PRELIMINARY REPORT:
2022 TAX PREFERENCE PERFORMANCE REVIEWS

Historic Automobile Museums Sales and Use Tax Deferral

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.

July 2022

Executive Summary

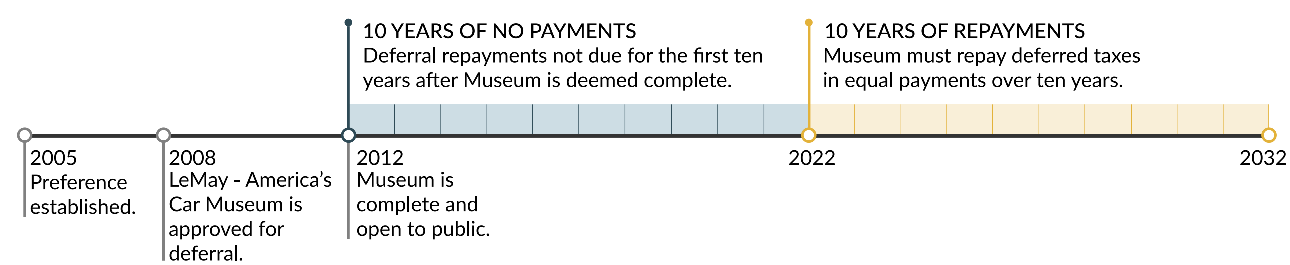
Tax deferral for historic automobile museums

Estimated Biennial Beneficiary Savings $46,600
Tax Type Sales and Use Tax RCW 82.32.580 **Applicable Statutes**

In 2005, the Legislature established a deferral program that allows nonprofits constructing eligible museums to apply for a sales and use tax deferral on construction costs. To qualify, the museum must maintain and display a collection of at least 500 automobiles.

Statute originally allowed beneficiaries to defer payment of sales and use tax for five years after the museum is completed. The 2017 Legislature extended the deferral period to ten years. After the deferral period, beneficiaries must repay the deferred taxes in equal annual installments during a ten-year period.

While the preference has no expiration date, it closed to applicants after December 31, 2008, as required by law. The preference has a single beneficiary: the LeMay - America's Car Museum ("Museum") in Tacoma. The Museum was completed in 2012. It will begin repaying deferred taxes in 2022.



Preference met the objective to improve fiscal stability, though influence on local economic vitality is less clear

The 2017 Legislature stated that the preference's policy objective is to increase the fiscal stability of historic automobile museums in Washington, thereby strengthening local economic vitality.

The tax deferral improved the fiscal stability of the beneficiary Museum. The deferral of sales and use tax allowed the Museum to keep more cash on hand during construction and the first ten years of operation. The Museum reports that this enabled it to pay off construction debt and build reserves to weather unexpected events, such as the COVID-19 pandemic.

Economic modeling suggests the Museum contributes approximately $8.1 million to the Pierce County economy per year.

Objectives (stated)	Results
Improve fiscal stability	**Met**. The Museum retained funds by not paying taxes at the time of construction.
Improve economic vitality	**Unclear.** The Museum contributes approximately $8.1 million to the Pierce County economy per year. However, local financial incentives likely influenced the Museum's location and construction more than the tax deferral.

Recommendations

Legislative Auditor's Recommendation: Continue until deferral is repaid in 2032

The Legislature should continue the preference until the current deferral is repaid in 2032. After that, the tax preference will no longer be necessary in statute.

You can find more information in Recommendations.

Commissioners' Recommendation

Available on Citizen Commission website October 2022.

REVIEW DETAILS

1. Tax deferral for museum construction

Nonprofits that build historic automobile museums can defer sales and use tax on construction costs

The Legislature established the deferral program in 2005 for nonprofits that construct historic automobile museums. The Department of Revenue (DOR) considered applications for the deferral until December 31, 2008, when the deferral program closed to new applicants. One nonprofit applied and is the preference's only beneficiary: the LeMay - America's Car Museum ("Museum") in Tacoma.

The deferral is intended to improve museum fiscal stability and thereby strengthen local economic vitality

The preference allows beneficiaries to defer paying sales and use tax on the construction of new museum facilities. Eligible beneficiaries must maintain and display a collection of at least 500 automobiles.

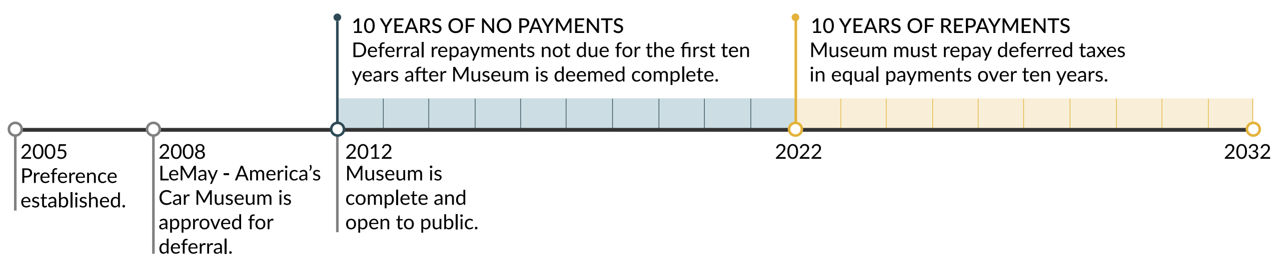
The Legislature originally passed the preference in 2005 as a five-year deferral with no stated intent. In 2017, the Legislature extended the deferral period by five years and stated its public policy objective to increase the fiscal stability of historic automobile museums and strengthen local economic vitality (see Section 3 for more detail).

Beneficiary repays deferred taxes over time

After DOR approves a beneficiary for the deferral, the beneficiary can defer payment of sales and use tax on construction costs. Once the museum is complete, DOR audits the project's purchases, and then the beneficiary has ten years before it must begin repaying the deferred taxes. Payments must be made in equal annual installments during a ten-year period. No interest is charged if payments are made on time.

The sole beneficiary (LeMay - America's Car Museum) completed construction in 2012. It must begin repaying the deferred taxes in December 2022.

Exhibit 1.1: The Museum defers taxes for ten years and makes equal payments for another ten years



Source: JLARC analysis of RCW 82.32.580.

2. $466,000 in beneficiary savings

LeMay - America's Car Museum saved $466,000 by deferring payment of $1.99 million in sales and use tax

The Department of Revenue (DOR) received and approved one deferral application from the LeMay - America's Car Museum ("Museum") in Tacoma. The Museum was completed in 2012 and incurred a balance of $1.99 million in sales and use tax.

Estimated lifetime beneficiary savings are $466,000

The deferral acts as an interest-free loan by allowing the Museum to delay paying the $1.99 million in sales and use tax.

JLARC staff calculated the beneficiary savings by comparing the deferral to a hypothetical situation in which the Museum took out a loan for the sales and use tax.

- Without the deferral, the Museum would have taken out a loan for the $1.99 million in sales and use tax. At the beginning of the deferral period, the Museum's other loans had an effective interest rate of 1.74%. If this interest rate was used for the hypothetical loan during a 20-year period (the length of the deferral and repayment period), the Museum would pay $466,000 in interest on the $1.99 million. In this scenario, the Museum would pay nearly $2.5 million: $1.99 million in taxes, plus $466,000 in interest.
- With the deferral, the Museum delayed the payment of the $1.99 million for ten years. After this time, the Museum will pay down this balance in $199,000 installments during a ten-year period. No interest is charged if payments are on time.

The total beneficiary savings over time are $466,000. The ten-year deferral and ten-year repayment periods span 20 years (2012-2032), meaning the Museum's savings are equivalent to $23,300 per year.

Exhibit 2.1: Beneficiary savings estimates

Biennium	Fiscal Year	Estimated Beneficiary Savings
2013-15 *7/1/13-6/30/15*	2014	$23,300
	2015	$23,300
2015-17 *7/1/15-6/30/17*	2016	$23,300
	2017	$23,300
2017-2019 *7/1/17 - 6/30/19*	2018	$23,300
	2019	$23,300
2019-21 *7/1/19-6/30/21*	2020	$23,300
	2021	$23,300
	2019-21 Biennium	$46,600

Source: JLARC staff analysis of data from the Department of Revenue and LeMay - America's Car Museum financial statements.

Five-year extension increased beneficiary savings by 42%

The 2017 Legislature extended the deferral period by five years. This moved the date of the Museum's first payment from December 2017 to December 2022. JLARC staff calculate that the extension increased beneficiary savings by $138,000, from $328,000 to $466,000, a 42% increase.

3. Preference has improved fiscal stability

Preference has contributed to the beneficiary's fiscal stability, which may have affected local economic vitality

The preference's stated objective is to increase the fiscal stability of historic automobile museums in Washington, thereby strengthening the economic vitality of the local community.

Tax deferral increased the Museum's cash flow

The deferral allows the beneficiary to delay payment of sales and use tax incurred during museum construction. Instead, the beneficiary has ten years of no tax payments, followed by ten years of equal annual payments.

Construction of the LeMay - America's Car Museum ("Museum") took place from 2010 to 2012, and resulted in a deferral balance of $1.99 million in sales and use tax. The Museum will pay this balance in installments of $199,000 from 2022 to 2032.

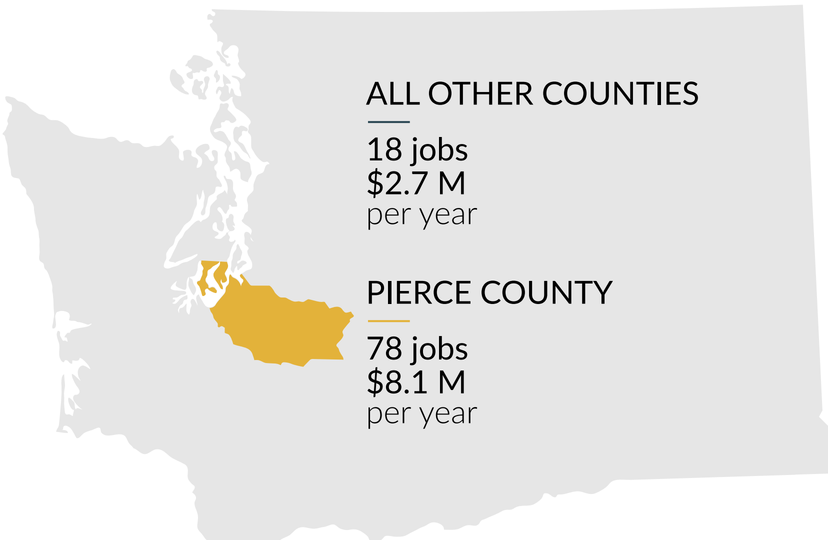
By delaying payment by ten years and then spreading the payments over another ten-year period, the Museum retained funds that otherwise would have been used for tax payments. Museum representatives reported to JLARC staff that the tax deferral allowed the Museum to keep more cash on hand. These funds were used to pay off debt and to endure unexpected decreases in revenues. For example, Museum representatives stated that the deferral allowed them to build a “reserve fund” that helped them weather approximately $3.5 million in lost revenue due to COVID-19.

The Museum contributes an estimated $8.1 million to the local community per year

JLARC staff used an economic modeling tool to estimate the economic impact of the Museum in Pierce County. The analysis compares the current economy against a hypothetical scenario in which the Museum does not operate. The modeled scenario evaluates the impact of the Museum's employment of 46 full-time equivalent employees and the indirect and induced jobs associated with their employment.

The economic analysis suggests that the Museum supports an average of 96 jobs per year, 78 of which are in Pierce County. The analysis also suggests that the Museum contributes an average of $10.8 million per year to the state economy, $8.1 million of which is in Pierce County.

Exhibit 3.1: The Museum contributes $8.1 million to the Pierce County economy each year



Source: JLARC staff analysis based on LeMay - America's Car Museum financial statements.

The Museum received additional government financial support

The above economic analysis evaluates the Museum's economic impact. It cannot isolate the economic impact of the deferral.

While our analysis suggests the deferral has met the goal of improving the Museum's fiscal stability, the deferral is not the only factor that affects local economic vitality. The Museum received other forms of government financial assistance during its construction in addition to the tax deferral. For example, the City of Tacoma donated $17 million in land, and the Department of Commerce issued the Museum an interest-free loan of $985,000. This additional financial support is more than 36 times the $466,000 in state tax savings and likely contributed more to the Museum's construction and operation in Pierce County.

4. Applicable statutes

RCW 82.32.580

Sales and use tax deferral - Historic automobile museum

RCW 82.32.580

(1) The governing board of a nonprofit organization, corporation, or association may apply for deferral of taxes on an eligible project. 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 project, estimated or actual costs of the project, time schedules for completion and operation of the project, and other information required by the department. The

department must rule on the application within sixty days. All applications for the tax deferral under this section must be received no later than December 31, 2008.

(2) 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 project.

(3) The nonprofit organization, corporation, or association must begin paying the deferred taxes in the tenth year after the date certified by the department as the date on which the eligible project is operationally complete. The first payment is due on December 31st of the tenth calendar year after such certified date, with subsequent annual payments due on December 31st of the following nine years. Each payment must equal ten percent of the deferred tax.

(4) The department may authorize an accelerated repayment schedule upon request of the nonprofit organization, corporation, or association.

(5) Except as provided in subsection (6) of this section, interest may not be charged on any taxes deferred under this section for the period of deferral. The debt for deferred taxes is not extinguished by insolvency or other failure of the nonprofit organization, corporation, or association.

(6) If the project is not operationally complete within five calendar years from issuance of the tax deferral or if at any time the department finds that the project is not eligible for tax deferral under this section, the amount of deferred taxes outstanding for the project is immediately due and payable. If deferred taxes must be repaid under this subsection, the department must assess interest, but not penalties, on amounts due under this subsection. Interest must be assessed at the rate provided for delinquent taxes under this chapter, retroactively to the date of deferral, and accrues until the deferred taxes due are repaid.

(7) Applications and any other information received by the department of revenue under this section are not confidential under RCW 82.32.330. This chapter applies to the administration of this section.

(8) This section applies to taxable eligible project activity that occurs on or after July 1, 2007.

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

(a) "Eligible project" means a project that is used primarily for a historic automobile museum.

(b) "Historic automobile museum" means a facility owned and operated by a nonprofit organization, corporation, or association that is used to maintain and exhibit to the public a collection of at least five hundred motor vehicles.

(c) "Nonprofit organization, corporation, or association" means an organization, corporation, or association exempt from tax under section 501(c) (3), (4), or (10) of the federal internal revenue code (26 U.S.C. Sec. 501(c) (3), (4), or (10)).

(d) "Project" means the construction of new structures, the acquisition and installation of fixtures that are permanently affixed to and become a physical part of those structures, and site preparation. For purposes of this subsection, structures do not include parking facilities used for motor vehicles that are not on display or part of the museum collection.

(e) "Site preparation" includes soil testing, site clearing and grading, demolition, or any other related activities that are initiated before construction. Site preparation does not include landscaping services or landscaping materials.

Appendix A: REMI overview

What is REMI?

JLARC staff used Regional Economic Models, Inc.'s (REMI) 39-region Tax-PI software (version 2.5) to model the economic impacts of the 2022 tax preference review of the sales and use tax deferral for historic automobile museums.

Multiple state government, private sector consulting firms, and research universities also use REMI's dynamic economic modeling to evaluate policy impacts.

Model is tailored to Washington and includes a government sector

Tax-PI is an economic impact tool used to evaluate the fiscal and economic effects and the demographic impacts of a 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 70 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.

Model simulates the full impact of a tax policy change

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 a tax policy change over time.

- Direct effects are industry specific and capture how a target industry responds to 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.

Model includes economic, demographic, and fiscal variables

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.
- Regional competitiveness is modeled via imports, exports, and output.
- Demographics are modeled using population dynamics (births, deaths, and economic and retirement migration) and include 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.

Appendix B: REMI analysis

REMI analysis shows the potential economic impact of the operations of the beneficiary museum

JLARC staff used Regional Economic Models, Inc.'s (REMI) Tax-PI tool to model a scenario that illustrates the economic impacts of the Museum's operations in Pierce County.

This technical appendix provides context and supporting information for the analysis and results summarized in Section 3.

REMI methodology

User inputs in REMI

REMI's Tax-PI model allows users to estimate the impacts of policy changes to Washington's economic activity and government finances (see Appendix A for an overview of the REMI model).

Before modeling policy scenarios, JLARC staff set parameters by calibrating the model to the state budget. JLARC staff used the November 2021 revenue estimates produced by the Economic and Revenue Forecast Council (ERFC) and budgeted expenditures from the 2021, as reported by the Legislative Evaluation and Accountability Program (LEAP) Committee. These sources provide the budget and revenue data for the model and serve as the starting point for Tax-PI's economic and fiscal forecasts.

Users also 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.

JLARC staff modeled the scenarios with expenditures set to be determined by demand. This avoids making assumptions about how policymakers may alter spending priorities in the future. In addition, current budget allocations are carried forward for each expenditure category.

To best isolate the effects of a hypothetical removal of the tax preference, JLARC staff modeled the scenarios with the **balanced budget restriction** turned off. The balanced budget restriction forces revenue and expenditures to be equivalent, and doing so may impose some limitations on economic activity and obscure the effects of a policy change.

JLARC staff modeled the potential impacts of the loss of the Museum to the Pierce County and state economy.

Data for the REMI model

The REMI model includes historical and demographic data from 2001 onward. 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 expenditures data for Washington comes from ERFC and LEAP. The inputs for the modeled scenario described below are based on JLARC staff estimates, public tax documents and financial statements, and interviews with the beneficiary.

Model estimates the economic impact of the Museum's operations

The modeled scenario does not evaluate the construction impact of the sales and use tax deferral.

Rather, the modeled scenario illustrates the impact of the employment of 46 full-time equivalent employees and the indirect and induced jobs associated with their employment at the Museum. To do so, the scenario reduced employment in the museum industry in Pierce County, adjusting for the productivity of Museum employees implied by the reported revenues of the Museum.

The economic analysis suggests that the Museum supported an additional 78 jobs in Pierce County, and 18 jobs in the rest of the state. The total reduction in economic output in Pierce County and the state was estimated at $8.1 million and $10.8 million per year, respectively.

RECOMMENDATIONS & RESPONSES

Legislative Auditor's Recommendation

Legislative Auditor's Recommendation: Continue

The Legislature should continue the preference until the current deferral is repaid in 2032. After that, the tax preference will no longer be necessary in statute.

Legislation Required: No

Fiscal Impact: None

Letter from Commission Chair

Available on Citizen Commission website October 2022.

Commissioners' Recommendation

Available on Citizen Commission website October 2022.

Agency Response

If applicable, available on Citizen Commission website October 2022.

MORE ABOUT THIS REVIEW

Study questions

Click image to view PDF of proposed study questions.

Washington JLARC

PROPOSED STUDY QUESTIONS

Sales and Use Tax Deferral for Historic Automobile Museums

State of Washington Joint Legislative Audit and Review Committee — December 2021

JLARC to review a sales and use tax deferral for historic automobile museums

In 2005, the Legislature established a sales and use tax deferral for the cost of on site preparation, construction, acquisition and installation of permanent fixtures for historic automobile museums.

This preference is included in the 10-year review schedule set by the Citizen Commission for Performance Measurement of Tax Preferences.

Tax deferral is intended to increase the fiscal stability of historic auto museums

To be eligible for the preference, a museum must maintain and exhibit a collection of at least 500 motor vehicles. The LeMay America's Car Museum in Tacoma has stated that it is benefiting from this preference. The deferral program closed for new participants on December 31, 2008.

The 2017 Legislature extended the deferral period by an additional five years, with repayments set to begin in 2022. The museum has a total of 10 years to repay the deferred taxes it owes. The Legislature also stated a public policy objective to increase the fiscal stability of historic auto museums and thereby improve the economic vitality of the communities that they are located in.

This study will address the following questions:

1. What are the estimated savings to the museum assuming that it fully repays its deferred taxes?
2. How has the preference affected the fiscal stability of the historic auto museum?
3. What is the economic impact of the museum on the community where it is located?

Study Timeframe

Preliminary Report: July 2022 **Proposed Final Report:** December 2022

Study Team

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JLARC Study Process

Study Mandate Budget, legislation, committee direction	**Proposed Study Questions**	Legislative Auditor's Preliminary Report	**For Tax Preferences:** • Citizen Commission meeting • Public testimony • Commission adopts comments	Legislative Auditor's Proposed Final Report Agency response included	Final Report Option to append committee comment
					Committee votes to distribute completed audit

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