PRELIMINARY REPORT

2022 Tax Preference Performance Reviews

Five of seven Legislative Auditor recommendations require action
Tax reviews follow same audit standards, different process than other work

Legislature created Citizen Commission for Performance Measurement of Tax Preferences.

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

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

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

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

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

**Required to make recommendation** to Legislature.
Legislative Auditor **recommends action on five preferences:**

- Commute Trip Reduction
- Nonprofit Hospitals and Cancer Clinics
- Dairy Processors
- Fruit and Vegetable Processors
- Seafood Processors

**Two preferences do not require legislative action:**

- Historic Automobile Museums Sales and Use Tax Deferral
- Dairy products used as ingredients for other dairy products
All reports include

ONE PAGE OVERVIEW

VIDEO SUMMARY

Preliminary Report | 2022 Tax Preference Performance Reviews
B&O Tax & Public Utility Tax

Commute Trip Reduction

Legislative Auditor’s Conclusion: More Washingtonians are using commute alternatives. However, fewer employers are requesting the tax credit, and the credit likely has limited influence on the amount of financial incentives employers provide.

Scheduled to expire: July 1, 2024

Estimated 2021-23 beneficiary savings: $4.1 million
Credit for up to 50% of financial incentives to use commute alternatives

Qualifying commute alternatives:

- Ride sharing.
- Using public transportation.
- Using car sharing programs.
- Non-motorized commuting.

Annual statutory limits:

- $60 per employee.
- $100,000 per employer.
- $2.75 million statewide.
- DOR prorates applications if state cap exceeded.
Stated objective: Increase Washingtonians’ use of commute alternatives

Statute directs Legislative Auditor to recommend continuing preference if review finds this objective is met.

Statewide, more commuters are using commute alternatives.

Source: American Community Survey 1-Year Estimates.
Stated objective: Reduce traffic congestion, energy use, and air pollution

CTR employee survey data:
- 800 – 1,000 sites.
- 500,000 – 600,000 employees.

Credit beneficiaries:
- 30% of sites.
- 52% of employees.

King County:
- 52% of sites.
- 65% of employees.
Stated objective: Reduce traffic congestion, energy use, and air pollution

More CTR site employees use commute alternatives

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>2015/16</td>
<td>39.1%</td>
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<tr>
<td>2017/18</td>
<td>42.0%</td>
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<tr>
<td>2019/20*</td>
<td>50.7%</td>
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*2019-20 survey cycle includes the start of the COVID-19 pandemic and represents responses from fewer CTR sites.
Stated objective: Reduce traffic congestion, energy use, and air pollution

More CTR site employees use commute alternatives

Annual, per-employee average (2015-16 to 2017-18):

- Vehicle-miles traveled: (320 miles)
- Fuel consumption: (15 gallons)
- GHG Emissions: (0.13 tons)

*2019-20 survey cycle includes the start of the COVID-19 pandemic and represents responses from fewer CTR sites.
Fewer employers are requesting credit

Credit applicants declined 56% from 2016-20.

Smaller employers had the largest drop in applications.

Decline continued during the COVID-19 pandemic.
Fewer employers are requesting credit

Credit applicants declined 56% from 2016-20.

Smaller employers had the largest drop in applications.

Decline continued during the COVID-19 pandemic.

Number of employees receiving incentives was more stable.
Preference likely of limited influence

Statutory caps reduce credit reimbursement rates.

| Employment less than or equal to 1,666 | $1.8 M (30%) CREDIT AWARDED | $5.9 M INCENTIVE PAID |
| Employment greater than 1,666 | $0.9 M (6%) CREDIT AWARDED | $14.5 M INCENTIVE PAID |

Fewer employers are applying for the credit.
Employer spending exceeds credit caps

ORCA Business Passport program

Employers with 5-500 employees:
• Spent $383 per employee in 2020.
• 35/455 employers applied for credit.

Largest employers spent $53 million on employee transit passes in 2019.
Employers offer incentives for reasons other than credit

- Employee recruitment & retention
- Sustainability & traffic management
- Local mandates
Legislative Auditor’s Recommendation

Continue and modify the preference.

Continue because more Washingtonians use commute alternatives.

Modify because the credit likely has limited influence on the amount of incentives employers provide. Modifications might include:

• Amending the preference to further reduce single-occupant vehicle travel; or
• Recategorizing the preference as one intended to provide tax relief to employers providing financial incentives for commute alternatives.
Legislative Auditor’s Conclusion: Dairy and fruit & vegetable beneficiaries had job and wage increases that exceeded industry and state averages. Seafood beneficiaries saw a decline in both. Although preferences reduced taxes, they remain higher than in neighboring states.

Estimated 2023-25 Beneficiary Savings:
Dairy: $10.5 M
Fruit & vegetable: $22.7 M
Seafood: $4.9 M
Presentation Overview

B&O tax preferences
Three industry job and wage analysis
Comparative effective tax rate analysis
B&O tax exemptions for processors of:

- **Dairy products**
- **Fruit & vegetables**
- **Seafood products**

- **Manufacturing products** such as yogurt and cheese, frozen French fries, wine, and frozen fish fillets.
- **Sales of products by the manufacturer** to in-state buyers who transport the items out of state.

Targeted B&O tax exemption for:

- Wholesale sales of dairy products to produce other dairy products, such as powdered whey.
When exemptions expire, 3 will be replaced with preferential rates and 1 will return to general B&O rate.

*Seafood and fruit & vegetable processors have paid varying preferential B&O tax rates since 1959 and 1965, respectively.
Presentation Overview

Preferences

Three industry job and wage analysis

Effective tax rate analysis
Dairy product processors

Beneficiaries employ 94% of industry workers.

Darigold, Inc. is the largest user, with 83% of all savings from 2015-2020.

2015 - 2020

<table>
<thead>
<tr>
<th>DARIGOLD</th>
<th>OTHER BENEFICIARIES</th>
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<tbody>
<tr>
<td>83%</td>
<td>17%</td>
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Dairy beneficiary jobs grew 27% - 2015-20
Dairy beneficiary employee wages increased 63% - 2015-20
2013 targeted dairy product B&O tax exemption

Dairy products sold at wholesale by the manufacturer for use as ingredient to make other dairy products (e.g., infant formula or powdered whey).

Industry representatives said the project this was intended to incentivize did not occur.

Average annual use - $62,000 since 2015.
Fruit & vegetable processors

Beneficiaries employ 74% of industry workers.

**Wineries** comprise 71% of beneficiaries but claim 19% of the tax savings.
F&V beneficiary jobs grew 23% - 2015-20

COVID-19 related employment changes

FRUIT & VEG WITH WINERY BENEFICIARIES

FOOD MANUFACTURING STATEWIDE
F&V beneficiary wages grew 69% - 2015-20
Seafood product processors

Beneficiaries employ 35%-51% of industry workers.

Unclear why more businesses don’t use preference. Economists and industry reps note:

• Not all WA seafood processing businesses conduct qualifying activities in-state.

• Self-employed fishing/processing businesses not included in employee data.
Seafood beneficiary jobs dropped 10% - 2015-20
Seafood beneficiary wages decreased 4% - 2015-20

COVID-19 related employment changes

57% STATEWIDE
50% FOOD MANUFACTURING

-4% SEAFOOD BENEFICIARIES
Presentation Overview

Preferences

Three industry job and wage analysis

Effective tax rate analysis
Preferences reduce effective tax rates, but WA still has highest rate among neighboring states (ID, OR, CA, AK)

**Effective tax rate (ETR):** the percentage reduction in a hypothetical firm’s rate of return due to taxes over 30-year period.

Hypothetical small and large manufacturing firms for each industry:

- Pre-incentive ETRs – calculated based on each state’s tax structure.
- Post-incentive ETRs – calculated after various state incentives are applied, reducing the tax rate by some percentage.
For each industry, Washington had highest ETR, pre- and post- incentive

In each scenario, Ernst & Young noted a significant factor in the results was Washington’s relatively high combined state/local sales tax.
Legislative Auditor’s Recommendation

B&O tax preferences for fruit and vegetable and dairy product processors: Continue and clarify

Because they are meeting the objectives of providing tax relief and creating and retaining industry jobs.

To facilitate future reviews, the Legislature should clarify its expectations for job and wage growth and determine the level of tax relief needed to meet those expectations.
B&O tax exemption for sales of dairy products used as ingredients to create other dairy products: Allow to expire

Allow to expire as scheduled, July 1, 2023. The activity that the preference was intended to incentivize did not occur.
Legislative Auditor’s Recommendation

B&O preferences for seafood processors: Review and clarify

Because they are only meeting one of two objectives.

While the preferences provide tax relief, beneficiary jobs in Washington have declined and their employee wages have decreased. It is unclear why more businesses are not using the preference or what the Legislature’s expectations are for the industry’s jobs and wages.
Nonprofit Hospitals and Nonprofit Cancer Clinics

Legislative Auditor’s Conclusion: The property tax exemptions meet the inferred intent of encouraging charity care and community benefits. Beneficiaries provide 99% of charity care statewide, and the value of charity care exceeds tax savings.

PROPERTY TAX

No expiration dates

Estimated 2023-25 Beneficiary Savings: $259.4 million

Dana Lynn | Pete van Moorsel

July 2022
Real and personal property exempt from tax under two separate laws

Private nonprofit and public hospitals (RCW 84.36.040(1)(e)).
• Exemption predates statehood.

Nonprofit cancer clinics affiliated with a nonprofit hospital (RCW 84.36.046).
• Exemption enacted in 1997.

Inferred objective: Support provision of charity care and community benefits.
Nonprofit hospitals and cancer clinics provide 3Xs the charity care than they received in tax savings and meet inferred intent

Charity care = medical care for which payment isn’t expected and patient isn’t billed.

Community benefits = providing unreimbursed medical care under programs with certain eligibility requirements, and services like providing education and research programs.
In 2019, beneficiary hospitals provided 99% of all charity care given in WA.

94 beneficiaries saved over $93 million in FY19.

Beneficiaries provided over $336 million in charity care.
Legislative Auditor’s Recommendation

Clarify the objectives of the preferences.
If the tax preferences are intended to support certain outcomes, the Legislature should clarify its expectations by adding performance statements that clearly state the public policy objectives and metrics to determine if the objectives have been met.
Historic Automobile Museums

Legislative Auditor’s Conclusion: The tax deferral meets the public policy objective of improving the fiscal stability of its one beneficiary. This may have improved economic vitality, but other local financial incentives likely had a larger influence.

Sales & Use Tax Deferral

Closed to new participants: 12/31/2008

Estimated Beneficiary Savings 2012-32: $466,000
Sales and use tax deferral on museum construction costs

- **2008**: Museum approved for deferral
- **2012**: Museum is complete and open to public
- **2017**: Deferral period extended
- **2022**: Deferral period extended
- **2032**: Museum must repay deferred taxes in equal payments over ten years

**10 YEARS OF NO PAYMENTS**
Deferral repayments not due for the first 10 years after Museum is complete.

**10 YEARS OF REPAYMENTS**
Museum must repay deferred taxes in equal payments over ten years.
Deferral intended to increase the fiscal stability of the Museum

Deferral functions as an interest-free loan.

Museum deferred $1.99 million in sales and use tax.

Total beneficiary savings (2012-32): $466,000.
Museum contributes to local and state economies

ALL OTHER COUNTIES
- 18 jobs
- $2.7 M per year

PIERCE COUNTY
- 78 jobs
- $8.1 M per year
Impact of the deferral likely is limited

Museum benefited from other public financial support

City of Tacoma donated $17 million in land
Legislative Auditor’s Recommendation

Continue until deferral is repaid in 2032

After that, the tax preference will no longer be necessary in statute.
Next Steps

July | Present preliminary report to JLARC.

August | Present preliminary report to Citizen Commission.

September | Citizen Commission obtains public testimony.

October | Citizen Commission adopts comments on the report.

November | Present proposed final report to JLARC.

View the 2022 Tax Preference Reviews:
www.leg.wa.gov/jlarc

- Video Summaries
- Interactive Data
- One Page Overviews
- PDF Versions