve their goals.
- MFTE will be reviewed by JLARC staff in 2019.

Legislative Auditor's recommendation

Allow to expire and consider other strategies

The preference has not stimulated construction of any new housing in the residential targeted areas of Mason County. While the preference has no official expiration date, no new applications may be approved after January 1, 2020.

The complete report is on the JLARC web site.

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

Preliminary Report:

2018 Tax Preference Performance Reviews

Multifamily Housing in Mason County

Legislative Auditor's Conclusion:

The preference has not stimulated multifamily housing construction in Mason County. A review of a similar preference in 2019 may identify some possible strategies.

July 2018

Property tax exemption for Multifamily Housing in Mason County

The preference provides a property tax exemption to owners for new, expanded, or updated multifamily housing in targeted areas of rural counties. Mason County is the only rural county that qualifies under current law.

The housing must have at least four units and include affordable housing. The property remains exempt for eight to twelve years, depending on the percent of units that are affordable. Affordability and income limits are defined by Mason County.

The preference was created in 2014. Developers may not apply after January 1, 2020.

Estimated Biennial Beneficiary Savings

$0

Tax Type

Property Tax

Chapter 84.14 RCW

Applicable Statutes

The stated public policy objective is not being met

The Legislature stated a public policy objective in the tax preference performance statement for the preference when it was enacted in 2014.

Objective (stated)	Results
Stimulate construction of multifamily housing in target areas of rural counties where housing options, including affordable housing options, are severely limited.	**Not met**. No developers have built multifamily housing in Mason County since 2014.

Preference related to a broader exemption that JLARC staff will review in 2019

The preference is related to an exemption that is commonly referred to as the Multifamily Property Tax exemption (MFTE). Like this preference, the MFTE allows a larger number of local governments to provide a property tax exemption to stimulate the construction of multifamily housing within designated areas.

This preference for Mason County has more stringent income and project eligibility requirements than MFTE. For example, at least 20% of units must be affordable to qualify for the preference. An upcoming 2019 JLARC review of MFTE may identify factors that help multifamily housing preferences achieve their goals. That review may also be informative for the Mason County preference.

Recommendations

Legislative Auditor's Recommendation: Allow to expire and consider other strategies

The Legislature stated it intended to extend the preference if at least 20 percent of new housing units were occupied by low or moderate income households. However, there has been no new multifamily housing developed in Mason County since the preference was enacted.

The Legislature should allow the preference to expire and consider whether different strategies would be more successful for attracting new development.

While it has not achieved its objective to stimulate housing development, an upcoming 2019 JLARC review of a related preference may provide information to improve the incentive.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2018

REVIEW DETAILS

1. What is the preference?

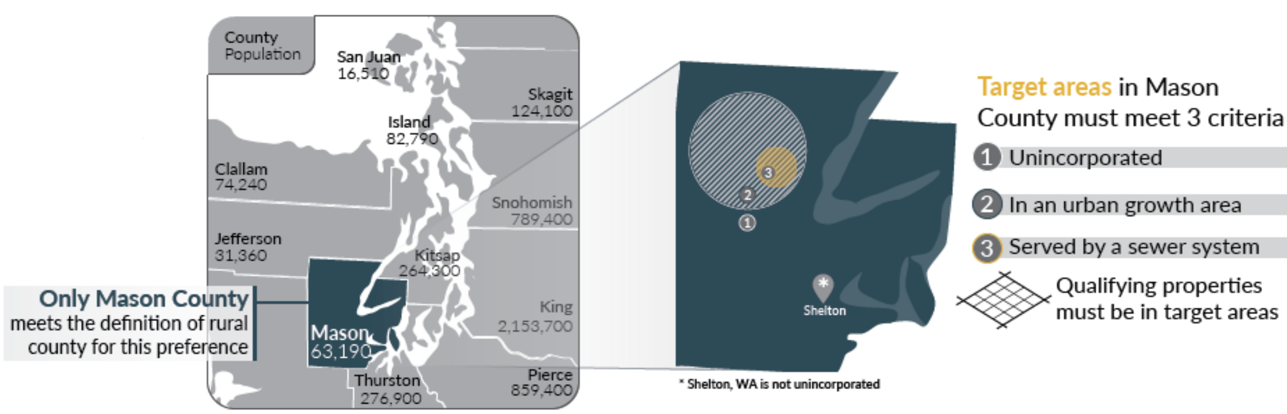
Property tax exemption available in Mason County to stimulate construction of multifamily housing

Stated objective: Stimulate construction of new multifamily housing in rural counties

The Legislature passed this preference in 2014 to "stimulate construction of new multifamily housing in urban growth areas located in unincorporated areas of rural counties where housing options, including affordable housing options, are severely limited."

The tax preference performance statement further indicated that the Legislature wanted to increase the number of affordable housing units for low to moderate income residents in certain counties.

Exhibit 1.1: Preference is limited to target areas within Mason County



Source: JLARC staff analysis of RCW 84.14.010 and 84.14.040.

The preference is available only in a designated rural county, which statute defines as one that borders Puget Sound and has a population between 50,000 and 71,000. This effectively limits the preference to Mason County.

As allowed by statute, Mason County designated three target areas: Allyn, Belfair, and an unincorporated area near Shelton. A target area must be in an unincorporated area (i.e., not in a city or town), within an urban growth area, and served by a sewer system. A property must lie within a target area to qualify for the preference. See appendix for maps showing the designated areas.

Property tax exemption available for multifamily housing with affordable units

The preference provides a property tax exemption on new, expanded, or updated multifamily housing. The exemption applies only to the newly constructed improvements, not the value of the land or existing improvements. The housing must have at least four units and include affordable housing. The properties may be rented or sold.

Mason County adopted the following rules regarding affordability:

- If at least 20 percent of the units are affordable for low or moderate income households, the owner is eligible for an 8-year exemption.
- If at least 50 percent of the units are affordable for low or moderate income households, the owner is eligible for a 12-year exemption.

What does affordable housing mean?

In general, housing is affordable if housing costs (including utilities) are less than 30 percent of the household income for a low or moderate income family.

Mason County defines "low income" and "moderate income" based on the median income in the county, adjusted for family size. Low income means that a household's income is less than 50 percent of the county's median income. Moderate income is less than 80 percent for the 8 year exemption, or between 80 and 115 percent for the 12 year exemption.

Exhibit 1.2: How income limits and affordable rent are calculated

2018 Mason County Area Median Income (AMI): $63,100		
	Family of Four	**Individual**
Low Income	$32,500 ($2,708 per month)	$22,750 ($1,896 per month)
Affordable rent (30% of monthly income including utilities)	$812 per month	$569 per month

Source: JLARC staff analysis of RCW 84.14.010(1), 84.14.010(9); JLARC staff analysis of HUD 2018 income limits. HUD adjusts income limits based on family size and other factors.

Statute and local ordinance include reporting requirements

When a property is granted an exemption, the county must report information to the Department of Commerce in the year the exemption is granted. Additionally, the owner must report annually to the county with information on occupancy, compliance, and changes to the property.

Preference scheduled to expire in 2020

The preference took effect June 12, 2014. New applications may not be approved after January 1, 2020.

The Legislature stated that if at least 20 percent of the new housing was occupied by households below 80 percent of the area median income for the county, it intended to extend the expiration date.

REVIEW DETAILS

2. Objective not met

The preference has not led to additional multifamily housing. Future study of related preference may identify some possible reasons.

Preference has not led to multifamily housing development

Staff of Mason County and the city of Shelton stated there has been no multifamily residential construction since the preference was enacted in 2014. Information on the program was not readily available on websites for the county or the Department of Commerce. Mason County staff noted that costs for new sewer connections were prohibitive to many builders, and that the county passed an ordinance in June 2017 to lower the connection fees for new construction. Staff said that some developers have expressed interest in using the preference, but that none have applied for it to date.

No beneficiaries or economic impacts from the preference

The Mason County Assessor reported that no properties are using the preference. Because it has never been used, there are no beneficiaries or economic impacts to report.

Reviewing related exemption in 2019 could shed light on why preference did not achieve objective

The preference is related to the Multifamily Property Tax Exemption (MFTE). The Legislature passed the MFTE in 1995, and JLARC staff are scheduled to review it in 2019.

The MFTE allows certain sized cities and counties to provide a property tax exemption to stimulate the construction of new, rehabilitated, or converted multifamily housing within designated areas. Only the value of the eligible housing improvements are exempt (i.e., the land and existing improvements remain taxable).

- If the property has four or more units, it may be eligible for an eight-year exemption.
- If the property also includes at least 20 percent affordable housing, it may be eligible for the twelve-year exemption.

The preference for Mason County has more income and project eligibility requirements than MFTE. These differences are described in the next section of the report.

The upcoming 2019 JLARC review of MFTE may inform discussions about the factors that help multifamily housing preferences achieve their goals.

REVIEW DETAILS

3. Other counties and states

More stringent affordability requirements in Mason County

JLARC staff compared Mason County's exemption to the experience of other counties and states to help identify some potential reasons why this preference did not result in new multifamily housing.

There are more stringent affordability requirements for the Mason County exemption than for the MFTE

This exemption is related to the broader Multifamily Tax Exemption (MFTE) program for urban areas. However, the Legislature imposed more stringent requirements for this preference in Mason County, and Mason County imposed additional requirements. These requirements affect the percent of housing that must be affordable and the income thresholds. Compared to areas that qualify for the broader MFTE, Mason County developers must include more affordable housing and charge lower rent to qualify.

Exhibit 3.1: Affordable housing requirements and low-income thresholds exemplify the more stringent requirements for this preference.

Example: Affordable housing requirements

Preference	MFTE	This preference (as set by Legislature)	This preference (as set by Mason County)
8 year exemption	0%	20% of units	20% of units
12 year exemption	20% of units	20% of units	50% of units

Example: Low-income thresholds

Preference	MFTE	This preference (as set by Legislature)	This preference (as set by Mason County)
8 year exemption	No requirement	80% of AMI or lower	50% of AMI or lower
12 year exemption	80% of AMI or lower	80% of AMI or lower	50% of AMI or lower

Source: JLARC staff analysis of RCW 84.14.020 and 84.14.040, Mason County Code 17.90.030 and 17.90.070.

Other rural counties report multifamily housing development challenges

JLARC staff contacted staff in 17 counties considered rural by the Office of Financial Management to determine whether the lack of new multifamily residential construction is unique to Mason County.

- Five of the 17 counties reported no multifamily development in their unincorporated areas since 2014.
- Four of the counties did not provide information.
- Only three counties had developments with at least four units as required for this preference. One was farmworker housing built by a local housing authority, one was vacation homes near a ski resort, and one was built by a religious community.

Similar program in Oregon was not used in unincorporated areas

JLARC staff searched for similar programs in Oregon and California, two other west coast states with a similar urban/rural divide. California does not have a comparable property tax preference.

Oregon has a program that is similar to Washington in that it allows local jurisdictions to create zones to incentivize multifamily housing. Zones may be created by either cities or counties, but no counties have opted to create zones.

REVIEW DETAILS

4. Applicable statutes

Chapter 84.14 RCW

Tax preference performance statement—2014 c 96:

This section is the tax preference performance statement for the tax preference contained in RCW 84.14.040 and 84.14.060. This performance statement is only intended to be used for subsequent evaluation of the tax preference. It is not intended to create a private right of action by any party or be used to determine eligibility for preferential tax treatment.

(1) The legislature categorizes this tax preference as one intended to induce certain designated behavior by taxpayers, as indicated in RCW 82.32.808(2)(a).

(2) It is the legislature's specific public policy objective to stimulate the construction of new multifamily housing in urban growth areas located in unincorporated areas of rural counties where housing options, including affordable housing options, are severely limited. It is the legislature's intent to provide the value of new housing construction, conversion, and rehabilitation improvements qualifying under chapter 84.14 RCW an exemption from ad valorem property taxation for eight to twelve years, as provided for in RCW 84.14.020, in order to provide incentives to developers to construct new multifamily housing thereby increasing the number of affordable housing units for low to moderate-income residents in certain rural counties.

(3) If a review finds that at least twenty percent of the new housing is developed and occupied by households making at or below eighty percent of the area median income, at the time of occupancy, adjusted for family size for the county where the project is located or where the housing is intended exclusively for owner occupancy, the household may earn up to one hundred fifteen percent of the area median income, at the time of sale, adjusted for family size for the county where the project is located, then the legislature intends to extend the expiration date of the tax preference.

(4) In order to obtain the data necessary to perform the review in subsection (3) of this section, the joint legislative audit and review committee may refer to data provided by counties in which beneficiaries are utilizing the preference, the office of financial management, the department of commerce, the United States department of housing and urban development, and other data sources as needed by the joint legislative audit and review committee." [2014 c 96 § 1.]

RCW 84.14.005: Findings.

The legislature finds:

(1) That in many of Washington's urban centers there is insufficient availability of desirable and convenient residential units, including affordable housing units, to meet the needs of a growing number of the public who would live in these urban centers if these desirable, convenient, attractive, affordable, and livable places to live were available;

(2) That the development of additional and desirable residential units, including affordable housing units, in these urban centers that will attract and maintain a significant increase in the number of permanent residents in these areas will help to alleviate the detrimental conditions and social liability that tend to exist in the absence of a viable mixed income residential population and will help to achieve the planning goals mandated by the growth management act under RCW 36.70A.020; and

(3) That planning solutions to solve the problems of urban sprawl often lack incentive and implementation techniques needed to encourage residential redevelopment in those urban centers lacking a sufficient variety of residential opportunities, and it is in the public interest and will benefit, provide, and promote the public health, safety, and welfare to stimulate new or enhanced

residential opportunities, including affordable housing opportunities, within urban centers through a tax incentive as provided by this chapter.

[2007 c 430 § 1; 1995 c 375 § 1.]

RCW 84.14.007: Purpose.

It is the purpose of this chapter to encourage increased residential opportunities, including affordable housing opportunities, in cities that are required to plan or choose to plan under the growth management act within urban centers where the governing authority of the affected city has found there is insufficient housing opportunities, including affordable housing opportunities. It is further the purpose of this chapter to stimulate the construction of new multifamily housing and the rehabilitation of existing vacant and underutilized buildings for multifamily housing in urban centers having insufficient housing opportunities that will increase and improve residential opportunities, including affordable housing opportunities, within these urban centers. To achieve these purposes, this chapter provides for special valuations in residentially deficient urban centers for eligible improvements associated with multiunit housing, which includes affordable housing. It is an additional purpose of this chapter to allow unincorporated areas of rural counties that are within urban growth areas to stimulate housing opportunities and for certain counties to stimulate housing opportunities near college campuses to promote dense, transit-oriented, walkable college communities.

[2014 c 96 § 2; 2012 c 194 § 1; 2007 c 430 § 2; 1995 c 375 § 2.]

RCW 84.14.010: Definitions.

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

(1) "Affordable housing" means residential housing that is rented by a person or household whose monthly housing costs, including utilities other than telephone, do not exceed thirty percent of the household's monthly income. For the purposes of housing intended for owner occupancy, "affordable housing" means residential housing that is within the means of low or moderate-income households.

(2) "Campus facilities master plan" means the area that is defined by the University of Washington as necessary for the future growth and development of its campus facilities for campuses authorized under RCW 28B.45.020.

(3) "City" means either (a) a city or town with a population of at least fifteen thousand, (b) the largest city or town, if there is no city or town with a population of at least fifteen thousand, located

in a county planning under the growth management act, or (c) a city or town with a population of at least five thousand located in a county subject to the provisions of RCW 36.70A.215.

(4) "County" means a county with an unincorporated population of at least three hundred fifty thousand.

(5) "Governing authority" means the local legislative authority of a city or a county having jurisdiction over the property for which an exemption may be applied for under this chapter.

(6) "Growth management act" means chapter 36.70A RCW.

(7) "High cost area" means a county where the third quarter median house price for the previous year as reported by the Washington center for real estate research at Washington State University is equal to or greater than one hundred thirty percent of the statewide median house price published during the same time period.

(8) "Household" means a single person, family, or unrelated persons living together.

(9) "Low-income household" means a single person, family, or unrelated persons living together whose adjusted income is at or below eighty percent of the median family income adjusted for family size, for the county where the project is located, as reported by the United States department of housing and urban development. For cities located in high-cost areas, "low-income household" means a household that has an income at or below one hundred percent of the median family income adjusted for family size, for the county where the project is located.

(10) "Moderate-income household" means a single person, family, or unrelated persons living together whose adjusted income is more than eighty percent but is at or below one hundred fifteen percent of the median family income adjusted for family size, for the county where the project is located, as reported by the United States department of housing and urban development. For cities located in high-cost areas, "moderate-income household" means a household that has an income that is more than one hundred percent, but at or below one hundred fifty percent, of the median family income adjusted for family size, for the county where the project is located.

(11) "Multiple-unit housing" means a building having four or more dwelling units not designed or used as transient accommodations and not including hotels and motels. Multifamily units may result from new construction or rehabilitated or conversion of vacant, underutilized, or substandard buildings to multifamily housing.

(12) "Owner" means the property owner of record.

(13) "Permanent residential occupancy" means multiunit housing that provides either rental or owner occupancy on a nontransient basis. This includes owner-occupied or rental accommodation that is leased for a period of at least one month. This excludes hotels and motels that predominately offer rental accommodation on a daily or weekly basis.

(14) "Rehabilitation improvements" means modifications to existing structures, that are vacant for twelve months or longer, that are made to achieve a condition of substantial compliance with existing building codes or modification to existing occupied structures which increase the number of multifamily housing units.

(15) "Residential targeted area" means an area within an urban center or urban growth area that has been designated by the governing authority as a residential targeted area in accordance with this chapter. With respect to designations after July 1, 2007, "residential targeted area" may not include a campus facilities master plan.

(16) "Rural county" means a county with a population between fifty thousand and seventy-one thousand and bordering Puget Sound.

(17) "Substantial compliance" means compliance with local building or housing code requirements that are typically required for rehabilitation as opposed to new construction.

(18) "Urban center" means a compact identifiable district where urban residents may obtain a variety of products and services. An urban center must contain:

(a) Several existing or previous, or both, business establishments that may include but are not limited to shops, offices, banks, restaurants, governmental agencies;

(b) Adequate public facilities including streets, sidewalks, lighting, transit, domestic water, and sanitary sewer systems; and

(c) A mixture of uses and activities that may include housing, recreation, and cultural activities in association with either commercial or office, or both, use.

[2017 c 52 § 16; 2014 c 96 § 3. Prior: 2012 c 194 § 2; prior: 2007 c 430 § 3; 2007 c 185 § 1; 2002 c 146 § 1; 2000 c 242 § 1; 1997 c 429 § 40; 1995 c 375 § 3.]

NOTES:

Effective date—2007 c 185: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and takes effect July 1, 2007." [2007 c 185 § 3.]

Severability—1997 c 429: See note following RCW 36.70A.3201.

RCW 84.14.020: Exemption—Duration—Valuation.

(1)(a) The value of new housing construction, conversion, and rehabilitation improvements qualifying under this chapter is exempt from ad valorem property taxation, as follows:

(i) For properties for which applications for certificates of tax exemption eligibility are submitted under chapter 84.14 RCW before July 22, 2007, the value is exempt for ten successive years beginning January 1 of the year immediately following the calendar year of issuance of the certificate; and

(ii) For properties for which applications for certificates of tax exemption eligibility are submitted under chapter 84.14 RCW on or after July 22, 2007, the value is exempt:

(A) For eight successive years beginning January 1st of the year immediately following the calendar year of issuance of the certificate; or

(B) For twelve successive years beginning January 1st of the year immediately following the calendar year of issuance of the certificate, if the property otherwise qualifies for the exemption under chapter 84.14 RCW and meets the conditions in this subsection (1)(a)(ii)(B). For the property to qualify for the twelve-year exemption under this subsection, the applicant must commit to renting or selling at least twenty percent of the multifamily housing units as affordable housing units to low and moderate-income households, and the property must satisfy that commitment and any additional affordability and income eligibility conditions adopted by the local government under this chapter. In the case of projects intended exclusively for owner occupancy, the minimum requirement of this subsection (1)(a)(ii)(B) may be satisfied solely through housing affordable to moderate-income households.

(b) The exemptions provided in (a)(i) and (ii) of this subsection do not include the value of land or nonhousing-related improvements not qualifying under this chapter.

(2) When a local government adopts guidelines pursuant to RCW 84.14.030(2) and includes conditions that must be satisfied with respect to individual dwelling units, rather than with respect to the multiple-unit housing as a whole or some minimum portion thereof, the exemption may, at the local government's discretion, be limited to the value of the qualifying improvements allocable to those dwelling units that meet the local guidelines.

(3) In the case of rehabilitation of existing buildings, the exemption does not include the value of improvements constructed prior to the submission of the application required under this chapter. The incentive provided by this chapter is in addition to any other incentives, tax credits, grants, or other incentives provided by law.

(4) This chapter does not apply to increases in assessed valuation made by the assessor on nonqualifying portions of building and value of land nor to increases made by lawful order of a county board of equalization, the department of revenue, or a county, to a class of property throughout the county or specific area of the county to achieve the uniformity of assessment or appraisal required by law.

(5) At the conclusion of the exemption period, the new or rehabilitated housing cost shall be considered as new construction for the purposes of chapter 84.55 RCW.

[2007 c 430 § 4; 2002 c 146 § 2; 1999 c 132 § 1; 1995 c 375 § 5.]

RCW 84.14.030: Application—Requirements.

An owner of property making application under this chapter must meet the following requirements:

(1) The new or rehabilitated multiple-unit housing must be located in a residential targeted area as designated by the city or county;

(2) The multiple-unit housing must meet guidelines as adopted by the governing authority that may include height, density, public benefit features, number and size of proposed development, parking, income limits for occupancy, limits on rents or sale prices, and other adopted requirements indicated necessary by the city or county. The required amenities should be relative to the size of the project and tax benefit to be obtained;

(3) The new, converted, or rehabilitated multiple-unit housing must provide for a minimum of fifty percent of the space for permanent residential occupancy. In the case of existing occupied multifamily development, the multifamily housing must also provide for a minimum of four additional multifamily units. Existing multifamily vacant housing that has been vacant for twelve months or more does not have to provide additional multifamily units;

(4) New construction multifamily housing and rehabilitation improvements must be completed within three years from the date of approval of the application;

(5) Property proposed to be rehabilitated must fail to comply with one or more standards of the applicable state or local building or housing codes on or after July 23, 1995. If the property proposed to be rehabilitated is not vacant, an applicant must provide each existing tenant housing of comparable size, quality, and price and a reasonable opportunity to relocate; and

(6) The applicant must enter into a contract with the city or county approved by the governing authority, or an administrative official or commission authorized by the governing authority, under which the applicant has agreed to the implementation of the development on terms and conditions satisfactory to the governing authority.

[2012 c 194 § 3; 2007 c 430 § 5; 2005 c 80 § 1; 1997 c 429 § 42; 1995 c 375 § 6.]

NOTES:

Severability—1997 c 429: See note following RCW 36.70A.3201.

84.14.040: Designation of residential targeted area—Criteria—Local designation—Hearing—Standards, guidelines.

(1) The following criteria must be met before an area may be designated as a residential targeted area:

(a) The area must be within an urban center, as determined by the governing authority;

(b) The area must lack, as determined by the governing authority, sufficient available, desirable, and convenient residential housing, including affordable housing, to meet the needs of the public who would be likely to live in the urban center, if the affordable, desirable, attractive, and livable places to live were available;

(c) The providing of additional housing opportunity, including affordable housing, in the area, as determined by the governing authority, will assist in achieving one or more of the stated purposes of this chapter; and

(d) If the residential targeted area is designated by a county, the area must be located in an unincorporated area of the county that is within an urban growth area under RCW 36.70A.110 and the area must be: (i) In a rural county, served by a sewer system and designated by a county prior to January 1, 2013; or (ii) in a county that includes a campus of an institution of higher education, as defined in RCW 28B.92.030, where at least one thousand two hundred students live on campus during the academic year.

(2) For the purpose of designating a residential targeted area or areas, the governing authority may adopt a resolution of intention to so designate an area as generally described in the resolution. The resolution must state the time and place of a hearing to be held by the governing authority to consider the designation of the area and may include such other information pertaining to the designation of the area as the governing authority determines to be appropriate to apprise the public of the action intended.

(3) The governing authority must give notice of a hearing held under this chapter by publication of the notice once each week for two consecutive weeks, not less than seven days, nor more than thirty days before the date of the hearing in a paper having a general circulation in the city or county where the proposed residential targeted area is located. The notice must state the time, date, place, and purpose of the hearing and generally identify the area proposed to be designated as a residential targeted area.

(4) Following the hearing, or a continuance of the hearing, the governing authority may designate all or a portion of the area described in the resolution of intent as a residential targeted area if it finds, in its sole discretion, that the criteria in subsections (1) through (3) of this section have been met.

(5) After designation of a residential targeted area, the governing authority must adopt and implement standards and guidelines to be utilized in considering applications and making the determinations required under RCW 84.14.060. The standards and guidelines must establish basic requirements for both new construction and rehabilitation, which must include:

(a) Application process and procedures;

(b) Requirements that address demolition of existing structures and site utilization; and

(c) Building requirements that may include elements addressing parking, height, density, environmental impact, and compatibility with the existing surrounding property and such other amenities as will attract and keep permanent residents and that will properly enhance the livability of the residential targeted area in which they are to be located.

(6) The governing authority may adopt and implement, either as conditions to eight-year exemptions or as conditions to an extended exemption period under RCW 84.14.020(1)(a)(ii)(B), or both, more stringent income eligibility, rent, or sale price limits, including limits that apply to a higher percentage of units, than the minimum conditions for an extended exemption period under RCW 84.14.020(1)(a)(ii)(B). For any multiunit housing located in an unincorporated area of a county, a property owner seeking tax incentives under this chapter must commit to renting or selling at least twenty percent of the multifamily housing units as affordable housing units to low and moderate-income households. In the case of multiunit housing intended exclusively for owner occupancy, the minimum requirement of this subsection (6) may be satisfied solely through housing affordable to moderate-income households.

[2014 c 96 § 4; 2012 c 194 § 4; 2007 c 430 § 6; 1995 c 375 § 7.]

NOTES: Tax preference performance statement -- 2014 c 96

RCW 84.14.050: Application—Procedures.

An owner of property seeking tax incentives under this chapter must complete the following procedures:

(1) In the case of rehabilitation or where demolition or new construction is required, the owner must secure from the governing authority or duly authorized representative, before commencement of rehabilitation improvements or new construction, verification of property noncompliance with applicable building and housing codes;

(2) In the case of new and rehabilitated multifamily housing, the owner must apply to the city or county on forms adopted by the governing authority. The application must contain the following:

(a) Information setting forth the grounds supporting the requested exemption including information indicated on the application form or in the guidelines;

(b) A description of the project and site plan, including the floor plan of units and other information requested;

(c) A statement that the applicant is aware of the potential tax liability involved when the property ceases to be eligible for the incentive provided under this chapter;

(3) The applicant must verify the application by oath or affirmation; and

(4) The application must be accompanied by the application fee, if any, required under RCW 84.14.080. The governing authority may permit the applicant to revise an application before final action by the governing authority.

[2012 c 194 § 5; 2007 c 430 § 7; 1999 c 132 § 2; 1997 c 429 § 43; 1995 c 375 § 8.]

NOTES:

Severability—1997 c 429: See note following RCW 36.70A.3201.

RCW 84.14.060: Approval—Required findings.

(1) The duly authorized administrative official or committee of the city or county may approve the application if it finds that:

(a) A minimum of four new units are being constructed or in the case of occupied rehabilitation or conversion a minimum of four additional multifamily units are being developed;

(b) If applicable, the proposed multiunit housing project meets the affordable housing requirements as described in RCW 84.14.020;

(c) The proposed project is or will be, at the time of completion, in conformance with all local plans and regulations that apply at the time the application is approved;

(d) The owner has complied with all standards and guidelines adopted by the city or county under this chapter; and

(e) The site is located in a residential targeted area of an urban center or urban growth area that has been designated by the governing authority in accordance with procedures and guidelines indicated in RCW 84.14.040.

(2) An application may not be approved after July 1, 2007, if any part of the proposed project site is within a campus facilities master plan, except as provided in RCW 84.14.040(1)(d).

(3) An application may not be approved for a residential targeted area in a rural county on or after January 1, 2020.

[2014 c 96 § 5; 2012 c 194 § 6. Prior: 2007 c 430 § 8; 2007 c 185 § 2; 1995 c 375 § 9.]

NOTES:

Tax preference performance statement—2014 c 96: See note following RCW 84.14.040.

Effective date—2007 c 185: See note following RCW 84.14.010.

RCW 84.14.070: Processing—Approval—Denial—Appeal.

(1) The governing authority or an administrative official or commission authorized by the governing authority must approve or deny an application filed under this chapter within ninety days after receipt of the application.

(2) If the application is approved, the city or county must issue the owner of the property a conditional certificate of acceptance of tax exemption. The certificate must contain a statement by a duly authorized administrative official of the governing authority that the property has complied with the required findings indicated in RCW 84.14.060.

(3) If the application is denied by the authorized administrative official or commission authorized by the governing authority, the deciding administrative official or commission must state in writing the reasons for denial and send the notice to the applicant at the applicant's last known address within ten days of the denial.

(4) Upon denial by a duly authorized administrative official or commission, an applicant may appeal the denial to the governing authority within thirty days after receipt of the denial. The appeal before the governing authority must be based upon the record made before the administrative official with the burden of proof on the applicant to show that there was no substantial evidence to support the administrative official's decision. The decision of the governing body in denying or approving the application is final.

[2012 c 194 § 7; 1995 c 375 § 10.]

RCW 84.14.080: Fees.

The governing authority may establish an application fee. This fee may not exceed an amount determined to be required to cover the cost to be incurred by the governing authority and the assessor in administering this chapter. The application fee must be paid at the time the application for limited exemption is filed. If the application is approved, the governing authority shall pay the application fee to the county assessor for deposit in the county current expense fund, after first deducting that portion of the fee attributable to its own administrative costs in processing the application. If the application is denied, the governing authority may retain that portion of the application fee attributable to its own administrative costs and refund the balance to the applicant.

[1995 c 375 § 11.]

RCW 84.14.090: Filing requirements for owner upon completion—Determination by city or county—Notice of intention by city or county not to file—Extension of deadline—Appeal.

(1) Upon completion of rehabilitation or new construction for which an application for a limited tax exemption under this chapter has been approved and after issuance of the certificate of occupancy, the owner must file with the city or county the following:

(a) A statement of the amount of rehabilitation or construction expenditures made with respect to each housing unit and the composite expenditures made in the rehabilitation or construction of the entire property;

(b) A description of the work that has been completed and a statement that the rehabilitation improvements or new construction on the owner's property qualify the property for limited exemption under this chapter;

(c) If applicable, a statement that the project meets the affordable housing requirements as described in RCW 84.14.020; and

(d) A statement that the work has been completed within three years of the issuance of the conditional certificate of tax exemption.

(2) Within thirty days after receipt of the statements required under subsection (1) of this section, the authorized representative of the city or county must determine whether the work completed, and the affordability of the units, is consistent with the application and the contract approved by the city or county and is qualified for a limited tax exemption under this chapter. The city or county must also determine which specific improvements completed meet the requirements and required findings.

(3) If the rehabilitation, conversion, or construction is completed within three years of the date the application for a limited tax exemption is filed under this chapter, or within an authorized extension of this time limit, and the authorized representative of the city or county determines that improvements were constructed consistent with the application and other applicable requirements, including if applicable, affordable housing requirements, and the owner's property is qualified for a limited tax exemption under this chapter, the city or county must file the certificate of tax exemption with the county assessor within ten days of the expiration of the thirty-day period provided under subsection (2) of this section.

(4) The authorized representative of the city or county must notify the applicant that a certificate of tax exemption is not going to be filed if the authorized representative determines that:

(a) The rehabilitation or new construction was not completed within three years of the application date, or within any authorized extension of the time limit;

(b) The improvements were not constructed consistent with the application or other applicable requirements;

(c) If applicable, the affordable housing requirements as described in RCW 84.14.020 were not met; or

(d) The owner's property is otherwise not qualified for limited exemption under this chapter.

(5) If the authorized representative of the city or county finds that construction or rehabilitation of multiple-unit housing was not completed within the required time period due to circumstances beyond the control of the owner and that the owner has been acting and could reasonably be expected to act in good faith and with due diligence, the governing authority or the city or county official authorized by the governing authority may extend the deadline for completion of construction or rehabilitation for a period not to exceed twenty-four consecutive months.

(6) The governing authority may provide by ordinance for an appeal of a decision by the deciding officer or authority that an owner is not entitled to a certificate of tax exemption to the governing authority, a hearing examiner, or other city or county officer authorized by the governing authority to hear the appeal in accordance with such reasonable procedures and time periods as provided by ordinance of the governing authority. The owner may appeal a decision by the deciding officer or authority that is not subject to local appeal or a decision by the local appeal authority that the owner is not entitled to a certificate of tax exemption in superior court under RCW 34.05.510 through 34.05.598, if the appeal is filed within thirty days of notification by the city or county to the owner of the decision being challenged.

[2012 c 194 § 8; 2007 c 430 § 9; 1995 c 375 § 12.]

RCW 84.14.100: Report—Filing.

(1) Thirty days after the anniversary of the date of the certificate of tax exemption and each year for the tax exemption period, the owner of the rehabilitated or newly constructed property must file with a designated authorized representative of the city or county an annual report indicating the following:

(a) A statement of occupancy and vacancy of the rehabilitated or newly constructed property during the twelve months ending with the anniversary date;

(b) A certification by the owner that the property has not changed use and, if applicable, that the property has been in compliance with the affordable housing requirements as described in RCW 84.14.020 since the date of the certificate approved by the city or county;

(c) A description of changes or improvements constructed after issuance of the certificate of tax exemption; and

(d) Any additional information requested by the city or county in regards to the units receiving a tax exemption.

(2) All cities or counties, which issue certificates of tax exemption for multiunit housing that conform to the requirements of this chapter, must report annually by December 31st of each year, beginning in 2007, to the department of commerce. The report must include the following information:

(a) The number of tax exemption certificates granted;

(b) The total number and type of units produced or to be produced;

(c) The number and type of units produced or to be produced meeting affordable housing requirements;

(d) The actual development cost of each unit produced;

(e) The total monthly rent or total sale amount of each unit produced;

(f) The income of each renter household at the time of initial occupancy and the income of each initial purchaser of owner-occupied units at the time of purchase for each of the units receiving a tax exemption and a summary of these figures for the city or county; and

(g) The value of the tax exemption for each project receiving a tax exemption and the total value of tax exemptions granted.

[2012 c 194 § 9; 2007 c 430 § 10; 1995 c 375 § 13.]

RCW 84.14.110: Cancellation of exemption—Notice by owner of change in use—Additional tax—Penalty—Interest—Lien—Notice of cancellation—Appeal—Correction of tax rolls.

(1) If improvements have been exempted under this chapter, the improvements continue to be exempted for the applicable period under RCW 84.14.020, so long as they are not converted to another use and continue to satisfy all applicable conditions. If the owner intends to convert the multifamily development to another use, or if applicable, if the owner intends to discontinue compliance with the affordable housing requirements as described in RCW 84.14.020 or any other condition to exemption, the owner must notify the assessor within sixty days of the change in use or intended discontinuance. If, after a certificate of tax exemption has been filed with the county assessor, the authorized representative of the governing authority discovers that a portion of the property is changed or will be changed to a use that is other than residential or that housing or amenities no longer meet the requirements, including, if applicable, affordable housing requirements, as previously approved or agreed upon by contract between the city or county and

the owner and that the multifamily housing, or a portion of the housing, no longer qualifies for the exemption, the tax exemption must be canceled and the following must occur:

(a) Additional real property tax must be imposed upon the value of the nonqualifying improvements in the amount that would normally be imposed, plus a penalty must be imposed amounting to twenty percent. This additional tax is calculated based upon the difference between the property tax paid and the property tax that would have been paid if it had included the value of the nonqualifying improvements dated back to the date that the improvements were converted to a nonmultifamily use;

(b) The tax must include interest upon the amounts of the additional tax at the same statutory rate charged on delinquent property taxes from the dates on which the additional tax could have been paid without penalty if the improvements had been assessed at a value without regard to this chapter; and

(c) The additional tax owed together with interest and penalty must become a lien on the land and attach at the time the property or portion of the property is removed from multifamily use or the amenities no longer meet applicable requirements, and has priority to and must be fully paid and satisfied before a recognizance, mortgage, judgment, debt, obligation, or responsibility to or with which the land may become charged or liable. The lien may be foreclosed upon expiration of the same period after delinquency and in the same manner provided by law for foreclosure of liens for delinquent real property taxes. An additional tax unpaid on its due date is delinquent. From the date of delinquency until paid, interest must be charged at the same rate applied by law to delinquent ad valorem property taxes.

(2) Upon a determination that a tax exemption is to be canceled for a reason stated in this section, the governing authority or authorized representative must notify the record owner of the property as shown by the tax rolls by mail, return receipt requested, of the determination to cancel the exemption. The owner may appeal the determination to the governing authority or authorized representative, within thirty days by filing a notice of appeal with the clerk of the governing authority, which notice must specify the factual and legal basis on which the determination of cancellation is alleged to be erroneous. The governing authority or a hearing examiner or other official authorized by the governing authority may hear the appeal. At the hearing, all affected parties may be heard and all competent evidence received. After the hearing, the deciding body or officer must either affirm, modify, or repeal the decision of cancellation of exemption based on the evidence received. An aggrieved party may appeal the decision of the deciding body or officer to the superior court under RCW 34.05.510 through 34.05.598.

(3) Upon determination by the governing authority or authorized representative to terminate an exemption, the county officials having possession of the assessment and tax rolls must correct the rolls in the manner provided for omitted property under RCW 84.40.080. The county assessor must

make such a valuation of the property and improvements as is necessary to permit the correction of the rolls. The value of the new housing construction, conversion, and rehabilitation improvements added to the rolls is considered as new construction for the purposes of chapter 84.55 RCW. The owner may appeal the valuation to the county board of equalization under chapter 84.48 RCW and according to the provisions of RCW 84.40.038. If there has been a failure to comply with this chapter, the property must be listed as an omitted assessment for assessment years beginning January 1 of the calendar year in which the noncompliance first occurred, but the listing as an omitted assessment may not be for a period more than three calendar years preceding the year in which the failure to comply was discovered.

[2012 c 194 § 10; 2007 c 430 § 11; 2002 c 146 § 3; 2001 c 185 § 1; 1995 c 375 § 14.]

NOTES:

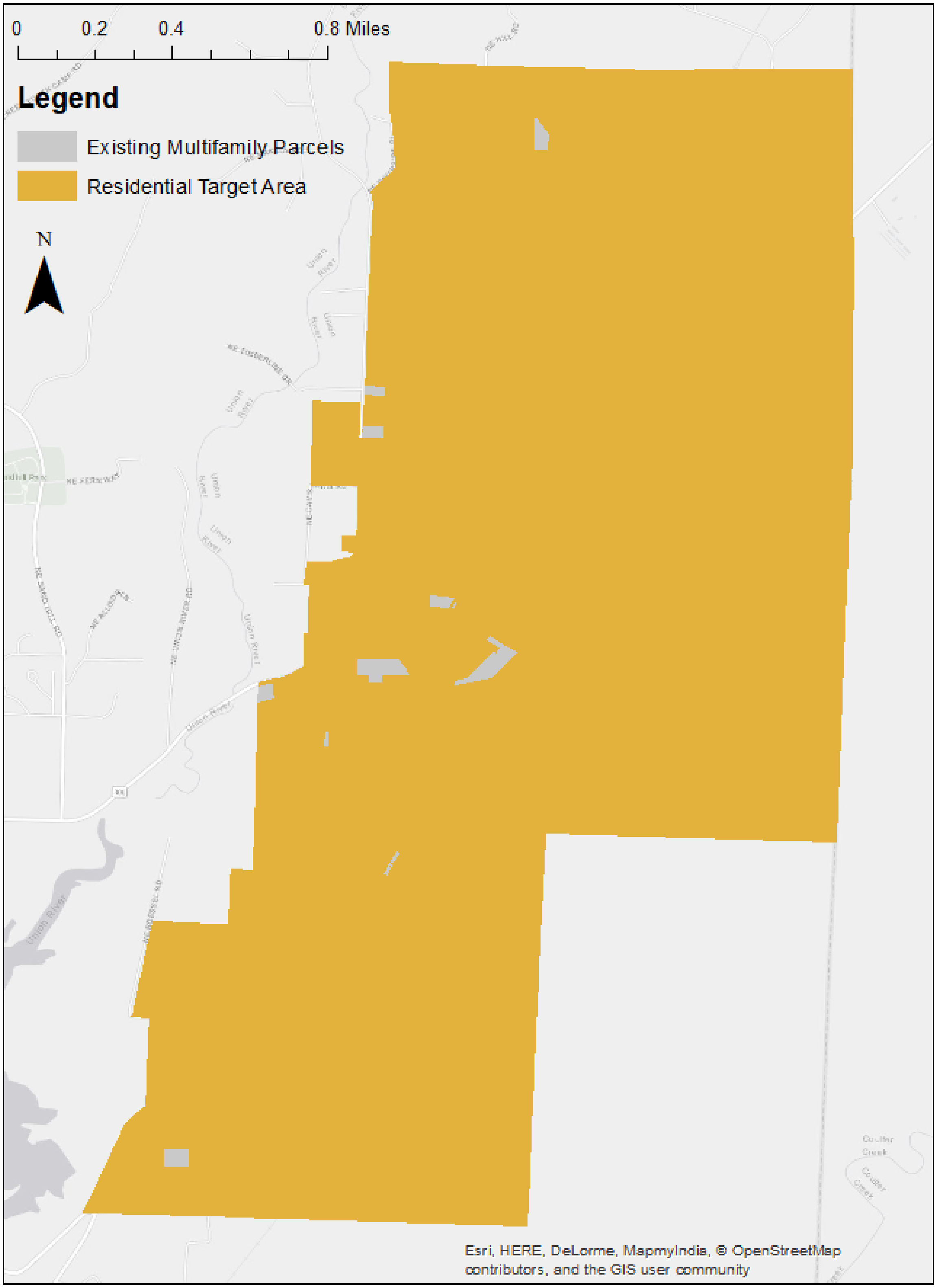
Application—2001 c 185 §§ 1-12: "Sections 1 through 12 of this act apply for [to] taxes levied in 2001 for collection in 2002 and thereafter." [2001 c 185 § 18.]

REVIEW DETAILS

Appendix: Mason County maps

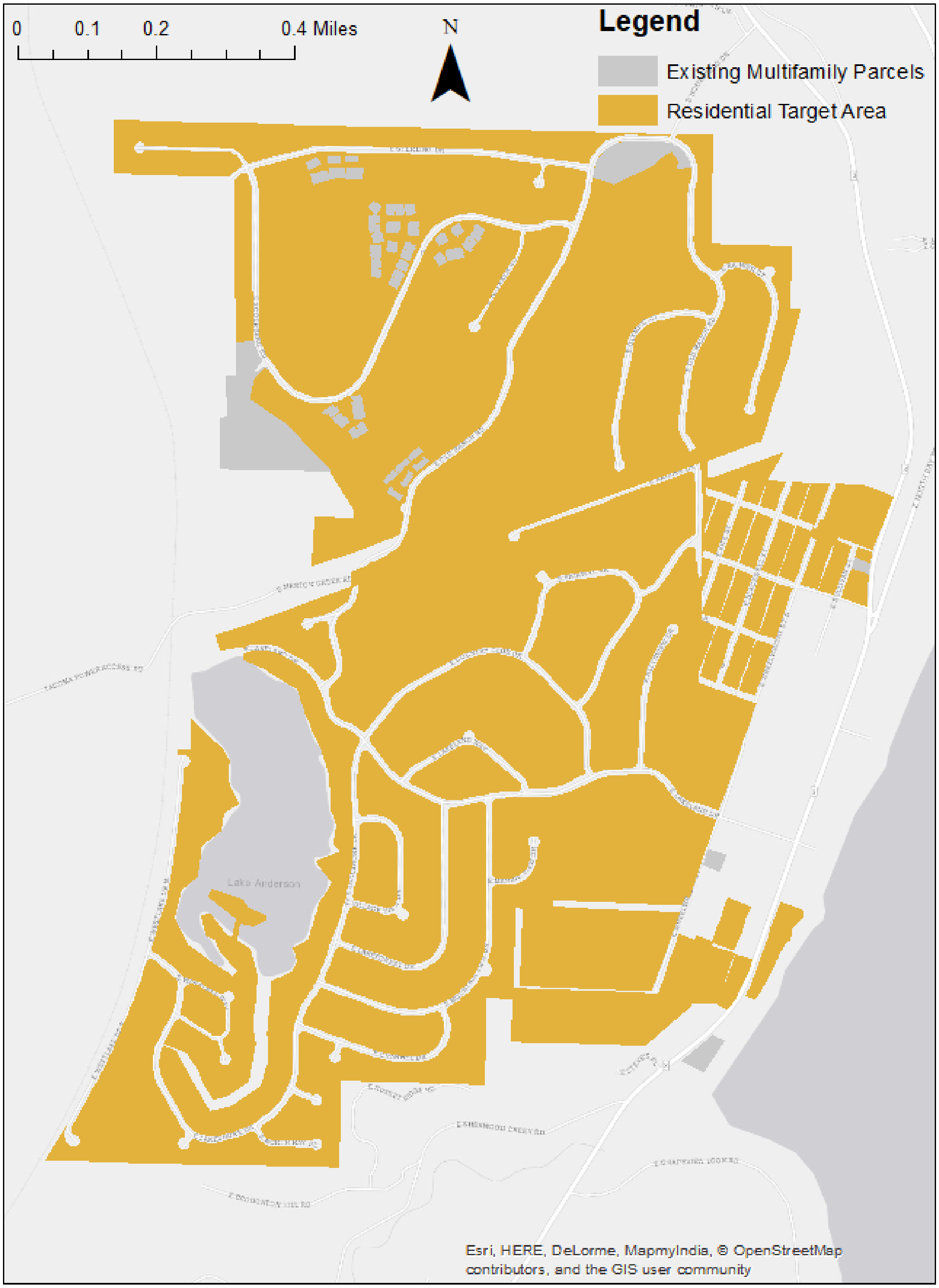
The following maps show the residential targeted areas designated by Mason County. The areas include parcels in specific zoning areas that are served by a sewer system. Because the sewer system in Shelton does not currently extend outside the city limits, there is no land in the targeted area.

Exhibit A.1: Residential target area in Belfair with existing multifamily parcels



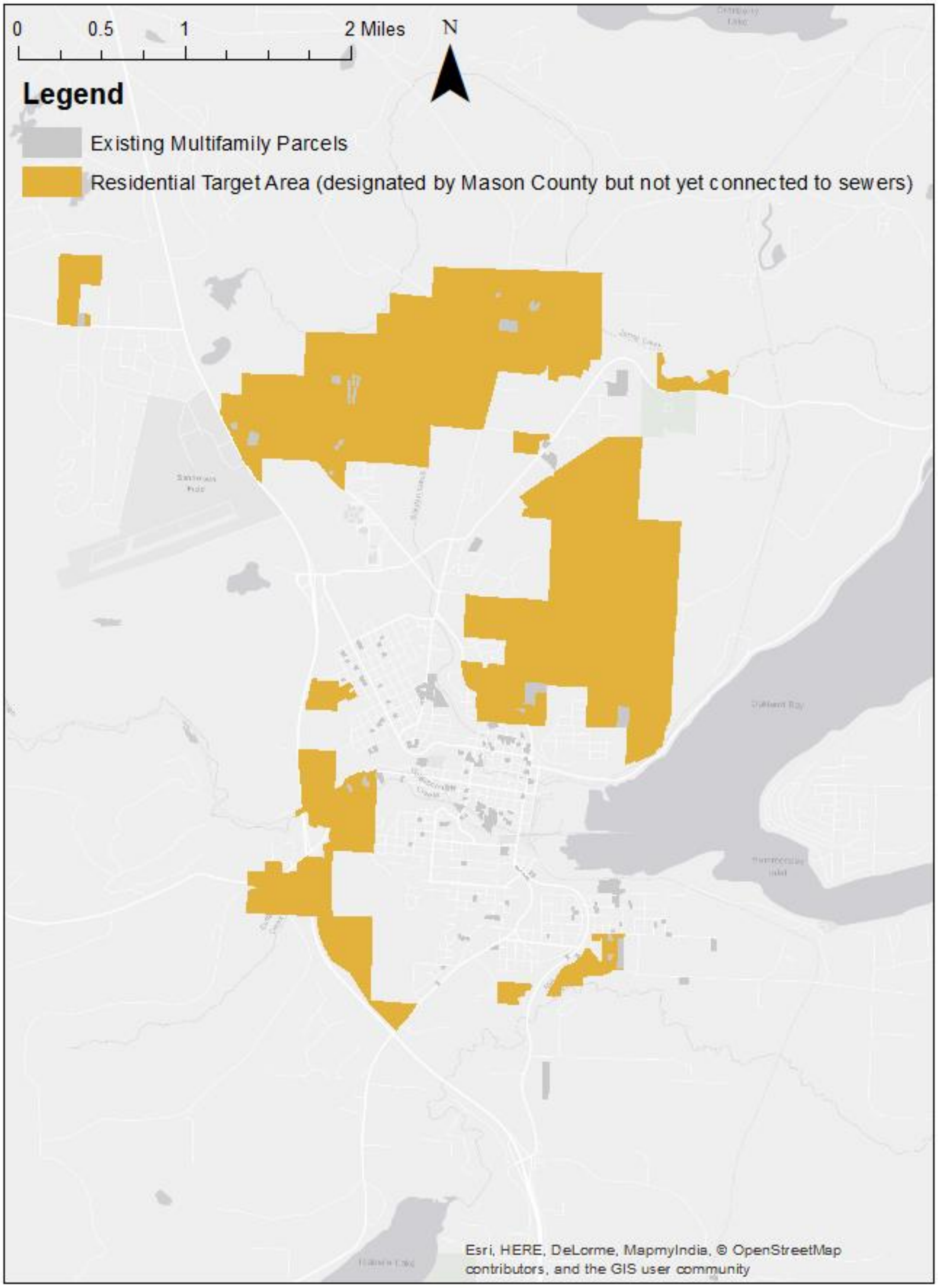
Source: Mason County GIS data on sewers, urban growth area and zoning, assessor's office parcel data.

Exhibit A.2: Residential target area in Allyn with existing multifamily parcels



Source: Mason County GIS data on sewers, urban growth area and zoning, assessor's office parcel data.

Exhibit A.3: Shelton's sewer system does not currently extend past the incorporated area



Source: Mason County GIS data on sewers, urban growth area and zoning, assessor's office parcel data.

RECOMMENDATIONS & AGENCY RESPONSE

Legislative Auditor's Recommendation

Legislative Auditor recommends allowing the preference to expire and considering other strategies

The Legislature should allow the preference to expire and consider whether different incentives would be more successful for attracting new development.

While the preference has no official expiration date, no new applications may be approved after January 1, 2020. The Legislature stated its intent to extend the deadline if at least 20 percent of new housing units were occupied by low or moderate income households. This has not occurred. The preference has not stimulated construction of any new housing in the residential targeted areas of Mason County.

An upcoming 2019 JLARC review of a related preference may provide information to improve the incentive.

Legislation Required: No.

Fiscal Impact: Depends on Legislative Action.

RECOMMENDATIONS & AGENCY RESPONSE

Letter from Commission Chair

Available October 2018

RECOMMENDATIONS & AGENCY RESPONSE

Commissioners' Recommendation

Available October 2018

RECOMMENDATIONS & AGENCY RESPONSE

Agency Response

If applicable, available October 2018

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Nonprofit or Library Fundraising

Preference provides tax relief by eliminating use tax on sales or prizes up to $12,000

Individual wins or purchases item at a fundraising event that is exempt from collecting sales tax

WITHOUT PREFERENCE → Individual owes **use tax** on items won or purchased

WITH PREFERENCE → **Individual does not owe use tax on certain items won or purchased**

Use tax is collected when sales tax is not collected at the time of sale.

RCW 82.12.225

Qualifying fundraising activities or events must be:

- Intended to raise money to further the goals of a nonprofit or library
- Time-limited
- Exempt from paying B&O tax on event income

Value of exempted items has increased over time

2013 — Preference enacted. Item value limit: $10,000

2015 — Expiration extended to 2020. Item value limit increased: $12,000

2020 — **Absent legislative action, the preference will expire on July 1, 2020.**

- No data available to estimate fiscal impact.
- Beneficiaries are not required to report use of the preference.

Legislative Auditor's recommendation

Continue and clarify (structural purpose)

The preference is achieving its objective to provide tax relief. The Legislature should consider:

- Making the preference permanent.
- Adding a mechanism to allow the exempt value to increase over time.
- Recategorizing the preference as one intended to provide tax relief to certain individuals.

Preliminary Report:

2018 Tax Preference Performance Reviews

Nonprofit or Library Fundraising

Legislative Auditor's Conclusion:

The preference is achieving its objective of providing tax relief to individuals who purchase or win items at nonprofit or library fundraising events.

July 2018

Use tax exemption for items acquired at nonprofit or library fundraising events

The preference provides a use tax exemption for individuals who purchase or win items at qualifying nonprofit or library fundraising events or activities.

Items are exempt from use tax if they are:

- Valued at less than $12,000.
- Obtained at an event that is exempt from collecting sales tax.

Qualifying fundraising events must be exempt from B&O tax, time-limited, and intended to raise money to further the goals of the nonprofit or library.

Estimated Biennial Beneficiary Savings Unknown - Beneficiaries not required to report savings.

Tax Type

Use Tax

RCW 82.12.225

Applicable Statutes

Stated public policy objective met

The Legislature stated a policy objective when it passed this preference in 2013.

Objective	Results
Provide use tax relief to individuals who purchase or win items at qualifying fundraising events.	**Met.**

Absent legislative action, the preference will expire on July 1, 2020.

Recommendation

Legislative Auditor's Recommendation: Continue and clarify (structural purpose)

The Legislature should continue and clarify the preference because it is achieving its objective of providing use tax relief to individuals who purchase or win items at qualifying nonprofit or library fundraising events.

If the Legislature does continue this preference, it should **consider making the preference permanent, adding a mechanism to allow the exempt value of items to increase with time, and recategorizing the preference as one intended to provide tax relief.**

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2018

REVIEW DETAILS

1. What is the preference?

Use tax exemption for individuals who purchase or win items at nonprofit or library fundraising events

Legislature stated its objective to provide use tax relief

The Legislature passed this preference with the stated purpose to provide use tax relief to individuals who support charitable activities by purchasing or winning items at fundraising events or through fundraising activities held by nonprofits or libraries. Those organizations are already exempt from collecting sales tax at qualifying fundraising events under existing law.

The Legislature categorized this preference as one intended to accomplish a "general purpose." Since 2013, the Legislature is required to include a performance statement for all new or expanded tax preferences and indicate which one of several categories of preferences best describes the legislative purpose.

What is use tax?

Use tax is a tax on the use of goods in Washington when sales tax was not collected at the time of sale. The use tax rate is the same as the sales tax rate. Goods used in Washington are subject to either sales or use tax, but not both.

Use tax exemption for items valued at less than $12,000

Individuals who purchase or win items valued at less than $12,000 at qualifying nonprofit or library fundraising events do not owe use tax on the items.

Qualifying fundraising events must meet specific criteria

To qualify for a use tax exemption, a nonprofit or library fundraising event must be:

- Exempt from paying business and occupation (B&O) tax on the gross income received from the event under RCW 82.04.3651.
- Limited in time rather than an ongoing business endeavor. For example, raffles and auctions qualify. Regular business operations, such as thrift stores, gift shops, or coffee shops, do not qualify. There is no limit to the number of qualifying events a nonprofit can hold in any given year.
- Raising money to further the goals of the nonprofit organization or library.

Preference scheduled to expire July 1, 2020

The preference took effect October 1, 2013, and is set to expire July 1, 2020.

REVIEW DETAILS

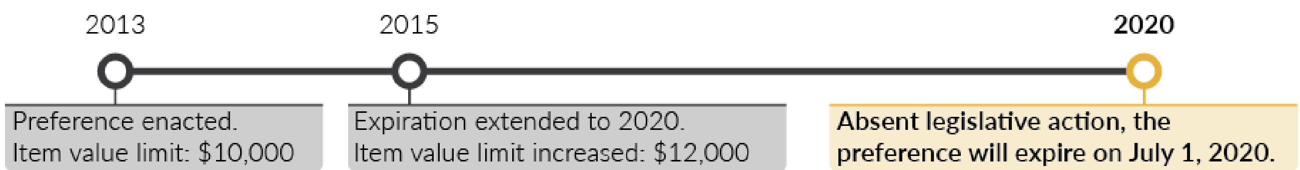
2. Items exempt from sales & use tax

Preference results in no sales or use tax for certain items acquired at qualifying fundraising events

Value of exempted items has increased over time

The Legislature initially passed this preference in 2013 to exempt items valued at less than $10,000. The original preference was scheduled to expire on July 1, 2017.

The 2015 Legislature expanded the exemption to cover items valued at less than $12,000, and extended the expiration date to July 1, 2020.



Source: JLARC staff analysis of RCW 82.12.225.

Preference removes use tax obligation for items already exempt from sales tax

Before this preference passed, existing law exempted nonprofit organizations and libraries from collecting **sales tax** on items purchased or won at qualifying fundraising events. However, there was no corresponding **use tax exemption** on those same items. Individuals who purchased or won items at qualifying fundraising events were required to pay use tax directly to the Department of Revenue on the value of the items.

With this preference, individuals are now exempt from paying either sales or use tax on items valued under $12,000 when acquired at qualifying fundraising events.

Other tax exemptions apply to nonprofit and library fundraising activities

In addition to this preference, nonprofit organizations and libraries are also exempt from the following:

- Paying business and occupation (B&O) tax on amounts earned at qualifying fundraising activities.
- Collecting sales tax from individuals who purchase goods at qualifying fundraising activities. The exemption applies regardless of the value of the goods.

REVIEW DETAILS

3. Objective met, impact unknown

Stated public policy objective achieved, unknown revenue impact

Preference is achieving the stated public policy objective

When this preference passed in 2013, the Legislature stated the public policy objective was to provide use tax relief to individuals who support charitable activities by purchasing or winning goods at fundraising events.

The preference is achieving the stated objective by exempting individuals from paying use tax on their purchases or winnings valued at under $12,000.

Preference has direct and indirect beneficiaries but size of revenue impact unknown

Direct beneficiaries of the preference are individuals who purchase or win items valued at less than $12,000 at qualifying fundraising events held by nonprofit organizations and libraries.

Indirect beneficiaries of the preference are Washington nonprofit organizations and libraries holding fundraising events.

Beneficiaries not required to report to DOR

In 2015, the Legislature directed JLARC to evaluate this preference to measure its effectiveness. While the public policy objective of providing use tax relief is being achieved, no data exists to identify how much tax relief is being provided.

Direct beneficiaries of the use tax exemption are not required to report, file, deduct, or otherwise document their use of the preference. Therefore, the number of individuals benefiting from this preference and its value cannot be determined. It is commonly known that many nonprofit organizations and libraries hold fundraising events throughout the year, such as auctions, raffles, or book sales. These events are not tracked by, or reported to, the Department of Revenue (DOR).

The nonprofit organizations and libraries holding qualifying fundraising events are also not required to report sales from these events to DOR.

When the Legislature extended and expanded the preference in 2015, the fiscal note at the time estimated a loss in state tax revenue of $15,000 per year for fiscal years 2018, 2019, and 2020. JLARC staff cannot validate the accuracy of this estimate.

REVIEW DETAILS

4. Applicable statutes

RCW 82.12.225

Exemptions—Nonprofit fund-raising activities. (Expires July 1, 2020.)

(1) The provisions of this chapter do not apply in respect to the use of any article of personal property, valued at less than twelve thousand dollars, purchased or received as a prize in a contest of chance, as defined in RCW 82.04.285, from a nonprofit organization or a library, if the gross income the nonprofit organization or library receives from the sale is exempt under RCW 82.04.3651.

(2) This section expires July 1, 2020. [2015 3rd sp.s. c 32 § 2; 2013 2nd sp.s. c 13 § 1402.]

Notes:

Tax preference performance statement—2015 3rd sp.s. c 32 § 2: "(1) This section is the tax preference performance statement for the tax preference in section 2 of this act. This performance statement is only intended to be used for subsequent evaluation of the tax preference. It is not intended to create a private right of action by any party or be used to determine eligibility for preferential tax treatment.

(2) The legislature categorizes this tax preference as one intended to accomplish a general purpose as indicated in RCW 82.32.808(2)(f).

(3) It is the legislature's specific public policy objective to provide use tax relief for individuals who support charitable activities by purchasing or winning articles of personal property from a nonprofit organization or library when the personal property is sales tax exempt.

(4) To measure the effectiveness of the exemption provided in this act in achieving the specific public policy objective described in [subsection] (3) of this section, the joint legislative audit and review committee must evaluate this tax preference." [2015 3rd sp.s. c 32 § 1.]

Intent—2013 2nd sp.s. c 13: "It is the intent of part XIV of this act to provide use tax relief for individuals who support charitable activities by purchasing or winning articles of personal property from a nonprofit organization or library when the personal property is sales tax exempt. It is also the intent of the legislation to provide this tax preference in a fiscally responsible manner by capping the exemption for articles of personal property that are valued at ten thousand dollars or less." [2013 2nd sp.s. c 13 § 1401.]

Effective date—2013 2nd sp.s. c 13: See note following RCW 82.04.43393.

RECOMMENDATIONS & AGENCY RESPONSE

Legislative Auditor's Recommendation

Legislative Auditor recommends continuing and clarifying the preference (structural purpose)

The Legislature should continue and clarify the preference because it is achieving the public policy objective of providing use tax relief to individuals who support charitable causes by purchasing or winning items at nonprofit or library fundraising events.

If the Legislature continues this preference before the July 1, 2020 expiration date, it should also consider whether to:

- **Make the preference permanent.** The related sales tax exemption for items purchased or won at fundraising events has no expiration date. This exemption was intended to provide relief from use tax for items already exempt from sales tax.

- **Add a mechanism to allow the exempt value** of items purchased or won **to increase with time**, such as automatic increases based on the rate of inflation. Currently the exempt value is set for items valued at less than $12,000.
- **Recategorize the preference as one intended to provide tax relief to certain individuals**, as noted in RCW 82.32.808(2)(e). Currently, the preference is categorized as one intended to accomplish a general purpose. A technical change in categories will ensure that the legislative purpose is clearly identified.

Legislation Required: Yes.

Fiscal Impact: Unknown.

RECOMMENDATIONS & AGENCY RESPONSE

Letter from Commission Chair

Available October 2018

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Commissioners' Recommendation

Available October 2018

RECOMMENDATIONS & AGENCY RESPONSE

Agency Response

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