23-05 FINAL REPORT: 2023 TAX PREFERENCE PERFORMANCE REVIEWS

Rural County and CEZ New Jobs

LEGISLATIVE AUDITOR'S 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.

November 2023

Executive Summary

Preference provides B&O tax credit for manufacturers and other businesses that create new jobs in rural counties or CEZs

Estimated Biennial Beneficiary Savings $582,000 (2025-27 biennium)
Tax Type Business and occupation tax RCWs 82.62.030, 82.62.045

This preference provides a business and occupation (B&O) tax credit for each new job created in a rural county or community empowerment zone (CEZ). Qualifying jobs must be full-time (at least 35 hours per week). Businesses must:

- Conduct manufacturing, research and development, or commercial testing.
- Increase their employment by 15% or more.
- Maintain the new positions for one year.

Two levels of credit are available, based on a threshold of $40,000:

- $2,000 for jobs with wages and benefits of $40,000 or less a year.
- $4,000 for jobs with wages and benefits over $40,000 a year.

The preference does not have an expiration date.

Legislature wanted to promote or attract businesses and create family wage jobs in distressed or rural areas

The preference was originally enacted in 1986 for counties with above average unemployment rates (i.e., distressed counties). Amendments over the ensuing years added eligible locations but kept the focus on distressed or rural areas. Since 1999, the preference has applied to all rural counties and CEZs.

The 1997 Legislature stated the preference was intended to encourage new and existing businesses to operate and expand in rural distressed counties. The Legislature also stated its intent to provide family wage jobs in these areas.

Objectives (stated)	Results
In rural distressed counties: • Promote business operation and expansion of existing businesses. • Attract or develop new businesses.	**Unclear**. • 36 businesses created 1,041 jobs in rural counties in fiscal years 2015-2020. Of these, 25 were existing and 11 were new. • Available data does not indicate whether the preference caused businesses to add jobs. However, an economic model suggests that if the preference led businesses to create 19 (2%) of the new jobs, the state would break even. • The number of businesses using the preference fell from 51 in fiscal year 2015 to 12 in fiscal year 2022. At the same time, the amount of credit used each year declined from $1.5 million to $291,000. The statutory annual maximum for the credit is $7.5 million.
Provide family wage jobs in rural distressed counties.	**Unclear**. • 54% of the jobs created in rural counties in fiscal years 2015-2020 paid $40,000 or less a year. This is close to the five-year average rural county wage ($42,000). • The preference's wage threshold has not been updated since 1997. For context, $40,000 in 1997 is equivalent to $70,000 as of December 2021.

Recommendations

Legislative Auditor's Recommendation: Continue and modify

The Legislature should continue the preference because it has been used by businesses that created jobs in eligible areas. Economic modeling suggests that the state breaks even if the preference causes only 2% of the jobs. It is unclear why use of the preference has declined.

The Legislature should modify the preference to promote and increase family wage jobs in rural counties. For example, the Legislature might consider increasing the wage threshold to reflect current economic conditions and linking future increases to inflation or wage benchmarks.

The Legislature should modify the preference to potentially increase the number of businesses applying for the credit. For example, the Legislature might consider increasing the credit amounts, or extending the preference to other industry sectors that could benefit rural counties.

You can find more information in Recommendations.

Commissioners' Recommendation

Endorse Legislative Auditor recommendation with comment. The Legislature should modify the preference to increase the number of businesses applying for the credit. This may require a more in-depth study of why use of the preference has declined.

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.

REVIEW DETAILS

1. B&O tax credit for new jobs in rural counties or CEZs

Preference provides B&O tax credit for businesses that create and retain new jobs in rural counties or community empowerment zones

Certain businesses that create and retain new jobs can receive B&O tax credits

Businesses that conduct manufacturing, research and development, or commercial testing activities can earn business and occupation (B&O) tax credits for new jobs. Qualifying jobs must be full-time (at least 35 hours per week). The credit amount is either $2,000 or $4,000, depending on each job's wages and benefits.

To qualify for the credit, a business must:

- Apply to the Department of Revenue (DOR) for the credit.
- Increase employment at a facility in a rural county or community empowerment zone (CEZ) by at least 15% in the four consecutive quarters after the position is filled.
- Maintain the increase in jobs for one year.
- Verify the job increase to DOR through annual reports.

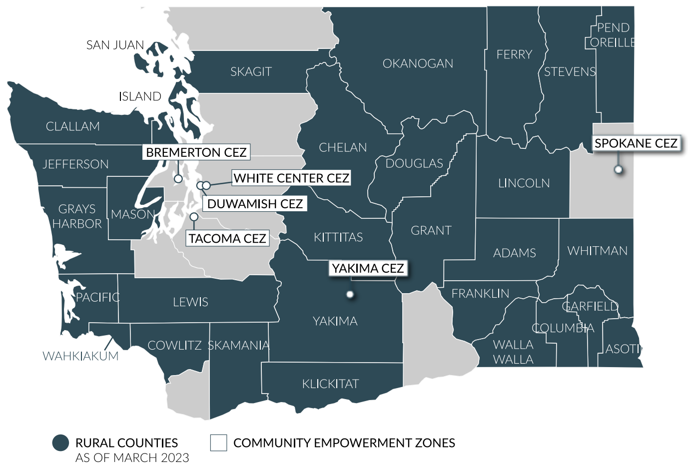
If a business does not keep the job for one year, it must pay back, with interest, any credit already used on tax returns.

Credits can be carried forward to future tax returns until they are used in full. However, credits will expire if the business closes or has not used any of its credits in six years. The preference does not have an expiration date.

Preference focuses on job creation in rural counties and community empowerment zones

The Legislature enacted the preference in 1986, targeting counties with above average unemployment (i.e., distressed counties). Amendments in subsequent years added more eligible locations but kept the focus on rural or distressed areas. Since 1999, the preference has been available to businesses in CEZs and all rural counties, whether or not they are distressed.

Exhibit 1.1: Preference is currently available in 30 rural counties and six CEZs



Rural county: A county with population density of less than 100 people per square mile or area under 250 square miles. In 2022, 15 of the 30 rural counties were also distressed.	Community empowerment zone (CEZ): Urban areas designated by the Department of Commerce based on limited employment opportunities, low incomes, lack of affordable housing, deteriorating infrastructure, and limited community service, job training, or education facilities.

Source: JLARC staff analysis of Office of Financial Management designations of rural counties as of June 2022 and Department of Revenue documentation on CEZs.

2. Beneficiaries created 1,041 jobs in rural counties

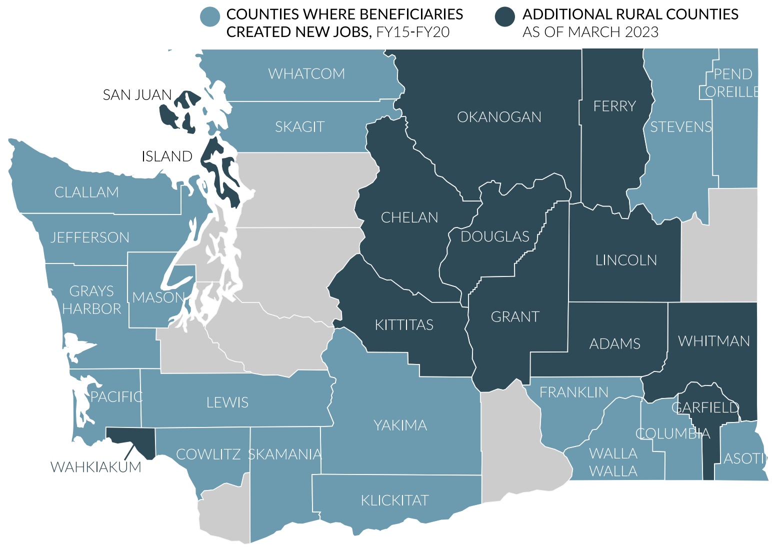
Businesses that received credits created over 1,000 jobs in rural counties (FY 2015-2020)

Beneficiary businesses created and filled over 1,000 new jobs in 18 rural counties

Department of Revenue (DOR) data shows that 36 businesses applied and qualified for the credit, creating 1,041 new jobs between July 1, 2014, and June 30, 2020. Of these businesses, 25 were existing and 11 were new.

Statute requires a business to report employment information for only two years after its application is accepted. As a result, the data does not show whether the businesses maintained those jobs after the first year.

Exhibit 2.1: In fiscal years 2015 through 2020, beneficiaries created jobs in 18 of 30 rural counties. None were created in community empowerment zones.



Source: JLARC staff analysis of DOR preference application and annual report data, fiscal years 2015-2020.

Note: Whatcom County qualified as a rural county (population less than 100 people/square mile) until 2016. Businesses that created jobs qualified for credits and used them between fiscal years 2015-2020.

Additional businesses applied for the preference

During fiscal years 2015 through 2020, an additional 31 businesses applied to use the preference but did not meet the 15% employment increase requirement.

In addition, 12 businesses applied for the preference between July 2020 and October 2022. As of October 2022, these businesses had not completed the two annual reports to confirm they maintained the 15% employment increase. Neither the businesses nor the jobs they initially reported creating are included in this analysis.

Manufacturing businesses are the most common users of the preference

The 36 businesses that qualified in fiscal years 2015 through 2020 were primarily manufacturers. This is a broad industry sector that includes food manufacturers, breweries, and businesses that produce items including household goods, bioscience products, and metal or timber products. In 15 of the 18 (83%) counties where jobs were created, manufacturing jobs are a larger percentage of total employment than the statewide average.

JLARC staff compiled information about race and ethnicity of workers in the manufacturing sector

As part of the Legislature's direction to include racial equity analysis in its evaluations, JLARC staff compiled available data on race and ethnicity characteristics of workers in the state's manufacturing sector.

DOR does not collect information about race or ethnicity of beneficiary business owners. Also, businesses do not report the race or ethnicity of their employees to DOR or the Employment Security Department (ESD). In the absence of actual beneficiary data, the following is intended to provide the Legislature with insight into the racial and ethnic characteristics of individuals the firms may hire for these new jobs.

Exhibit 2.2: Racial and ethnic detail is available for the manufacturing sector in the 18 counties where jobs were created

	Fourth quarter 2021 employment		Race/ethnicity of employees in manufacturing sector						
Area	All sectors	Manufacturing sector (percent)	White	Black / African American	American Indian / Alaska Native	Asian	Native Hawaiian / Pacific Islander	Two or more races	Hispanic / Latino of any race
Statewide	2,471,458	236,159 (9.6%)	66.3%	3.4%	0.7%	13.0%	0.8%	2.6%	13.2%
Asotin	4,747	421 (8.9%)	91.2%	0.0%	1.0%	0.0%	0.0%	1.7%	3.3%
Clallam	12,626	836 (7%)	88.3%	1.1%	1.3%	1.1%	0.0%	2.6%	5.5%
Columbia	796	137 (17%)	89.1%	0.0%	0.0%	0.0%	0.0%	0.0%	5.8%
Cowlitz	28,569	6,106 (21%)	78.8%	1.4%	1.1%	3.4%	1.0%	2.5%	11.9%
Franklin	22,932	3,492 (15%)	35.5%	2.5%	0.4%	4.7%	0.3%	0.8%	55.7%
Grays Harbor	13,806	2,207 (16%)	78.6%	1.4%	1.3%	2.8%	0.3%	2.3%	13.4%
Jefferson	5,024	476 (9.5%)	88.4%	1.2%	1.8%	0.6%	0.6%	1.8%	5.3%
Klickitat	4,677	1,305 (28%)	78.9%	2.3%	0.9%	2.6%	0.2%	2.0%	13.0%
Lewis	17,411	2,669 (15%)	76.2%	1.3%	1.0%	4.0%	0.3%	2.1%	15.2%
Mason	7,062	738 (10%)	69.5%	1.8%	2.0%	6.0%	0.5%	2.8%	17.3%
Pacific	3,763	541 (14%)	69.7%	1.3%	1.5%	4.8%	0.0%	2.8%	19.6%
Pend Oreille	1,124	115 (10%)	91.3%	0.0%	0.0%	0.0%	0.0%	0.0%	5.2%
Skagit	31,865	5,614 (18%)	70.7%	1.4%	0.5%	6.4%	0.4%	2.4%	18.2%
Skamania	1,216	291 (24%)	79.0%	1.4%	0.0%	1.0%	0.0%	2.1%	15.1%
Stevens	6,152	1,018 (17%)	89.9%	0.5%	1.9%	0.7%	0.0%	3.3%	3.4%
Walla Walla	18,589	3,638 (20%)	51.4%	1.8%	0.4%	6.6%	0.3%	1.6%	37.9%
Whatcom	61,076	8,069 (13%)	71.9%	1.9%	1.0%	8.0%	0.6%	2.2%	14.5%
Yakima	75,693	7,363 (10%)	47.8%	1.2%	1.3%	1.7%	0.2%	1.1%	46.8%

Source: JLARC staff analysis of U.S. Census Longitudinal Employer-Household Dynamics, LED Extraction Tool.

Notes:

Certain percentages in a county may not add to 100% due to rounding and the manner in which the U.S. Census reports data to ensure confidentiality of small sample sizes.

The Local Employment Dynamics (LED) integrates data from the ESD with federal censuses, surveys, and other administrative records to create a longitudinal data system on U.S. employment.

The county-level employee counts capture "stable employment," or those employees who worked on both the first and last day of the calendar year quarter.

3. 54% of jobs created paid $40,000 or less per year

Over half of the jobs created by beneficiaries paid $40,000 or less. The wage threshold has not changed since 1997.

The 1997 Legislature stated that the preference was intended to help businesses create family wage jobs in rural distressed counties. However, the Legislature did not define family wage.

Businesses reported that 54% of the jobs they created pay $40,000 or less

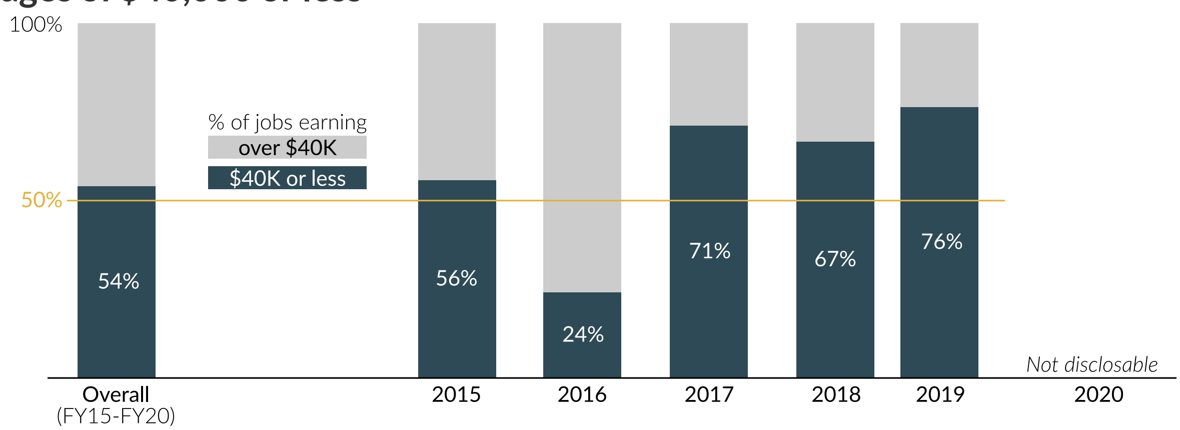
By law, the amount of credit a business can receive is based on whether a job's wages and benefits are above or below $40,000 per year:

- $2,000 for jobs with wages and benefits equal to or less than $40,000 per year.
- $4,000 for jobs with wages and benefits greater than $40,000 per year.

In fiscal years 2015 through 2020, businesses received credits for creating 1,041 jobs. Of those, 54% paid $40,000 or less per year. Employment Security Department (ESD) data for calendar years 2015 to 2020 shows that the $40,000 wage and benefit threshold is:

- Close to the five-year average rural county wage of $42,000.
- Lower than the five-year average statewide wage of $65,000.

Exhibit 3.1: Most jobs created by beneficiaries in rural counties had annual wages of $40,000 or less



Source: JLARC staff analysis of DOR data providing beneficiary-reported job numbers and wage categories.

Legislature set the wage threshold in 1997. It has not been updated.

Statute does not adjust the $40,000 wage threshold for inflation. It is now below average wages. However, even adjusted for inflation, the threshold would be lower than the 2021 statewide average annual wage.

- $40,000 in June 1997 is equivalent to $70,000 in December 2021.
- When the wage threshold was set in 1997, it exceeded both that year's rural county average wage of $23,300 and the statewide average wage of $30,800.
- The threshold is now below rural and state averages. Based on Bureau of Labor Statistics data, in 2021 the rural county average wage was $49,900 and the statewide average wage was $82,500. This is the most current data available.

4. Economic model estimates state's break-even point at 19 jobs

Economic model suggests that if the preference led businesses to create 19 of the 1,041 new jobs, the state would break even

The 1997 Legislature stated that the preference was intended to help businesses create jobs.

- Between fiscal years 2015 and 2020, 36 businesses in 18 rural counties qualified for the tax credits.
- These businesses reported creating 1,041 new jobs, with a total credit value of $3 million.

Available data, such as the reports filed with the Department of Revenue (DOR), do not indicate how many of the new jobs were created because of the preference. In lieu of information about the preference's impact on job creation, JLARC staff estimated the preference's break-even point.

Economic model estimates the value of the jobs outweighs the costs if at least 19 of the new jobs were due to the preference

When businesses claim the tax credits, their costs go down and they may add jobs. At the same time, there is a loss in state revenue. The model assumes that there is a corresponding reduction in state spending.

The model estimated that if at least 19 of the 1,041 jobs (2%) were created due to the preference, the state would break even. The model also suggested that job losses and gains related to this preference tend to be concentrated in the rural counties. More detail is in Appendix B.

JLARC staff modeled the preference's break-even point

Break even means the new jobs created by beneficiary businesses fully offset the jobs lost due to lower state spending.
In short, it's the point where there is no net loss of jobs statewide.

5. Preference use has declined

Preference use has not reached expected levels and is declining

Preference use declined over the eight-year study period, dropping from $1.5 million to $291,000

In fiscal years 2015 through 2022, 89 businesses claimed credits earned from the preference. This includes some of the 36 businesses that qualified in this time (Section 2) and some that carried the credits forward after qualifying in previous years.

- Beneficiary businesses claimed $8 million in business and occupation (B&O) tax credits over the eight fiscal years.
- Use dropped from $1.5 million in fiscal year 2015 to $291,000 in fiscal year 2022. This is an 81% decline.

Credit use was 4% to 22% of the maximum allowed each year

The Legislature capped the amount of credit that could be claimed at $7.5 million per fiscal year.

- In fiscal years 2015 through 2022, the average total beneficiary savings was $1 million per fiscal year.
- The average annual credit claimed was 13% of the maximum. It fell from 21% in fiscal year 2015 to 4% in fiscal year 2022.
- A JLARC review of this preference in 2013 also found low use. In fiscal years 2006 through 2012, the average beneficiary savings per fiscal year was $1.7 million (23% of the maximum).

Exhibit 5.1: Beneficiary savings have declined annually and are estimated to be $582,000 in the 2025-2027 biennium

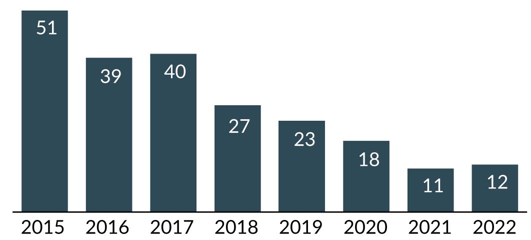
Biennium	Fiscal Year	Estimated Beneficiary Savings	Percent of $7.5 Million Maximum Credit Used
2013-15 *7/1/13 - 6/30/15*	2015	$1,540,000	21%
2015-17 *7/1/15 - 6/30/17*	2016	$1,316,000	18%
	2017	$1,667,000	22%
2017-19 *7/1/17 - 6/30/19*	2018	$1,065,000	14%
	2019	$1,283,000	17%
2019-21 *7/1/19 - 6/30/21*	2020	$466,000	6%
	2021	$388,000	5%
2021-23 *7/1/21 - 6/30/23*	2022	$291,000	4%
	2023	$291,000	
2023-25 *7/1/23 - 6/30/25*	2024	$291,000	
	2025	$291,000	
2025-27 *7/1/25 - 6/30/27*	2026	$291,000	
	2027	$291,000	
	2025-2027 biennium	$582,000	

Source: JLARC staff analysis of DOR tax return credit detail, July 1, 2014, to June 30, 2022.

Number of businesses claiming the preference also has decreased

The number of businesses claiming credits fell from 51 in fiscal year 2015 to 12 in fiscal year 2022. This is a 76% decline.

Exhibit 5.2: Number of beneficiaries using credit declined 76%



Source: JLARC staff analysis of DOR tax return credit detail.

Both large and small businesses claim the credit

According to Department of Revenue (DOR) records, 75% of the 89 businesses had gross income of $57 million or less in fiscal year 2022. The remaining 25% had gross income greater than $57 million. The credit amounted to 0.13% of the gross income reported for all 89 businesses in fiscal year 2022.

Respondents to JLARC staff's survey said the preference had a neutral impact on location and hiring decisions

JLARC staff surveyed the 89 businesses that used the preference in fiscal years 2015 through 2022. Thirteen business responded.

- On a scale of 1 to 5:
    - Respondents rated the preference a 2.6 in their decision to locate in a rural county or CEZ.
    - Respondents rated the preference a 3.1 in their decision to create new jobs.
- When asked if they would use the credit again:
    - Six said yes.
    - Four said no (two are now closed).
    - Three were unsure.

Most businesses replying to JLARC staff's survey stated that the $2,000 and $4,000 amounts of credits do not appear to be problematic. However, one respondent noted the credit amounts are too small to affect hiring decisions.

JLARC staff also spoke with staff at the Department of Commerce. They agreed that the credit amounts are not problematic. They stated that they regularly market the preference to businesses considering rural locations and the reactions are "very positive."

6. Applicable statutes

Sections of Chapter 82.62 RCW

82.62.010 Definitions.

82.62.020 Application for tax credits—Contents.

82.62.030 Allowance of tax credits—Limitations—Expiration.

82.62.045 Tax credits for eligible business projects in designated community empowerment zones.

82.62.050 Tax credit recipients to report to department—Payment of taxes and interest by ineligible recipients.

82.62.060 Employment and wage determinations.

82.62.080 Applications, reports, and other information subject to disclosure.

82.62.901 Effective date—1986 c 116 §§ 15-20.

Definitions

RCW 82.62.010

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

1. "Applicant" means a person applying for a tax credit under this chapter.
2. "Department" means the department of revenue.
3. "Eligible area" means a "rural county" as defined in RCW 82.14.370.
4.
    a. "Eligible business project" means manufacturing or research and development activities which are conducted by an applicant in an eligible area at a specific facility, provided the applicant's average qualified employment positions at the specific facility will be at least fifteen percent greater in the four consecutive full calendar quarters after the calendar quarter during which the first qualified employment position is filled than the applicant's average qualified employment positions at the same facility in the four consecutive full calendar quarters immediately preceding the calendar quarter during which the first qualified employment position is filled.

    b. "Eligible business project" does not include any portion of a business project undertaken by a light and power business as defined in RCW 82.16.010 or that portion of a business project creating qualified full-time employment positions outside an eligible area.

5. "First qualified employment position" means the first qualified employment position filled for which a credit under this chapter is sought.
6. "Manufacturing" means the same as defined in RCW 82.04.120. "Manufacturing" also includes:
    a. Before July 1, 2010: (i) Computer programming, the production of computer software, and other computer-related services, but only when the computer programming, production of computer software, or other computer-related services are performed by a manufacturer as defined in RCW 82.04.110 and contribute to the production of a new, different, or useful substance or article of tangible personal property for sale; and (ii) the activities performed by research and development laboratories and commercial testing laboratories; and
    b. Beginning July 1, 2010, the activities performed by research and development laboratories and commercial testing laboratories.
7. "Person" has the meaning given in RCW 82.04.030.
8.
    a. (i) "Qualified employment position" means a permanent full-time employee employed in the eligible business project during four consecutive full calendar quarters. (ii) For seasonal employers, "qualified employment position" also includes the equivalent of a full-time employee in work hours for four consecutive full calendar quarters.
    b. For purposes of this subsection, "full time" means a normal workweek of at least thirty-five hours.
    c. Once a permanent, full-time employee has been employed, a position does not cease to be a qualified employment position solely due to periods in which the position goes vacant, as long as: (i) The cumulative period of any vacancies in that position is not more than one hundred twenty days in the four-quarter period; and (ii) During a vacancy, the employer is training or actively recruiting a replacement permanent, full-time employee for the position.
9. "Recipient" means a person receiving tax credits under this chapter.
10. "Research and development" means the development, refinement, testing, marketing, and commercialization of a product, service, or process before commercial sales have begun, but only when such activities are intended to ultimately result in the production of a new, different, or useful substance or article of tangible personal property for sale. As used in this subsection, "commercial sales" excludes sales of prototypes or sales for market testing if the total gross receipts from such sales of the product, service, or process do not exceed one million dollars.

11. "Seasonal employee" means an employee of a seasonal employer who works on a seasonal basis. For the purposes of this subsection and subsection (12) of this section, "seasonal basis" means a continuous employment period of less than twelve consecutive months.
12. "Seasonal employer" means a person who regularly hires more than fifty percent of its employees to work on a seasonal basis.

Application for tax credits—Contents.

RCW 82.62.020

Application for tax credits under this chapter must be made within ninety consecutive days after the first qualified employment position is filled. The application shall be made to the department in a form and manner prescribed by the department. The application shall contain information regarding the location of the business project, the applicant's average employment, if any, at the facility for the four consecutive full calendar quarters immediately preceding the earlier of the calendar quarter during which the application required by this section is submitted to the department or the first qualified employment position is filled, 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 shall prescribe a method for calculating a seasonal employer's average employment levels. The department shall rule on the application within sixty days.

Allowance of tax credits—Limitations—Expiration

RCW 82.62.030

1.
    a. A person shall be allowed a credit against the tax due under chapter 82.04 RCW as provided in this section. The credit shall equal:
        i. Four thousand dollars for each qualified employment position with wages and benefits greater than forty thousand dollars annually that is directly created in an eligible business project and
        ii. Two thousand dollars for each qualified employment position with wages and benefits less than or equal to forty thousand dollars annually that is directly created in an eligible business project.
    b. For purposes of calculating the amount of credit under (a) of this subsection with respect to qualified employment positions as defined in RCW 82.62.010(8)(a)(ii):
        i. In determining the number of qualified employment positions, a fractional amount is rounded down to the nearest whole number; and
        ii. Wages and benefits for each qualified employment position shall be equal to the quotient derived by dividing: (A) The sum of the wages and benefits earned for the four consecutive full calendar quarter period for which a

credit under this chapter is earned by all of the person's new seasonal employees hired during that period; by (B) the number of qualified employment positions plus any fractional amount subject to rounding as provided under (b)(i) of this subsection. For purposes of this chapter, a credit is earned for the four consecutive full calendar quarters after the calendar quarter during which the first qualified employment position is filled.

2. The department shall keep a running total of all credits allowed under this chapter during each fiscal year. The department shall not allow any credits which would cause the total to exceed seven million five hundred thousand dollars in any fiscal year. If all or part of an application for credit is disallowed under this subsection, the disallowed portion shall be carried over to the next fiscal year. However, the carryover into the next fiscal year is only permitted to the extent that the cap for the next fiscal year is not exceeded.
3. No recipient may use the tax credits to decertify a union or to displace existing jobs in any community in the state.
4. (a) The credit may be used against any tax due under chapter 82.04 RCW, and, except as otherwise provided under this subsection (4), may be carried over until used.

   (b) Credits earned expire the first day of January of the year that is six years from the later of the year that:(i) The department is notified by the recipient, or a representative of the recipient, that the recipient has ceased engaging in business within this state as those terms are defined in chapter 82.04 RCW;(ii) The department closes the recipient's tax reporting account; or(iii) The recipient last claimed the credit on a return filed with the department.
5. No refunds may be granted for unused credits under this section.

Tax credits for eligible business projects in designated community empowerment zones.

RCW 82.62.045

1. For the purposes of this section "eligible area" also means a designated community empowerment zone approved under RCW 43.31C.020.
2. An eligible business project located within an eligible area as defined in this section qualifies for a credit under this chapter for those employees who at the time of hire are residents of the community empowerment zone in which the project is located, if the fifteen percent threshold is met. As used in this subsection, "resident" means the person makes his or her home in the community empowerment zone. A mailing address alone is insufficient to establish that a person is a resident for the purposes of this section.
3. All other provisions and eligibility requirements of this chapter apply to applicants eligible under this section.

Tax credit recipients to report to department—Payment of taxes and interest by ineligible recipients.

RCW 82.62.050

1. Each recipient shall submit a report to the department by the last day of the month immediately following the end of the four consecutive full calendar quarter period for which a credit under this chapter is earned. The report shall contain information, as required by the department, from which the department may determine whether the recipient is meeting the requirements of this chapter. If the recipient fails to submit a report or submits an inadequate report, the department may declare the amount of taxes for which a credit has been used to be immediately assessed and payable. The recipient must keep records, such as payroll records showing the date of hire and employment security reports, to verify eligibility under this section.
2. If, on the basis of a report under this section or other information, the department finds that a business project is not eligible for tax credit under this chapter for reasons other than failure to create the required number of qualified employment positions, the amount of taxes for which a credit has been used for the project shall be immediately due.
3. If, on the basis of a report under this section or other information, the department finds that a business project has failed to create the specified number of qualified employment positions, the department shall assess interest, but not penalties, on the credited taxes for which a credit has been used for the project. The interest shall be assessed at the rate provided for delinquent excise taxes, shall be assessed retroactively to the date of the tax credit, and shall accrue until the taxes for which a credit has been used are repaid.

Employment and wage determinations.

RCW 82.62.060

The employment security department shall make, and certify to the department of revenue, all determinations of employment and wages requested by the department under this chapter.

Applications, reports, and other information subject to disclosure.

RCW 82.62.080

Applications, reports, and any other information received by the department under this chapter, except applications not approved by the department, are not confidential and are subject to disclosure.

Effective date—1986 c 116 §§ 15-20.

RCW 82.62.901

Sections 15 through 20 of this act are necessary for the immediate preservation of the public peace, health, and safety, the support of the state government and its existing public institutions, and shall take effect April 1, 1986.

Appendix A: What is REMI?

What is REMI?

JLARC staff used Regional Economic Models, Inc.'s (REMI) 39-region (counties), 70 industry sector Tax-PI software (version 3.0) to model impacts of the B&O tax credit for new jobs created in rural counties and community empowerment zones (CEZs).

Multiple state governments, 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 estimate 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 regional 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 changes in business expenditures due to a tax preference and from changes in spending by government due to the associated revenue changes).
- 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 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 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 target 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 an economic and revenue forecast after incorporating 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 employment impacts associated with the B&O tax credit for rural and CEZ job creation

JLARC staff used Regional Economic Model, Inc.'s 39-region (counties), 70 industry sector Tax-PI software (version 3.0.0) to model scenarios that illustrate potential employment effects if the business and occupation (B&O) tax credit for new jobs created in rural counties and community empowerment zones (CEZs) were removed. See Appendix A for an overview of the REMI model.

This technical appendix provides context and supporting information for the analysis summarized in Section 4 of this report.

REMI methodology

Parameters reflect current patterns of revenue and spending

Before modeling policy scenarios, JLARC staff set parameters by calibrating the model to the state budget. JLARC staff used the November 2022 revenue estimates produced by the Economic and Revenue Forecast Council (ERFC) and budgeted appropriations from the 2022 state operating budget, as reported by the Legislative Evaluation and Accountability Program (LEAP) Committee. These sources provide the revenue and budget 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 might 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.

Model data comes from state and federal sources

The REMI model includes historical and demographic data since 2001. 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 and on applications and annual survey report submitted to the Department of Revenue (DOR).

Model inputs based on annual reports provided by Department of Revenue

JLARC staff based the inputs used to model the repeal of the B&O tax credit on beneficiary taxpayer detail collected by DOR. This information includes the number of jobs created and retained over four consecutive quarters and the total amount of the credit, as determined by the wages paid to each qualifying employee. Because some counties had fewer than three beneficiary business, JLARC staff created eight county clusters for the purposes of modeling the estimated impact of repealing the preference. A total amount was calculated and used to increase the manufacturing industry’s production costs in each county cluster. An equivalent aggregate total was also calculated and applied as new state spending.

A total of 36 businesses in 18 rural counties qualified for the B&O credit from fiscal year 2015 through 2020. These businesses reported creating 1,041 new jobs, with a total credit value of $3.04 million. None of the qualifying businesses were in a CEZ.

The B&O tax credit is available to businesses creating jobs in manufacturing, research and development, or commercial testing. However, NAICS code detail provided by DOR indicates that 83% of the qualifying businesses in the study period are manufacturers. JLARC staff modeled the employment impacts of the preference by removing jobs from the manufacturing industry in the counties where the qualifying businesses are located.

Modeled scenarios estimate the employment impact if the B&O tax credit were removed

The B&O tax credit for new jobs created in rural counties and CEZs has existed since the late 1980s. As such, the 1,041 new jobs reported from fiscal year 2015 through 2020 (see Section 2) are included in REMI's historical and baseline data. Because Tax-PI is a forecasting tool, JLARC staff could not model the employment impacts of this credit beginning in 2015.

Instead, JLARC staff modeled the potential impacts of the preference by developing scenarios that illustrate the repeal of the credit. The scenarios include three main policy changes, modeled against REMI's baseline forecast of the Washington economy. Repealing the preference:

1. Would increase production costs for the manufacturing industry in counties where beneficiary businesses are located.
2. Would result in increased tax revenue, which the state would spend on its operating budget.
3. May result in the loss of some of the qualifying jobs.

It is difficult to objectively determine how many of the new jobs were created as a direct result of the preference (i.e., how many of these new jobs would not exist but for the preference). Likewise, it is unknown how many of these jobs would be lost if the preference were repealed.

However, it is possible to estimate a range of net employment changes based on different assumptions about how the preference may impact manufacturing employment in rural counties. Therefore, the primary way the scenarios differ is in the assumptions about how many jobs might be lost if the preference is repealed.

Economic model estimates statewide employment breaks even if 19 direct jobs were lost due to the removal of the preference

The analyses of net employment changes are based on potential job losses at qualifying facilities plus potential statewide job gains due to increased state spending. The numbers below reflect the total job impacts (direct, indirect, and induced) of repeal, as well as the assumed increased production costs for beneficiary businesses and an equivalent increase in government spending.

In the two scenarios below, when the B&O tax credit is repealed, the model shows a decrease in jobs at the businesses that used the credit. There is also an increase in state revenue and a corresponding increase in state spending.

1. The first scenario uses the midpoint, assuming that 50% of the jobs associated with the preference would be lost.
    - If 520 (50%) of the 1,041 jobs created during the study period were eliminated, the state would see a total job loss of 1,351 jobs. 1,114 of those jobs (82%) would be lost in the 18 rural counties where beneficiaries are located.
2. The second scenario focuses on the break-even point for statewide employment. This is the amount of lost economic activity that would negate the employment gains associated with increased state spending.
    - If 19 (1.8%) of the 1,041 jobs created during the study period were eliminated, statewide employment would break even. That is, there would be no net job loss statewide.
    - However, the rural counties where these businesses are located would still see 42 jobs lost.

RECOMMENDATIONS & RESPONSES

Legislative Auditor's Recommendation

Legislative Auditor's Recommendation: Continue and modify

The Legislature should continue the preference because it has been used by businesses that created jobs in rural counties and community empowerment zones. Economic modeling suggests that the state would break even if the preference caused only 2% of the jobs. It is unclear why use of the preference has declined.

The Legislature should modify the preference to promote and increase family wage jobs in rural counties. For example, the Legislature might consider increasing the wage threshold to reflect current economic conditions and linking future increases to inflation or wage benchmarks.

The Legislature should modify the preference to potentially increase the number of businesses applying for the credit. For example, the Legislature might considers increasing the credit amounts, tying future increases to inflation, or extending the preference to other industry sectors that could benefit rural counties.

Legislation Required: Yes

Fiscal Impact: Depends on legislative action

Letter from Commission Chair

JLARC WASHINGTON | Citizen Commission for Performance Measurement of Tax Preferences

106 11th Ave SW, PO Box 40910, Olympia, WA 98504-0910 | (360) 786-5171
jlarc@leg.wa.gov | www.citizentaxpref.wa.gov | @WALegAuditor

November 2, 2023

The Honorable Senator June Robinson
The Honorable Senator Lynda Wilson
The Honorable Senator Marko Liias
The Honorable Senator Curtis King
The Honorable Senator Jake Fey
The Honorable Representative Andrew Barkis
The Honorable Representative Timm Ormsby
The Honorable Representative Chris Corry
The Honorable Representative April Berg
The Honorable Representative Cyndy Jacobsen
The Honorable Representative Cindy Ryu
The Honorable Representative Mike Volz

Re: 2023 Tax Preference Reviews

Dear Senators and Representatives:

I am pleased to be forwarding to you the comments that the Citizen Commission for Performance Measurement of Tax Preferences **unanimously adopted for this year's review of tax preferences**. Our comments are informed by JLARC staff work, public testimony, and our professional knowledge of Washington's tax structure.

The Citizen Commission consists of five voting members appointed by each of the four caucuses and the Governor's office and represent a broad range of ideologies and professional backgrounds. Members include a retired tax attorney and CPA, the president of the Edmonds Education Association, a University of Washington public policy professor, a retired K-12 teacher, and myself, the Chief Economist at Avista. Notably, reviews this year included:

Five Legislative Auditor recommendations that require legislative action:

- A review of **Interstate Transportation Tax Preferences**, in which the Legislative Auditor recommends **clarifying** the objectives. The four preferences are no longer necessary to comply with the Constitution, but the Legislature may have other objectives. The 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.
- A review of a preference for **Rural County and CEZ New Jobs**, in which the Legislative Auditor recommends **continuing and clarifying the preference**. 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.
- A review of a preference for **International Services**, in which the Legislative Auditor recommends **terminating the preference.** Use of the preference is 99% lower than originally expected and it has not met the goal of attracting and retaining jobs.

COMMISSION MEMBERS
Dr. Grant Forsyth, *Chair*
Avista Corp.

Andi Nofziger-Meadows, *Vice Chair*
Edmonds Education Association

Ronald Bueing

Dr. Sharon Kioko
Evans School of Public Policy and Governance
University of Washington

James Orr

NON-VOTING MEMBERS
Senator Mark Mullet
Chair, Joint Legislative Audit & Review Committee

Pat McCarthy
State Auditor

Letter from Commission Chair

- A review of a **Hazardous Substance Tax Exemption for Pesticides Sold Out of State**, in which the Legislative Auditor recommends **continuing and modifying the preference**. It improves industry competitiveness, but the increase in total hazardous substance tax revenue is likely not due to the preference.
- A review of a preference for **Historic Ships and Vessels**, in which the Legislative Auditor recommends **clarifying the objective**. It is unclear if the preference met the inferred goal of keeping historic vessels in Washington. Owners of eleven historic vessels saved an estimated $21,000 in 2023.

One Legislative Auditor recommendation that does not require legislative action:

- A review of a preference for **Rehabilitated Historic Properties**, in which the Legislative Auditor recommends **continuing the preference** because it is meeting its objective to promote historic property revitalization. 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.

The Commission endorses all of the Legislative Auditor's recommendations. **The full text of the Commission's comments is attached and will be added to JLARC's proposed final reports in November**. Summaries of the JLARC staff's analysis and recommendations and brief videos of each review are available here.

As Chair of the Citizen Commission, I would be pleased to discuss the Commission's position and comments with you and any interested legislators. These reviews provide valuable information as the Legislature considers whether individual preferences are meeting policy objectives. Please feel free to contact me (grant.forsyth@leg.wa.gov) or the Legislative Auditor, Eric Thomas (eric.thomas@leg.wa.gov or 360-786-5182).

Sincerely,

Grant D. Forsyth

Grant D. Forsyth, Chair
Citizen Commission for Performance Measurement of Tax Preferences

Commissioners' Recommendation

The Commission endorses the Legislative Auditor's recommendation with comment. The Legislature should modify the preference to increase the number of businesses applying for the credit. This may require a more in-depth study of why use of the preference has declined.

Agency Response

STATE OF WASHINGTON

September 11, 2023

Eric Thomas, Legislative Auditor
Joint Legislative Audit and Review Committee
PO Box 40910
Olympia, WA 98504-0910

Dear Mr. Thomas:

The Office of Financial Management and the Washington State Department of Revenue have reviewed the Joint Legislative Audit and Review Committee's (JLARC) preliminary report on the 2023 tax preference performance reviews. This year's report includes six recommendations in six separate tax reports provided on preferences for interstate transportation, creating jobs in rural counties and CEZs, international business services, storing pesticides sold out of state, historic vessels, and rehabilitating historic properties.

We appreciate JLARC's thorough analysis and the detailed review provided by the Citizen Commission for Performance Measurement of Tax Preferences. A system that provides for a continuous review of state tax preferences is critical to ensure that the state of Washington maintains a fair and equitable tax system.

While we have no specific comments on the 2023 preliminary report, we continue to support JLARC's recommendations for the inclusion of performance statements and public policy objectives for all tax preferences where they do not exist in statute today. We also have reviewed your new racial equity analysis for this report and recognize the challenges you had in obtaining robust race and ethnicity data. As you requested, OFM will schedule a meeting with JLARC and the Equity Office to discuss ways in which you might obtain better data for this review in the future.

Thank you for the opportunity to review this material and the recommendations made by JLARC and provide comments.

Sincerely,

David Schumacher, Director
Office of Financial Management

Drew Shirk, Director
Department of Revenue

cc: Nona Snell, Budget Director, OFM
Rachel Knutson, Senior Budget Advisor, OFM
Kathy Oline, Assistant Director for Research & Fiscal Analysis, DOR

MORE ABOUT THIS REVIEW

Study questions

Click image to view PDF of proposed study questions

Washington JLARC

PROPOSED STUDY QUESTIONS
Rural County and CEZ B&O Job Credit

State of Washington Joint Legislative Audit and Review Committee — UPDATED: December 2022

B&O credits for certain businesses creating new jobs in rural counties or community empowerment zones (CEZs)

In 1986, the Legislature established a B&O tax credit for new jobs created by manufacturing, research and development, and commercial testing businesses that hire workers, originally for economically distressed areas. Since 1999, the preference has been available in either rural counties or CEZs.

- Rural counties have a population density of less than 100 people per square mile or are smaller than 225 square miles.
- CEZs were designated by the Department of Commerce as areas within cities generally characterized by high unemployment and low wages. There are six designated CEZs in the state.

The B&O tax credit levels are equal to:

- $4,000 for each new job with wages and benefits greater than $40,000 a year.
- $2,000 for each new job with wages and benefits of $40,000 or less a year.

A business must apply for the credit, and it must increase employment within one year by at least 15% or repay the credit. Statewide credit is capped at $7.5 million per fiscal year.

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

Legislature stated an intent to promote new and existing businesses and family wage jobs in rural distressed areas

The Legislature stated the objective for this preference in 1997, as part of a larger economic development bill. The public policy objective is to assist "rural distressed areas" in their efforts to address above average unemployment rates and below average employment growth. It also set public policy goals related to promoting ongoing, new, and expanded business activity in rural distressed areas and to providing family wage jobs to citizens of those areas.

This study will address the following questions

1. To what degree has the preference been used and how many new jobs have been created using the preference?
   a. What are the racial and ethnic characteristics of the beneficiaries using the tax preference and the new jobs created?
   b. How do beneficiaries using the preference learn about it?
2. What are the wages of new jobs, and where are those jobs located?
3. Are the qualifying areas experiencing above average unemployment or below average employment growth?

JOINT LEGISLATIVE AUDIT & REVIEW COMMITTEE
106 11th Ave SW, Olympia, WA 98501
Email: JLARC@leg.wa.gov | **Phone:** (360) 786-5171

4. What is the estimated economic impact of the reported new jobs compared to the estimated economic impact of foregone revenue?

In accordance with RCW 44.28.076, JLARC staff determined there are racial equity considerations for this study and they are included in the study questions above.

Study timeframe

Preliminary Report: July 2023 **Proposed Final Report:** December 2023

Study team

Team Lead	Dana Lynn	(360) 786-5177	dana.lynn@leg.wa.gov
Research Analyst	Eric Whitaker	(360) 786-5618	eric.whitaker@leg.wa.gov
Project Coordinator	Eric Thomas	(360) 786-5182	eric.thomas@leg.wa.gov
Legislative Auditor	Keenan Konopaski	(360) 786-5187	keenan.konopaski@leg.wa.gov

JLARC Study Process

Washington Joint Legislative Audit and Review Committee
106 11th Ave SW, Suite 2500
PO Box 40910
Olympia, WA 98504-0910

Phone: 360-786-5171
Email: JLARC@leg.wa.gov