

# 23-05 FINAL REPORT

## 2023 TAX PREFERENCE PERFORMANCE REVIEWS

### Overview

November 2023

#### 2023 Reviews: Five of six Legislative Auditor recommendations require action

The Legislative Auditor issued six tax preference reports in 2023. The preferences benefit businesses or individuals involved in:

1. Providing interstate transportation.
2. Creating new jobs in rural counties and community empowerment zones.
3. Providing international business services.
4. Storing pesticides sold out of state
5. Maintaining historic vessels.
6. Rehabilitating historic properties.

Each report includes one Legislative Auditor recommendation to the Legislature. All but one (rehabilitating historic properties) require legislative action.

#### This year's reviews include requirement for racial equity analysis

The 2021 Legislature charged JLARC with including a racial equity analysis in its audits and other reviews when it is relevant to the study's mandate and scope (RCW 44.28.076). We identified relevant questions for each of the tax preference reviews (see [Study Questions](#)).

Race and ethnicity data for the businesses using the preferences studied in 2023 was not available. In lieu of actual data, JLARC staff searched for other sources of data that could provide insight into who benefits from or is affected by each preference. Our secondary sources included surveys and U.S. Census Bureau data. Specific data sources are discussed in each report.

In 2022, the Department of Revenue asked beneficiaries of 48 tax preferences to submit race and ethnicity data on their annual tax performance reports. This includes beneficiaries that are specifically required to file an annual report and those who use preferences intended to improve industry competitiveness or create or retain jobs.

While this will improve the availability of data, JLARC staff anticipate that obtaining robust race and ethnicity data will continue to be a challenge for future reviews. Limitations include:

- The request to report information does not apply to all tax preferences JLARC is required to review.
- Race and ethnicity data is requested about employees, not business owners or other affected stakeholders.
- Businesses are asked to provide race and ethnicity of their employees statewide. Data will not be location specific.
- Businesses are not required to supply this information about their employees.

Obtaining race and ethnicity information from all preference users may require additional legislation. For example, the Legislature might require state agencies to collect the desired data. Such efforts will likely require balancing the interest in gathering race and ethnicity data with efforts to streamline and simplify taxpayer reports.

## Five recommendations require legislative action

### Interstate Transportation Tax Preferences

[Report](#) | [Summary](#) | [Video Summary](#)

**Conclusion:** The four preferences make Washington’s commercial transportation industry more competitive. They support more freight traffic at ports and higher employment in transportation and freight-dependent industries.

<b>Tax type:</b>	Public utility tax
<b>Biennial beneficiary savings:</b>	\$219.8 million (2027-29 biennium)
<b>Applicable statutes:</b>	RCW 82.16.050 subsections 6, 8, 9, and 10
<b>Expiration date:</b>	None

**Legislative Auditor's Recommendation:** Clarify because the preferences are no longer necessary to comply with the U.S. Constitution and the Legislature may have other objectives.

**Commissioners' Recommendation:** Endorse with [comment](#)

### Rural County and CEZ New Jobs

[Report](#) | [Summary](#) | [Video Summary](#)

**Conclusion:** Beneficiaries created over 1,000 jobs in rural counties, but use continues to decline. The preference's wage threshold has not been updated since 1997.

<b>Tax type:</b>	Business and occupation tax
<b>Biennial beneficiary savings:</b>	\$582,000 (2025-27 biennium)

Applicable statutes: RCW 82.62.030

Expiration date: None

**Legislative Auditor's Recommendation: Continue and modify** because the preference has been used by businesses that created jobs. However, the Legislature may want to consider increasing the wage threshold or modifying the preference to increase the number of businesses using it.

**Commissioners' Recommendation:** Endorse with [comment](#)

## International Services

[Report](#) | [Summary](#) | [Video Summary](#)

**Conclusion:** Preference use is 97% lower than originally expected. It has not met the goal of attracting and retaining jobs.

**Tax type:** Business and occupation tax

**Biennial beneficiary savings:** \$80,000 (2025-27 biennium)

**Applicable statutes:** RCW 82.04.44525

**Expiration date:** None

**Legislative Auditor's Recommendation: Terminate** because it has not achieved the stated intent to attract and retain businesses in community empowerment zones or international service districts. The Legislature may want to consult with the Department of Commerce and local economic development entities to consider other approaches.

**Commissioners' Recommendation:** Endorse without comment

## Hazardous Substance Tax Exemption for Pesticides Sold Out of State

[Report](#) | [Summary](#) | [Video Summary](#)

**Conclusion:** Preference is for businesses that store and transport agricultural pesticides sold out of state. Total hazardous substance tax revenue has increased, but likely not due to the preference.

**Tax type:** Hazardous substance tax

**Biennial beneficiary savings:** \$319,000 (2023-25 biennium)

**Applicable statutes:** RCW 82.21.040(5)

**Expiration date:** 1/1/2026

**Legislative Auditor's Recommendation: Continue and modify** because the preference improves industry competitiveness. The Legislature should consider new metrics to evaluate the preference in light of 2019 changes to Hazardous Substance Tax or recategorize the preference.

**Commissioners' Recommendation:** Endorse with [comment](#)

## Historic Ships and Vessels

[Report](#) | [Summary](#) | [Video Summary](#)

**Conclusion:** Owners of eleven historic vessels saved an estimated \$21,000 in 2023. It is unclear if the preference met the inferred goal of keeping historic vessels in Washington.

<b>Tax type:</b>	Property tax
<b>Biennial beneficiary savings:</b>	\$22,000 (2025-27 biennium)
<b>Applicable statutes:</b>	RCW 84.36.080(2)
<b>Expiration date:</b>	None

**Legislative Auditor's Recommendation:** Clarify the objectives and identify performance metrics.

**Commissioners' Recommendation:** Endorse with [comment](#)

### One recommendation does not require legislative action

## Rehabilitated Historic Properties

[Report](#) | [Summary](#) | [Video Summary](#)

**Conclusion:** Property owners saved \$56.8 million over the past 10 years, primarily in King County and for commercial properties. While preference use has declined, use increased 6% between 2020 and 2022.

<b>Tax type:</b>	Property tax
<b>Biennial beneficiary savings:</b>	\$22.7 million (2025-27 biennium)
<b>Applicable statutes:</b>	RCW 84.26.070
<b>Expiration date:</b>	1/1/2031

**Legislative Auditor's Recommendation:** Continue because the preference is meeting its objective to promote historic property revitalization. JLARC staff will review the preference again before the January 1, 2031, expiration date and determine whether preference use has increased over time.

**Commissioners' Recommendation:** Endorse with [comment](#)

The Citizen Commission for the Performance Measurement of Tax Preferences also considers preferences based on information provided by the Department of Revenue. [View the 2023 Expedited Preference Review.](#)

## Committee Action to Distribute Report

On November 29, 2023 this report was approved for distribution by the Joint Legislative Audit and Review Committee.

Action to distribute this report does not imply the Committee agrees or disagrees with the Legislative Auditor recommendations.

## More about 2023 reviews

### Study questions

The Citizen Commission for the Performance Measurement of Tax Preferences selected the following tax preferences for a performance review by JLARC staff in 2023:

- [Interstate Commercial Transportation Preferences \(Public Utility Tax\)](#) | RCW 82.16.050 (subsections 6, 8, 9, and 10) | 1935, 1937, 2007
- [Rural County and CEZ B&O Job Credit](#) | Ch. 82.62 RCW | 1986
- [International Services B&O Tax Credit](#) | RCW 82.04.44525 | 1998
- [Hazardous Substance Tax Exemption for Pesticides Sold Out of State](#) | Ch. 82.21 RCW | 1989
- [Property Tax Preferences for Historic Ships and Vessels](#) | RCW 84.36.080(2), 84.36.060(1)(a) | 1945
- [Property Tax Preference for Rehabilitated Historic Properties](#) | Ch. 84.26 RCW, Sections .010, .020, .070 | 1985

In addition, the Commission opted to 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. [View the 2023 Expedited Preference Review.](#)

**Table 1: 2023 expedited review included 45 preferences**

Preference Name	RCW	Year Enacted
Bailed Tangible Personal Property for R&D (Use Tax)	82.12.0265	1961
Cigarette Stamping (B&O Tax)	82.04.601	2007
Custom Computer Software (Property Tax)	84.36.600	1991
Custom Software (Sales and Use Tax)	82.04.050(6)(a)(i)-(ii)	1998
Digital Codes (Sales and Use Tax)	82.08.0208; 82.12.0208	2009
Digital Goods and Services for Business Purposes (Sales and Use Tax)	82.08.02087; 82.12.02087	2009

Preference Name	RCW	Year Enacted
Digital Goods and Services for Multiple Points of Use (Sales and Use Tax)	82.08.02088; 82.12.02088	2009
Digital Goods or Automated Services for the Public (Sales and Use Tax)	82.08.02082; 82.12.02082	2009
Easements for Removing Products (Leasehold Excise Tax)	82.29A.020(1)(b)(i)	1975
Federal Small Business Innovation Grants (B&O Tax)	82.04.4261	2004
Federal Small Business Technology Transfer Grants (B&O Tax)	82.04.4262	2004
Forest Land Compensating Tax (Property Tax)	84.33.140(13)-(14)	1971
Forest Land Special Assessments (Property Tax)	84.33.210(1)	1992
Form Lumber (Sales and Use Tax)	82.08.0274; 82.12.0268	1965
Goods in Transit (Property Tax)	84.36.300	1961
Data Center Equipment (Sales and Use Tax)	82.08.986; 82.12.986	2010
Gravitational Wave Observatory (Sales and Use Tax)	82.08.02569; 82.12.02569	1996
Historic Property (Leasehold Excise Tax)	82.29A.130(17)	2005
Import and Export Commerce (B&O Tax)	82.04.610	2007
Import and Export Commerce (Sales Tax)	82.08.990	2007
Grave or Cemetery Lot for Sale (Real Estate Excise Tax)	82.45.010(3)(m)	1951
Joint Municipal Utility Authority (B&O Tax)	82.04.655	2011
Joint Municipal Utility Authority (Public Utility Tax)	82.16.305	2011
Joint Municipal Utility Authority (Sales and Use Tax)	82.08.999; 82.12.999	2011
Intangibles (Property Tax)	84.36.070	1931
Life Sciences Discovery Fund (B&O Tax)	82.04.4263	2005
Mini bottle liquor sales (Liquor tax - expires 6/30/2023)	82.08.150(10)(b)	2021
Minimum Taxable Threshold (Estate Tax)	83.100.020(1)	2005
Minimum to File Tax Return (Multiple Taxes)	82.32.045(5)	1996
Municipal Sewer Service Payments (B&O Tax)	82.04.432	1967
Nonprofit R&D (B&O Tax)	82.04.260(3)	1965
Newspapers (Sales and Use Tax)	82.08.0253; 82.08.0253(1)(b); 82.12.0345	1935

Preference Name	RCW	Year Enacted
Prewritten Computer Software (Property Tax)	84.40.037	1991
Public Historical Sites (Leasehold Excise Tax)	35.21.755	1977
Public Institution R&D Machinery and Equipment (Sales and Use Tax)	82.08.025651; 82.12.025651	2011
Purchases by Residents of Alaska and Hawaii (Sales Tax)	82.08.0269	1961
Recycling or Salvage Materials (Solid Waste Collection Tax)	82.18.010(3)	1986
Sales Tax Sourcing Costs (Multiple Taxes)	82.32.760(1)(b)	2007
Sales to Nonresidents from No or Low Sales Tax States (Sales Tax)	82.08.0273	1965
Small Timber Harvesters (B&O Tax)	82.04.333	1990
Standing Timber (B&O Tax)	82.04.334	2007
Timber Tax Minimum (Timber Tax)	84.33.086	1984
Self-Service Laundry Facilities (Sales and Use Tax)	82.04.050(2)(a)	1998
Vending Machine Sales (Sales Tax)	82.08.080	1963
Trade-Ins (Sales Tax)	82.08.010(1)(a)	1984

Source: 2023 expedited tax review

**Table 2: 2023 expedited review included 17 preferences that are a critical part of the tax structure**

Preference Name	RCW	Year Enacted
Casual Sales (Sales Tax)	82.08.0251	1935
Cemeteries (Property Tax)	84.36.020	1854
Endowment Funds (B&O Tax)	82.04.4282(8)	1935
Joint Utility Services (Public Utility Tax)	82.16.050(3)	1935
Leases Under \$250 per Year and Short Term Leases (Leasehold Excise Tax)	82.29A.130(8)-(9)	1976
Minimum Income Threshold (Public Utility Tax)	82.16.040	1935
Municipal Utilities (Public Utility Tax)	82.16.050(1)	1935
Products Shipped Out-of-State (Litter Tax)	82.19.050(1)	1992
Professional Employer Organization Wages (B&O Tax)	82.04.540(2)	2006
Nonresidents' Personal Property (Use Tax)	82.12.0251	1935
Public Utilities (B&O Tax)	82.04.310(1)	1935
Public Utility Operating Property (Sales and Use Tax)	82.08.0256; 82.12.0257	1935
Sales for Resale (Public Utility Tax)	82.16.050(2)	1935

Preference Name	RCW	Year Enacted
Sales or Use Tax Paid in Another State (Use Tax)	82.12.035	1967
Sales Subject to Public Utility Tax (Sales Tax)	82.08.0252	1935
Sewerage Processing and Disposal (Public Utility Tax)	82.16.050(13)	1987
Timber (Property Tax)	84.33.040	1971

Source: 2023 expedited tax review

## Audit Authority

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

JLARC's nonpartisan staff analysts, under the direction of the Legislative Auditor, conduct performance audits, program evaluations, sunset reviews, and other analyses assigned by the Legislature and JLARC.

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 analysts 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.

## Timeframe for the study

A preliminary audit report will be presented at the July 2023 JLARC meeting and at the August 2023 meeting of the Commission. A final report will be presented to JLARC in November 2023.

## 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 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 2023, JLARC staff reviewed six preferences. The Commission's website includes analysis of preferences completed in previous years: See <https://www.citizentaxpref.wa.gov>.

## JLARC staff's approach to the tax preference reviews

Statute guides the main topics 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))

## JLARC staff's analysis of tax preferences

JLARC staff carefully analyzes a variety of evidence when 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 of the preference

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 that requires 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 preference 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.

## Contact information

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