



Preliminary Report

2023 Tax Preference Performance Reviews

Five of six Legislative Auditor recommendations require action.



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August 2023

Second step in public hearings of reviews

July | Present preliminary report to JLARC.

August | Present preliminary report to Citizen Commission.

September | Citizen Commission receives public testimony.

October | Citizen Commission adopts comments on the report.

November | Present proposed final report to JLARC.

Full report:
leg.wa.gov/jlarc/taxReports/2023/overview.html



Video Summary



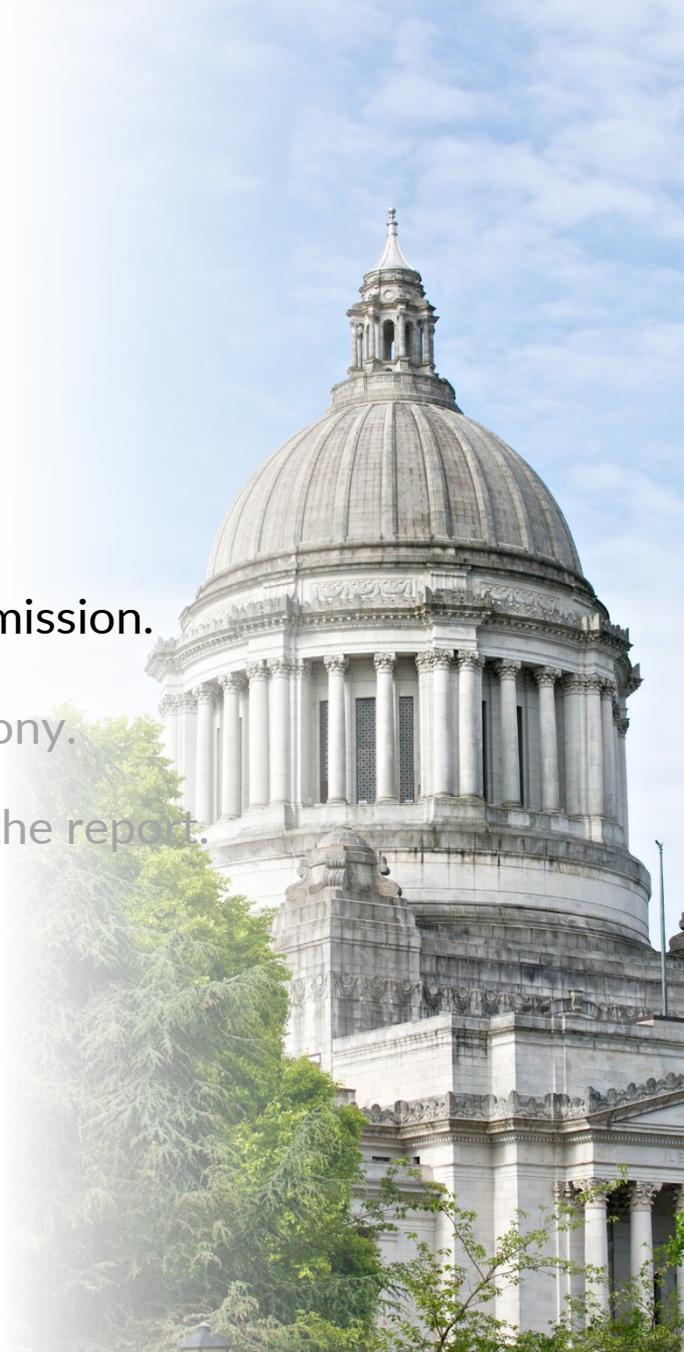
Interactive Data



One Page Overview



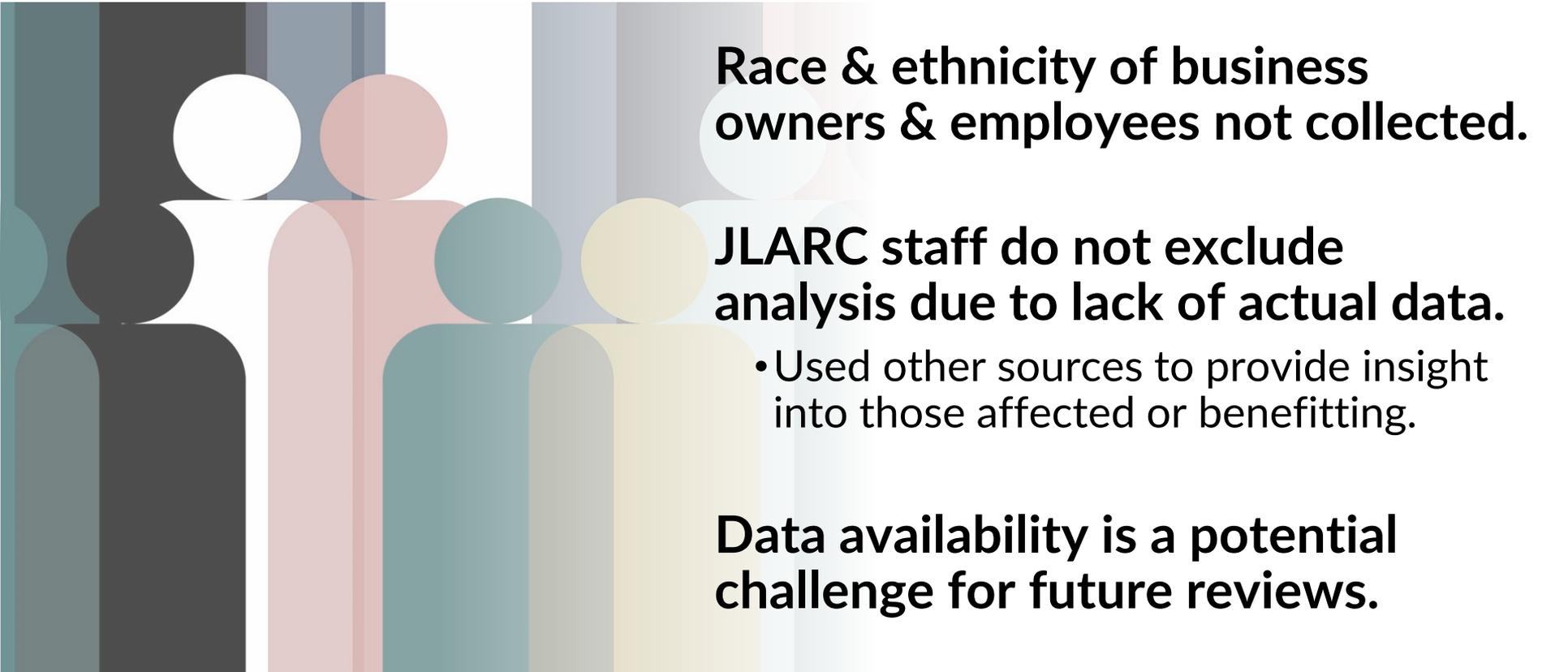
PDF Version





Racial equity analysis

RCW 44.28.076



Race & ethnicity of business owners & employees not collected.

JLARC staff do not exclude analysis due to lack of actual data.

- Used other sources to provide insight into those affected or benefitting.

Data availability is a potential challenge for future reviews.

Presentation Overview

Five recommendations require legislative action:

Interstate Transportation

Rural Counties and CEZ New Jobs

International Services

Pesticides Sold Out of State

Historic Ships and Vessels

One does not require legislative action:

Rehabilitated Historic Properties





PUBLIC UTILITY TAX

Interstate Transportation Tax Preferences

Legislative Auditor's Conclusion: 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.

No expiration date

Estimated 2027-29
Beneficiary Savings:
\$219.8 Million



Overview

- 1 Preferences reduce tax cost for four transportation industries.
- 2 Citizen Commission requested economic analysis.
- 3 Preferences make commercial transportation industry more competitive.



Commercial transportation that takes place entirely within Washington is generally subject to PUT

Tax rate depends on transportation activity:

Activity	PUT Rate
Motor transportation, railroad activities, other public service businesses.	1.926%
Urban transportation and vessels under 65 feet in length.	0.642%
Log hauling over public roads.	1.3696%



Four preferences reduce the Public Utility Tax paid by commercial transportation providers

They exempt earnings from transportation in Washington if the goods move across state or international lines.



Preference 1: In-state portion of interstate transportation

EXEMPT:

Gross earnings
from in-state
portion of
interstate
transportation

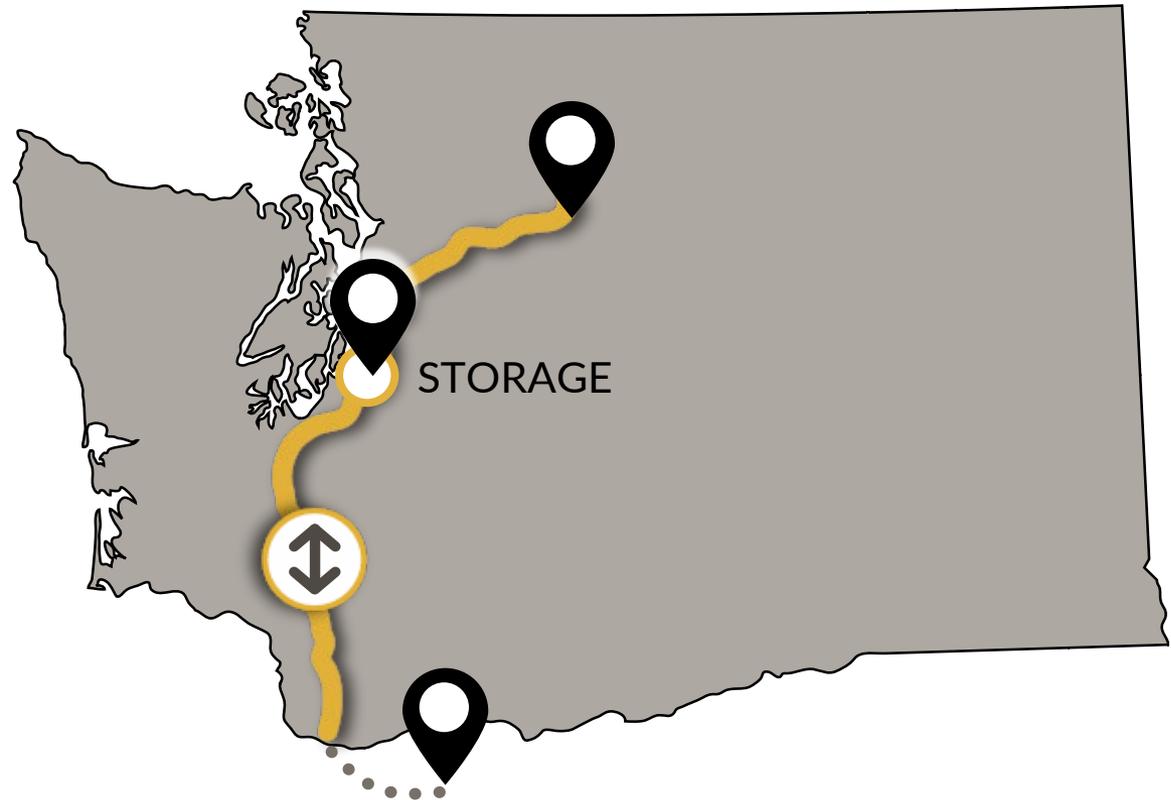




Preference 2: Through freight

EXEMPT:

Gross earnings from the entire in-state portion of interstate freight shipment with stop(s)

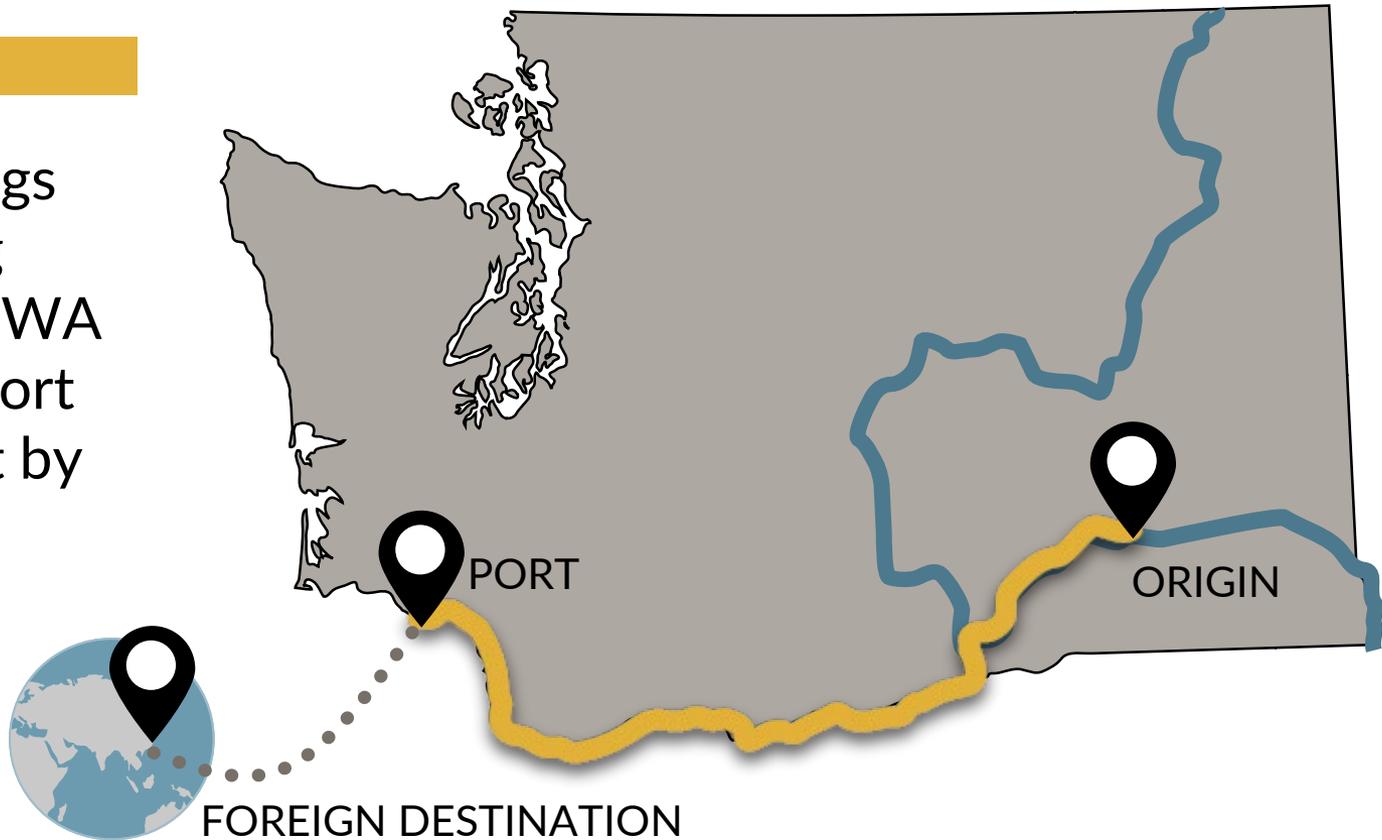




Preference 3: Shipments to port

EXEMPT:

Gross earnings from moving freight from WA location to port for transport by vessel

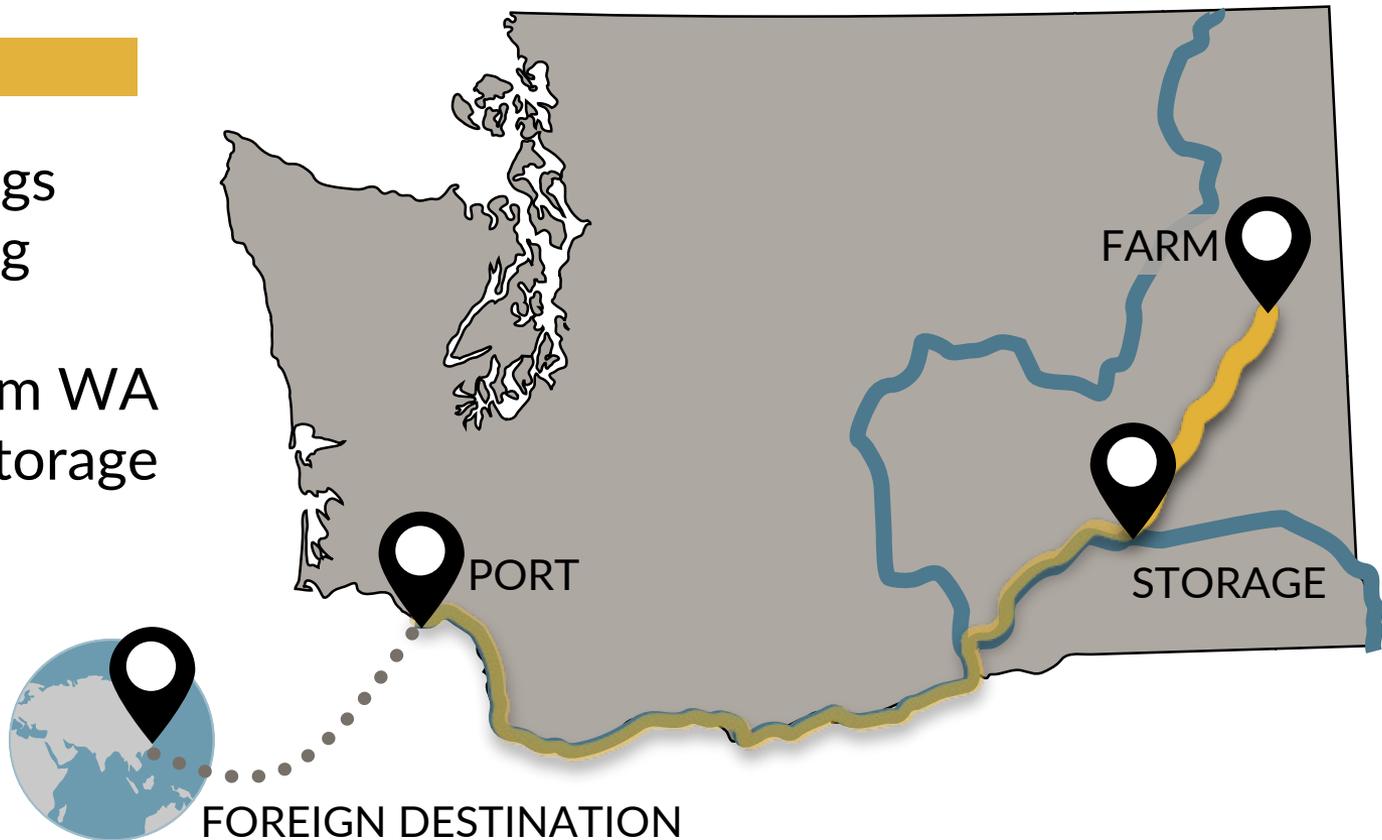




Preference 4: Shipping farm products to port

EXEMPT:

Gross earnings from shipping agricultural products from WA location to storage before port





Citizen Commission requested economic analysis of repealing the preferences

1930s

WA Legislature: 3 preferences enacted.
Comply with U.S. Constitution.

1977

Supreme Court: Gross income tax on interstate transportation is constitutional.

Must meet 4-part test:

Fairly apportioned | Substantial nexus
Nondiscriminatory | Fairly related

2010

JLARC review: terminate or clarify.

Original objective no longer relevant.

Citizen Commission: did not endorse.

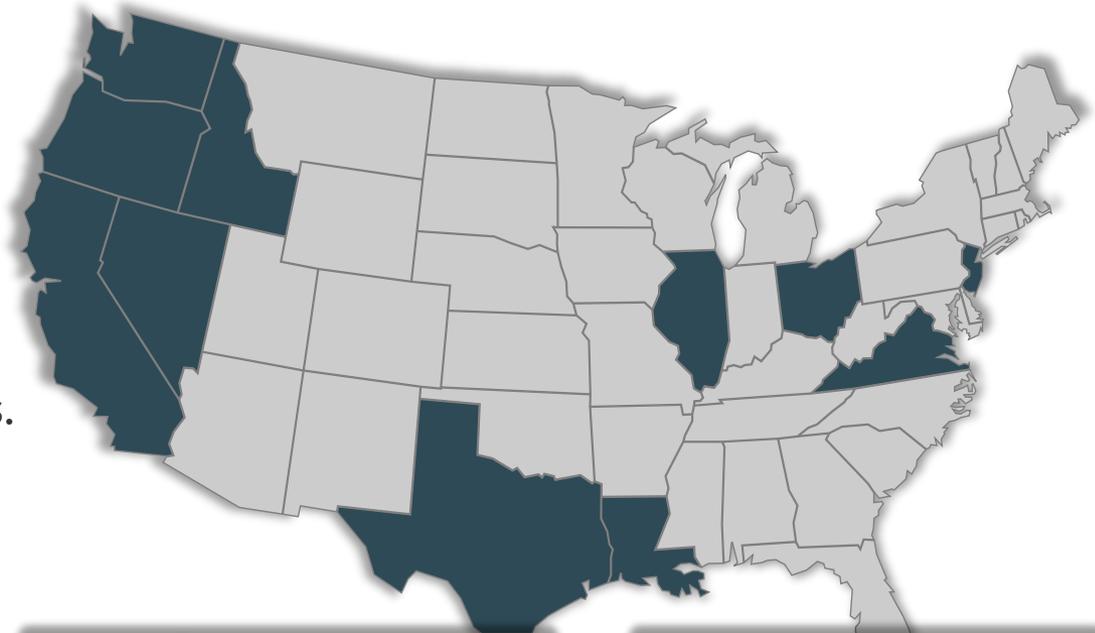
- Termination could have unintended negative consequences.
- Economic analysis needed.

Preferences make WA commercial transportation industry more competitive

Estimated beneficiary savings: \$219.8 million
(2027-29 biennium)

Consultant analysis:

Rail & truck transportation: preferences reduce effective state & local tax to **less than the average of 10 comparison states.**



Applies **states & local taxes** to hypothetical businesses.

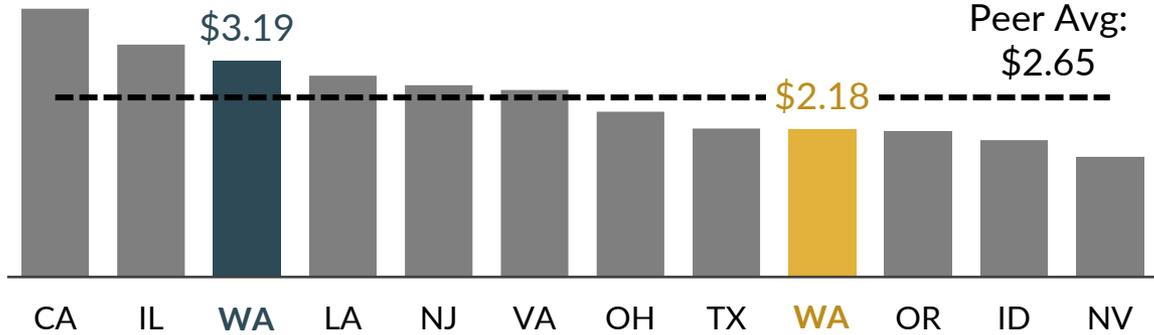
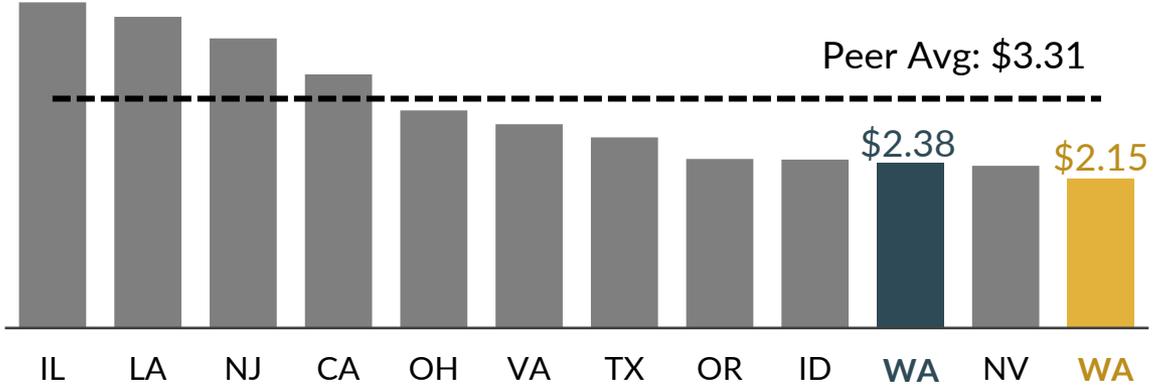


Estimates tax reduction from any **tax preferences.**



Expresses taxes as **\$ per thousand ton-miles.**

WA taxes on interstate rail and truck transportation are lower than average



- WA rate without preferences
- WA rate with preferences

Rates shown in dollars per thousand ton-miles

Preferences support increased freight volume at ports

2010 stakeholders' concern: repeal could affect competitiveness.

- Make WA ports relatively more expensive.
- Reduce freight volume and economic activity.

2023 JLARC staff worked with an expert in supply chains and freight transportation.

Estimated freight diversions if preferences repealed:

Trade Type	Estimated Diversion
Containerized Imports	-0.16%
Containerized Exports	-0.5%
Bulk Grain Exports	-2.7%

Preferences support additional employment for WA transportation industry and its customers

Impact of repeal estimated using economic model of the state economy.

Scenario A

Transportation businesses pass **none** of the tax cost to customers.

Sector	Job Losses	Job Gains	Net Change
Private	-1,730	945	-785
Public	-180	925	745
Total	-1,910	1,870	-40

Mainly:

- Transportation
- Construction
- Manufacturing
- Retail

Scenario B

Transportation businesses pass **all** tax cost to customers.

Sector	Job Losses	Job Gains	Net Change
Private	-1,805	945	-860
Public	-165	925	760
Total	-1,970	1,870	-100

Mainly:

- Manufacturing
- Farming
- Retail
- Transportation
- Forestry, fishing, & hunting



Legislative Auditor's Recommendation

The Legislature should clarify the objectives for these preferences.

- No longer necessary to comply with the Constitution because the U.S. Supreme Court has changed its interpretation of the Commerce Clause.
- The Legislature may have other objectives for the preferences, though it has not stated them in law.



Legislative Auditor's Recommendation

- If the Legislature has other objectives, it should state those objectives and, if applicable, establish measurable criteria.
- If the Legislature's sole objective is to avoid taxing any activity whose taxation is constitutionally prohibited, it should repeal the preferences because a fairly apportioned PUT would be constitutionally permitted.
- Such a change would require a method of apportioning transportation income to activities within the state.



B&O Tax

Rural County and CEZ New Jobs

Legislative Auditor's Conclusion:

The preference was used by 36 businesses over six years to create over 1,000 jobs, but use continues to decline. The wage threshold has not been changed since 1997.

Enacted 1986.
No expiration date

Estimated 2025-27
Beneficiary Savings:
\$582,000

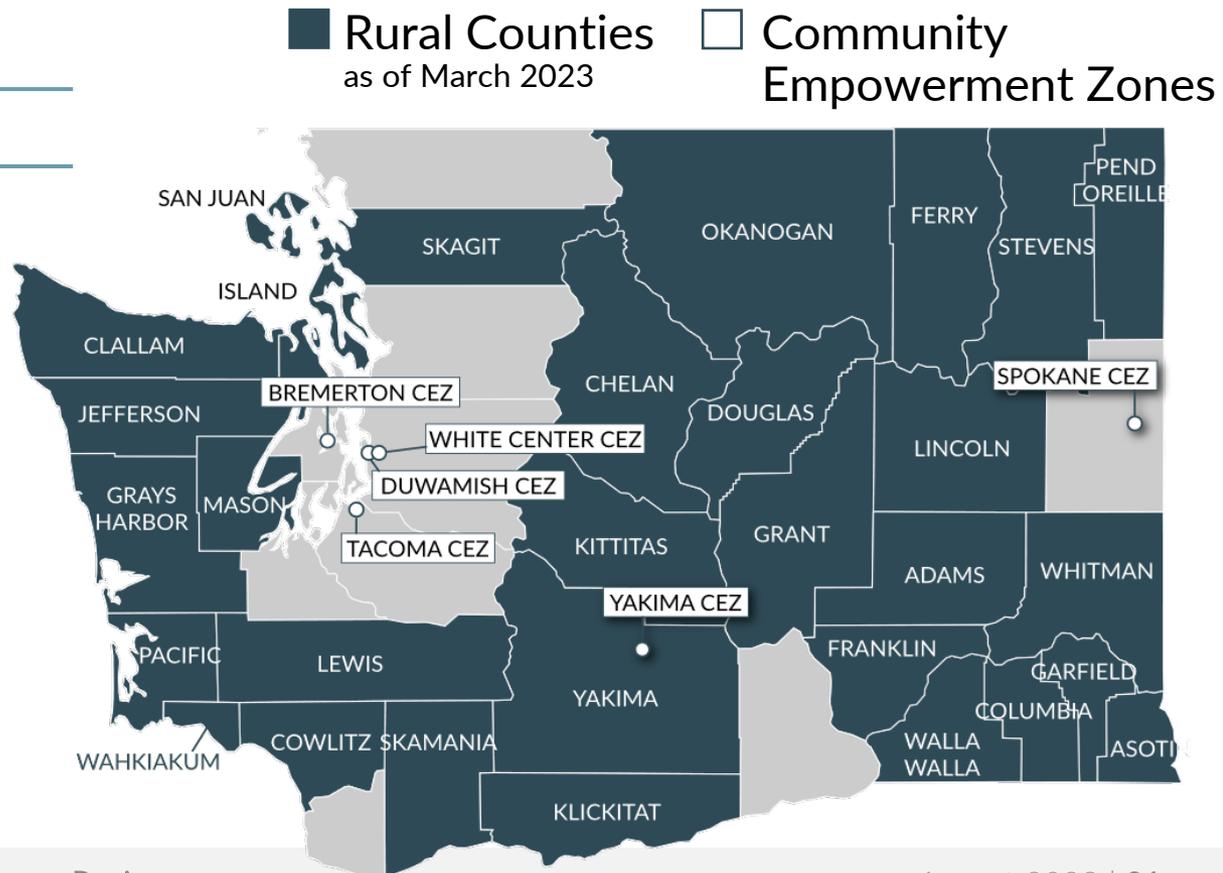
B&O tax credit to promote or attract businesses and create family wage jobs in rural and distressed areas

Credit amounts:

Wages	Credit
\$40K or less	\$2,000
Over \$40K	\$4,000

Manufacturing, R&D, and commercial testing

Maintain job for 1 year to receive credits



Over 1,000 jobs created in 6 years

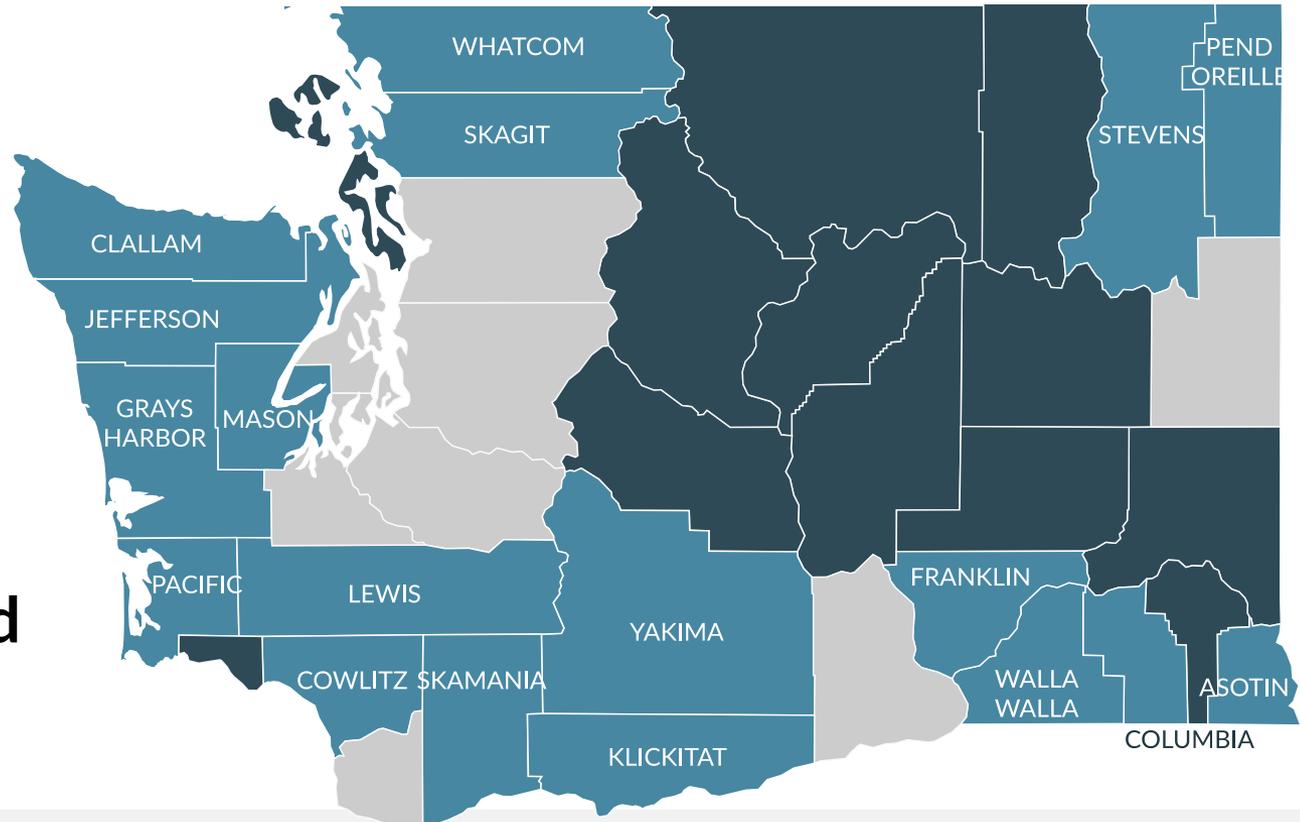
**Jobs created in
18 rural counties**

36 businesses

- 25 expanding
- 11 new
- Most were manufacturers

**54% of jobs paid
\$40,000 or less**

■ Counties with jobs created (FY 15-20)
■ Other rural counties



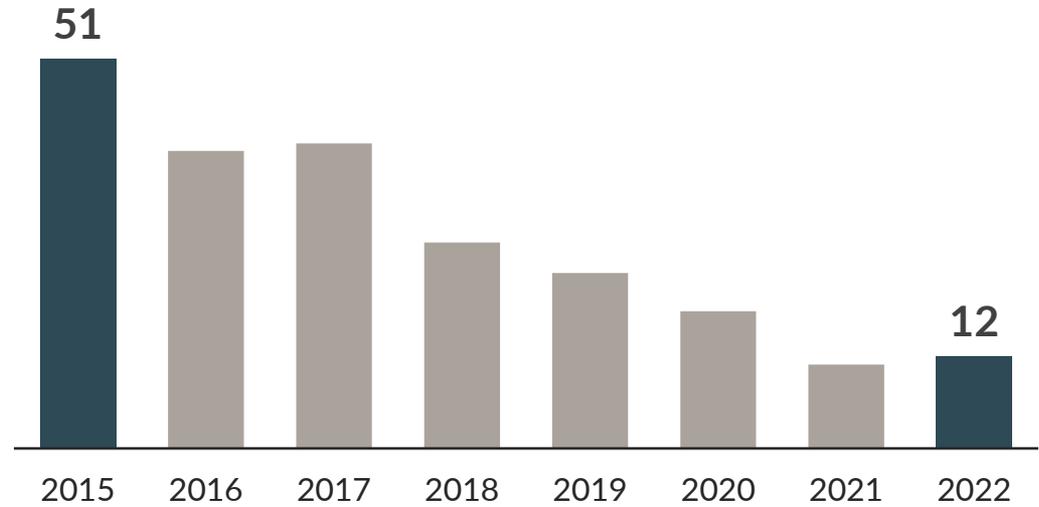


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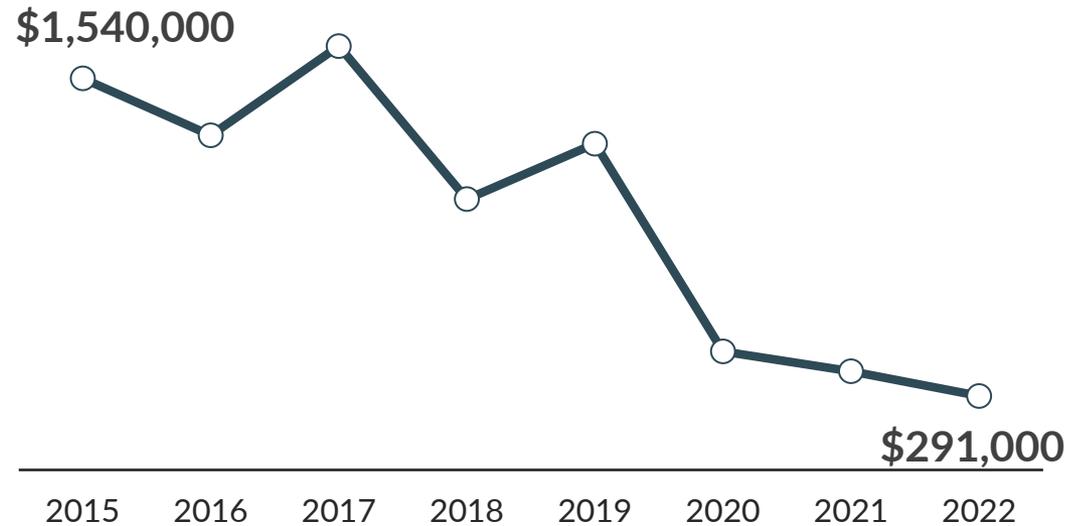
BREAK EVEN POINT

If 2% of the 1,041 new jobs reported are due to the preference, then employment gains offset the job loss associated with lower state spending.

Credit use
declined 76%

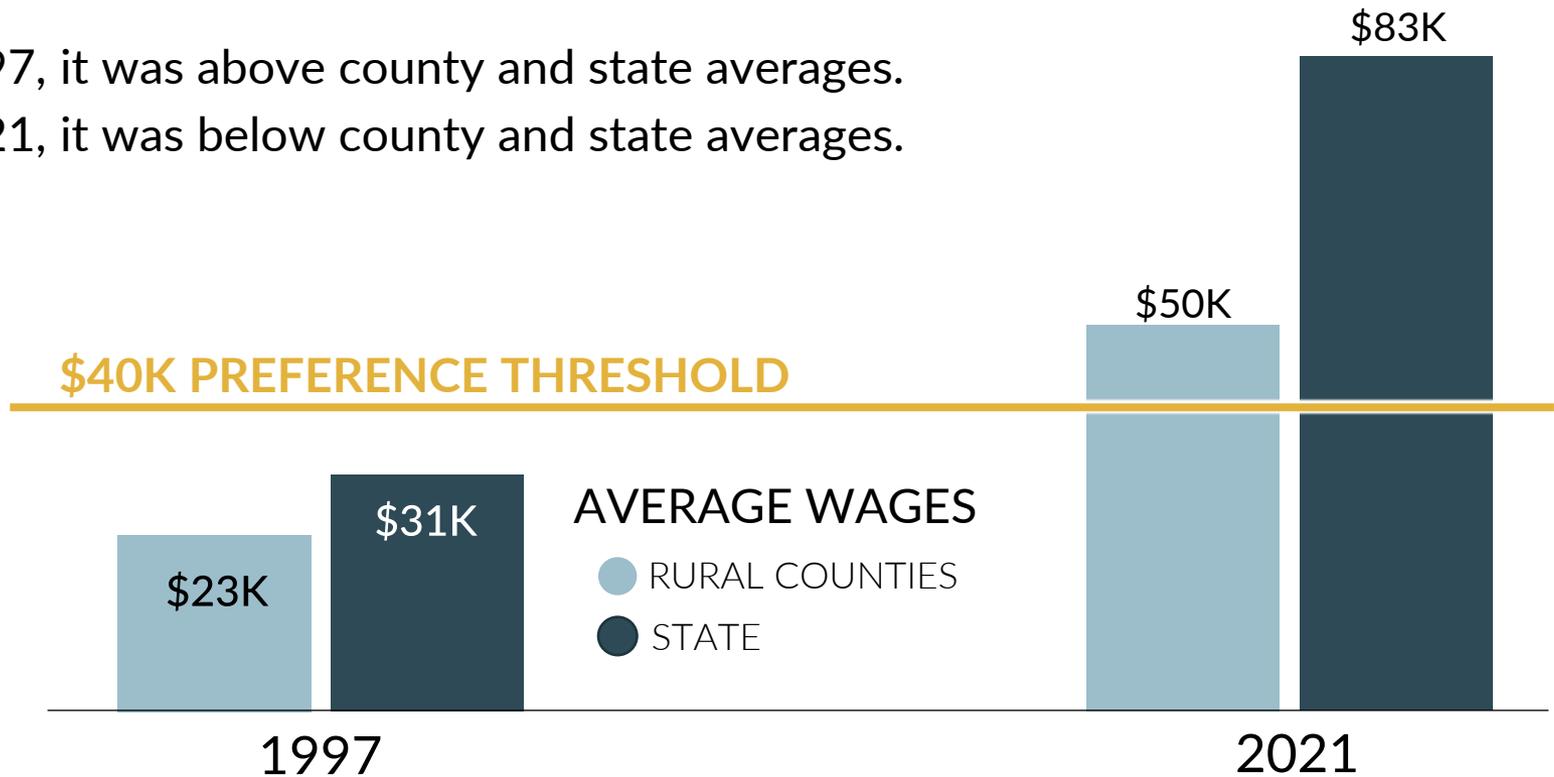


Beneficiary
savings
declined 81%



\$40,000 wage threshold is unchanged since 1997

In 1997, it was above county and state averages.
In 2021, it was below county and state averages.



89 beneficiary businesses surveyed

Preference neutral in:

Location Decisions



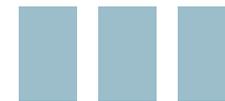
Decisions to Add Jobs



Of the 13 respondents:



6 would use again



3 undecided



4 would not

Department of Commerce markets

“Very positive” responses

The image shows the Washington State Capitol building, a large neoclassical structure with a prominent dome and a portico supported by columns. The building is set against a clear blue sky. In the foreground, there are some people walking on the steps and a green lawn.

Legislative Auditor's Recommendation

Continue and modify.

Continue because 36 businesses created over 1,000 jobs over six years.

Modify to:

- 1) Promote and increase family wage jobs.
- 2) Potentially increase the number of businesses applying for the credit.



B&O Tax

International Services

Legislative Auditor's Conclusion:

Preference use is 99% less than originally expected. It has not met the goal of attracting and retaining jobs.

Enacted 1998.
No expiration date.

Estimated 2025-27
Beneficiary Savings:
\$80,000

B&O tax credit for creating jobs that serve international clients in certain urban areas

Value of the credit is \$3,000 in the first year.

- Maximum value of \$15,000 if job maintained for four additional years.

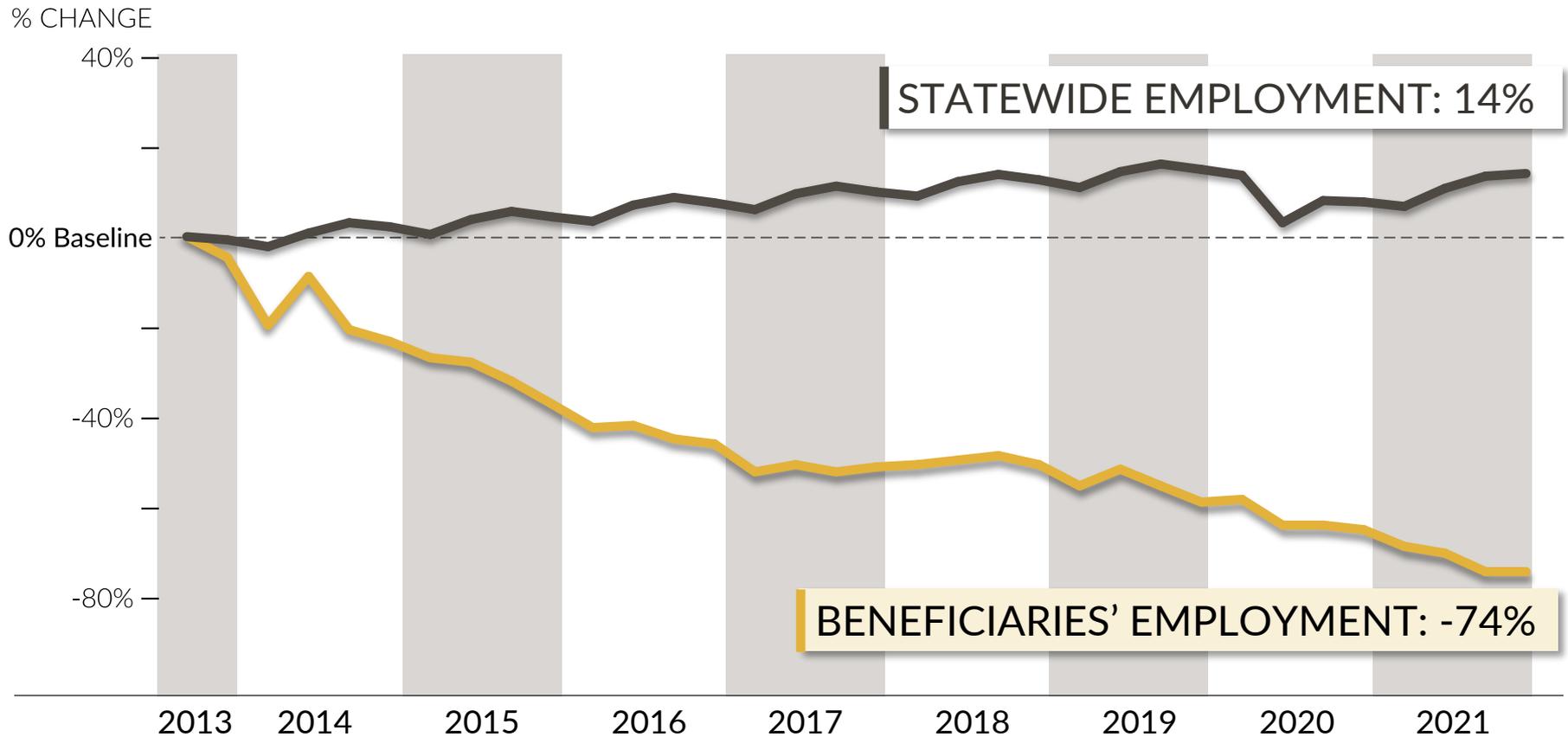


Stated public policy objective:

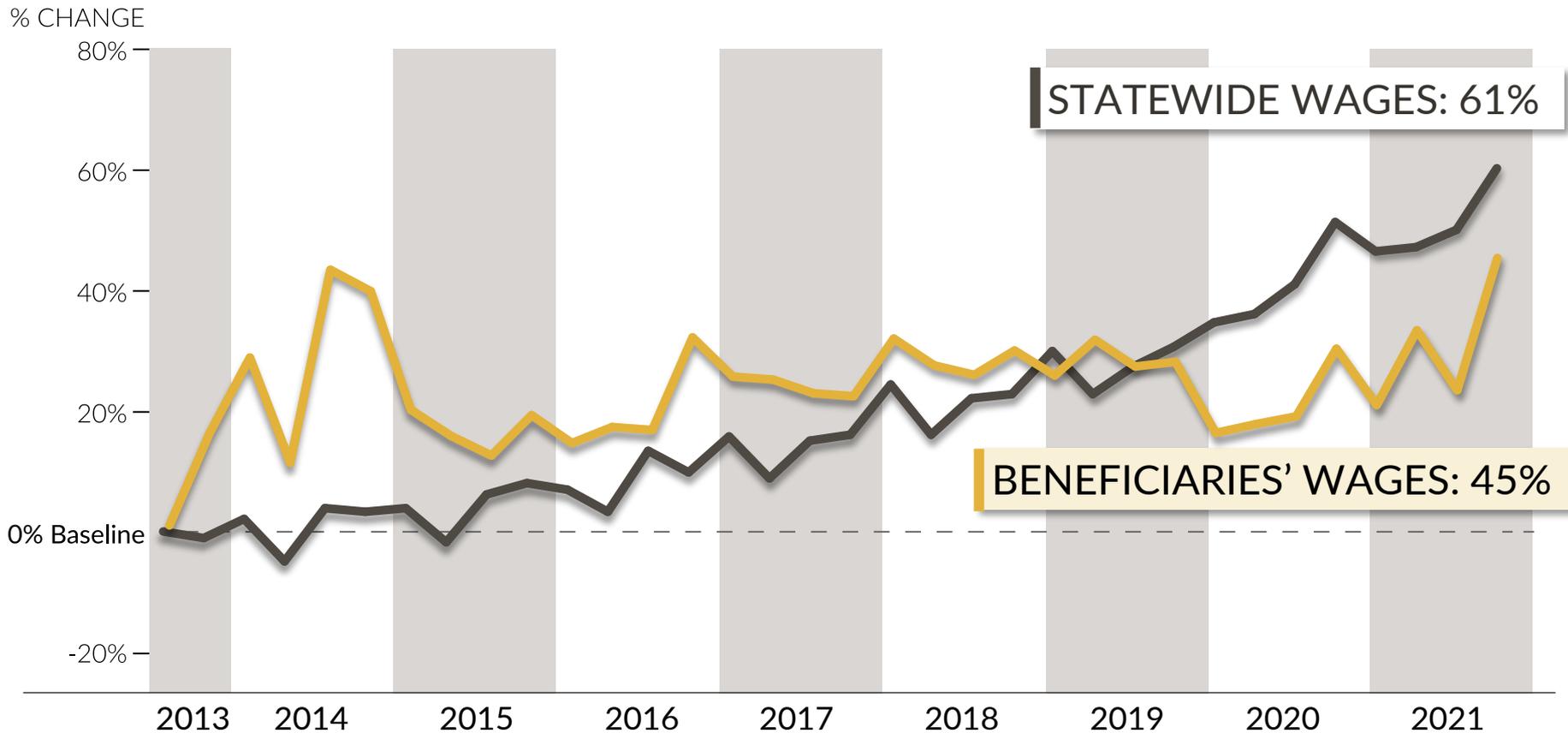
Attract and retain businesses in CEZs and ISDs that provide professional services to international clients.

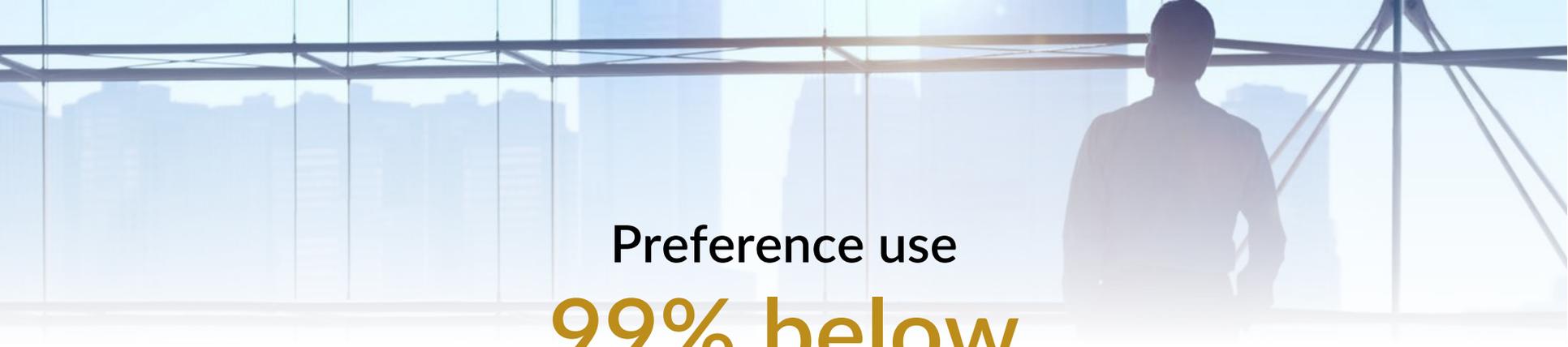
Goal: Attract and retain jobs in CEZs or ISDs

Not Achieved



Beneficiaries' wage growth less than statewide gains

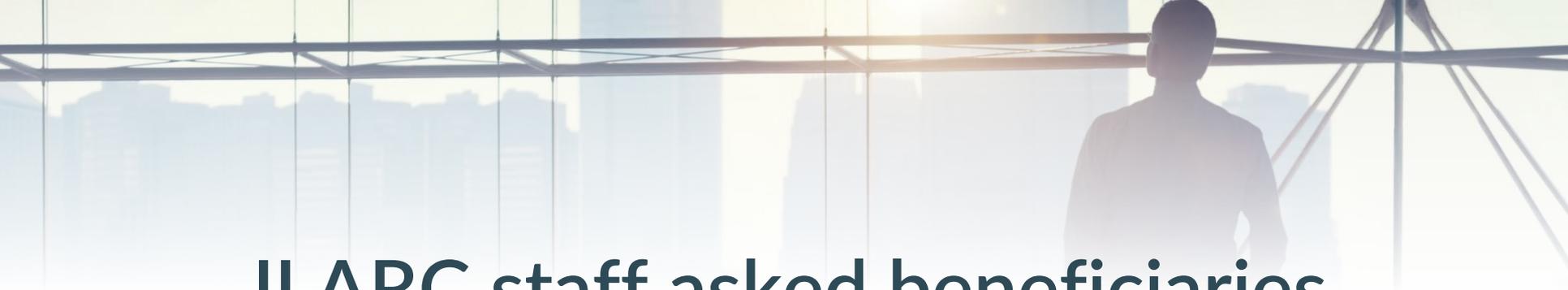




Preference use
99% below
expected levels (1998 fiscal note)

	Expected	Actual
Preference Use	148 businesses	8 businesses over 10 years. Maximum 5 in any single year.
Beneficiary savings	\$9.9 million	\$12,300 – \$71,500*

**based on FY13-19. FY20-22 not disclosable.*



JLARC staff asked beneficiaries and economic development entities about the preference

Beneficiaries

No response.

Economic development entities in CEZs and ISDs

Not aware of preference or whether it had been used in their city.

Preference not beneficial in recruiting businesses.



Legislative Auditor's Recommendation

Terminate because it hasn't achieved the public policy objective to attract and retain businesses in CEZs and ISDs.

The Legislature may want to consult with the Department of Commerce or local economic development entities to consider other approaches.



HAZARDOUS SUBSTANCE TAX (HST)

Pesticides Sold Out of State

Legislative Auditor's 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.

Scheduled to
Expire:
January 1, 2026

Estimated 2023-25
Beneficiary Savings:
\$319,000



Preference intended to keep pesticide storage businesses in WA and increase HST revenue

2015 Legislature

Exemption to:

- Incentivize in-state storage.
- Strengthen state's position as a regional ag distribution hub.
- Increase overall HST revenue.

To extend if HST revenue increases.

Use of the preference has declined

2016-22

7 businesses (in total) have claimed the preference

2018-19

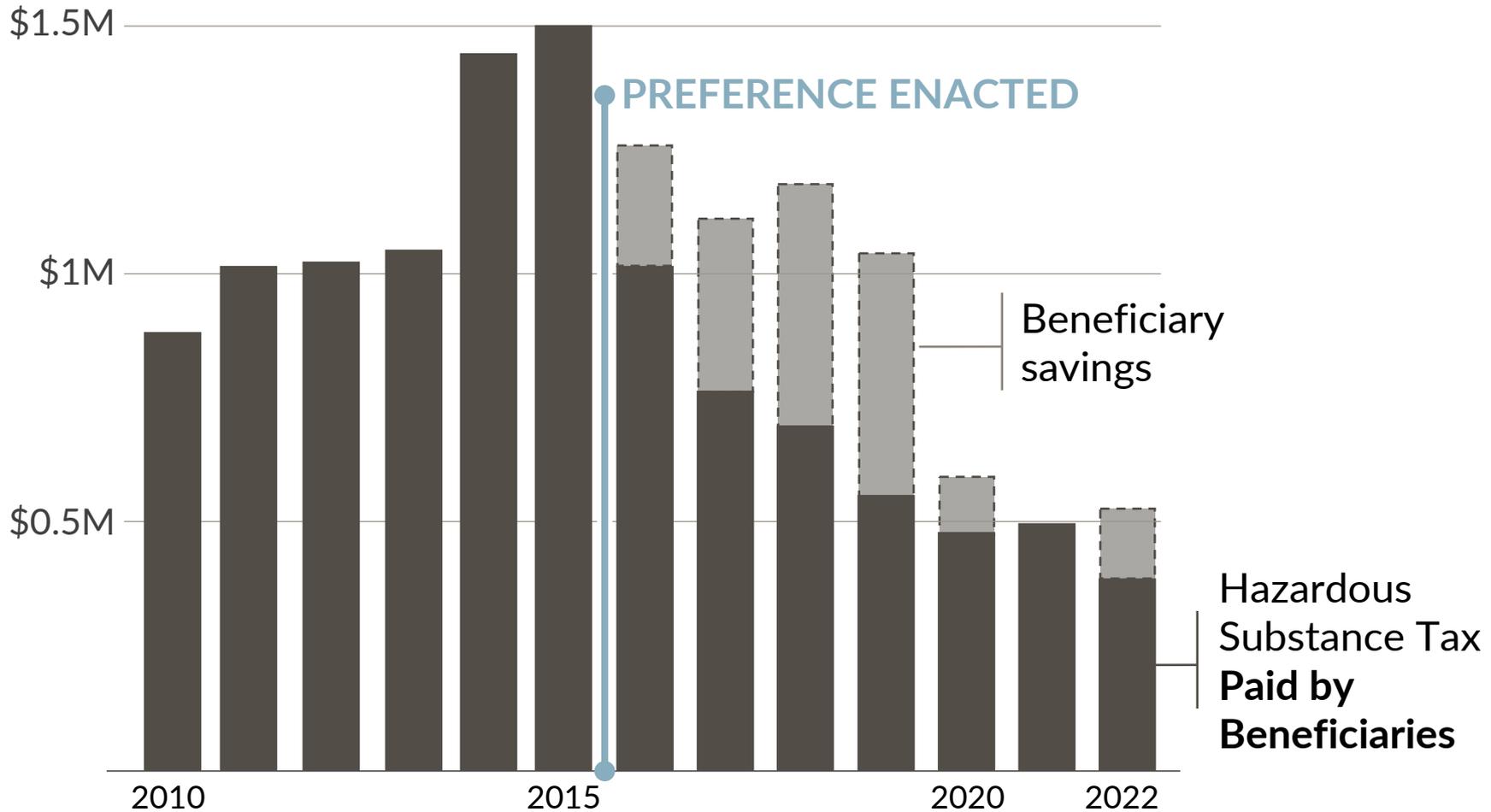
5 businesses claimed \$490,000

2022

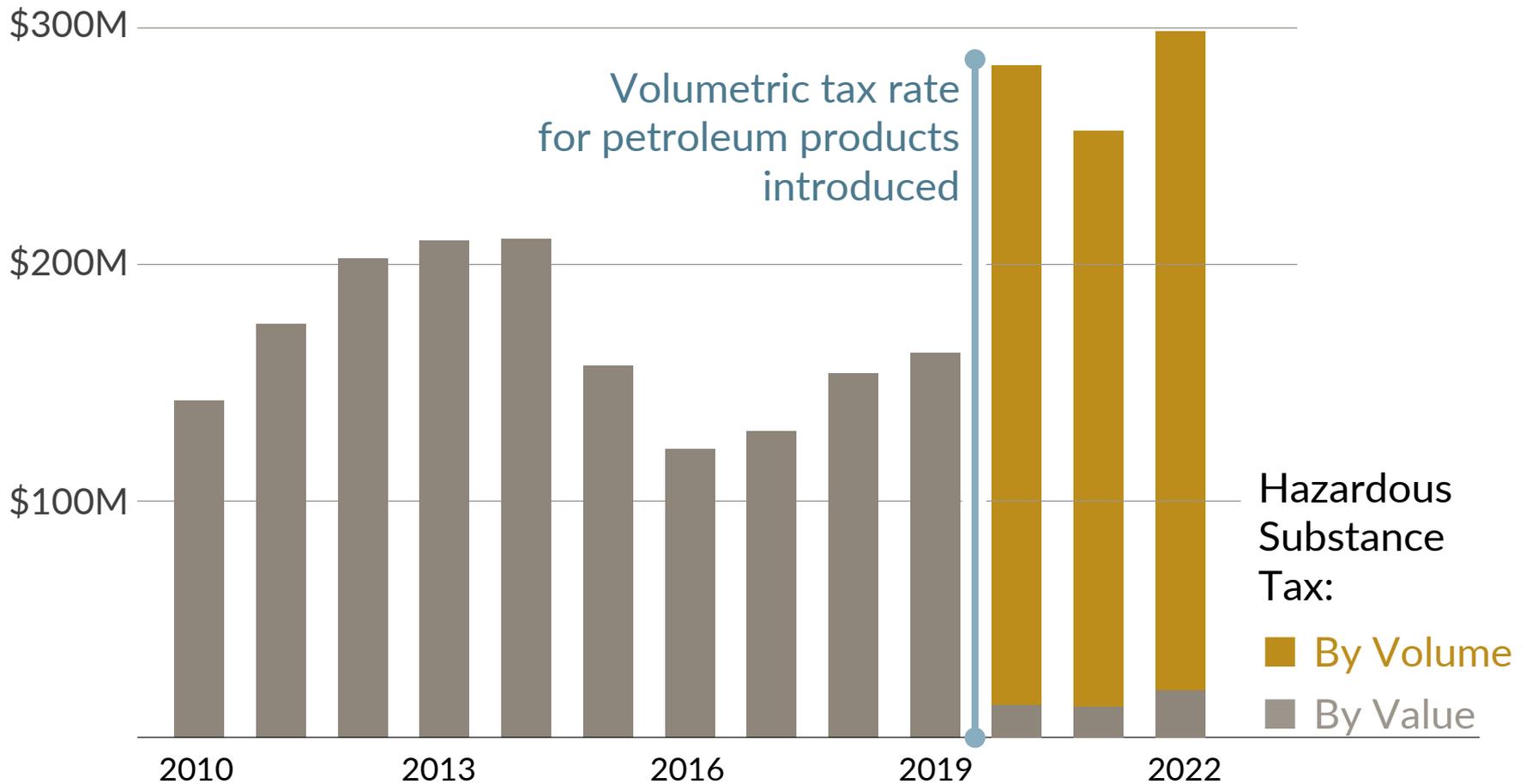
3 businesses claimed \$139,000



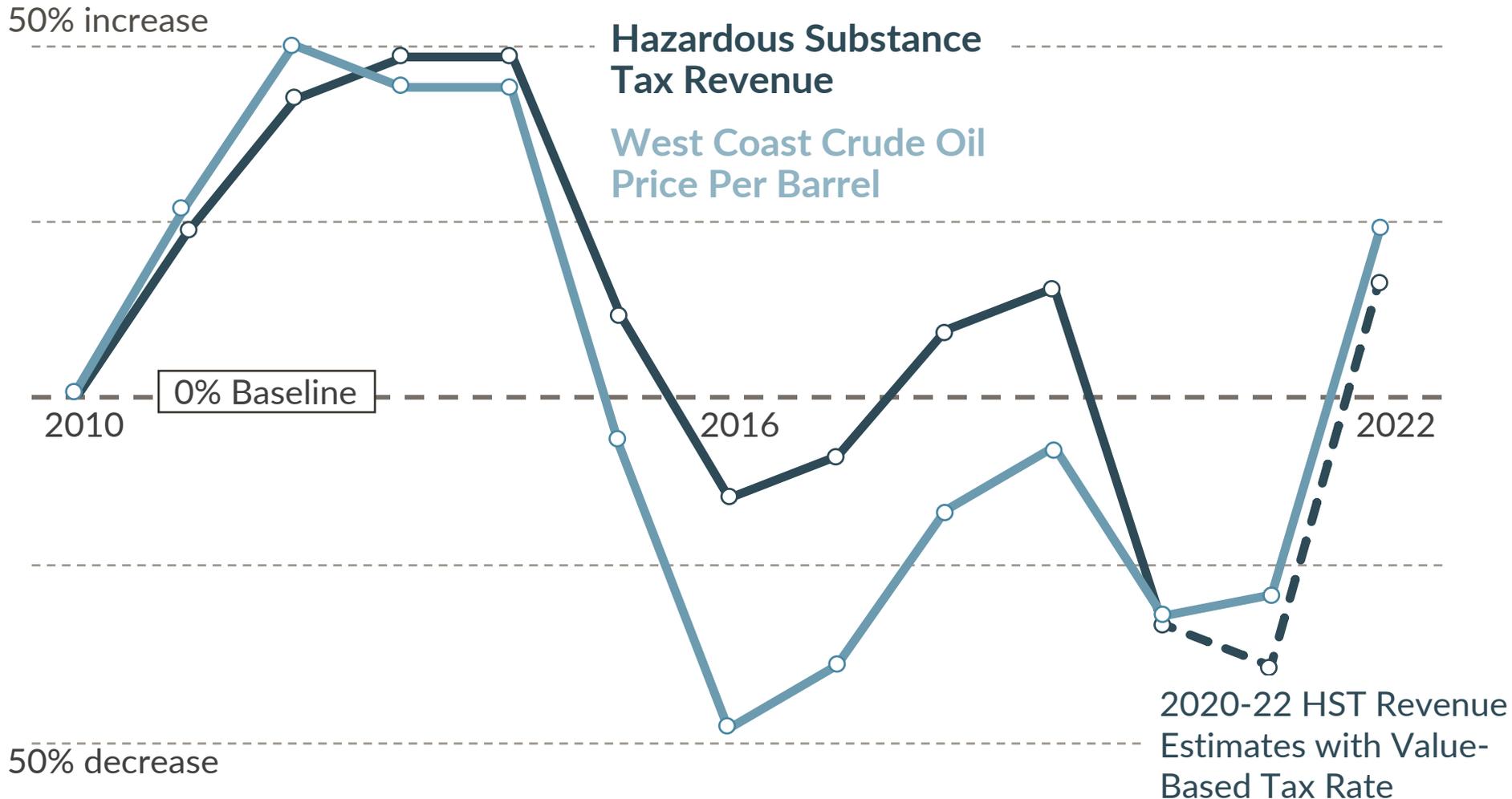
Beneficiaries' HST decreased by 74% between 2015 and 2022



HST revenue increased with the introduction of a volumetric tax rate for petroleum products



Under the value-based tax rate, HST revenue was tied to crude oil prices





Legislative Auditor's Recommendation

Continue and modify.

The preference improves industry competitiveness.

But the current metric no longer makes sense in light of recent changes to the hazardous substance tax.

The Legislature may want to set new metrics or recategorize the preference before it expires in 2026.



Property Tax

Historic Ships and Vessels

Legislative Auditor's 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.

Enacted 1986.
No expiration date.

Estimated 2025-27
Beneficiary Savings:
\$21,000



Ships or vessels listed on a state or national historic register are exempt from property tax

11

Vessels in five cities on Puget Sound benefited from preference in 2023.

9 owned by nonprofits

2 owned by for-profit corporations

Must be commercial vessels.

Personal vessels are not subject to property tax.



Unclear if preference achieves inferred objective to keep vessels in Washington

Largest beneficiary leaving

The Western Flyer will return to CA once repairs are completed in 2023.

Some vessels exempted under other preference

5 of 11 ships also qualify for a property tax exemption as items displayed in a historic museum.

Some vessels do not qualify

15 vessels on historic registers have been relocated, deconstructed, or are otherwise ineligible.



Legislative Auditor's Recommendation

Clarify the preference's public policy objective and identify metrics to measure if the objective has been achieved.



Property Tax

Rehabilitated Historic Properties

Legislative Auditor's 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.

**Scheduled to
Expire:**
January 1, 2031

**Estimated 2025-27
Beneficiary Savings:**
\$22.7 million

Preference intended to promote rehabilitation of historic properties

Enacted in 1985.

Counties must pass an ordinance to enact preference.

On historic register

Property must be listed on a state or national historic register.

Costs deducted

County assessor deducts approved rehabilitation costs from assessed property value.

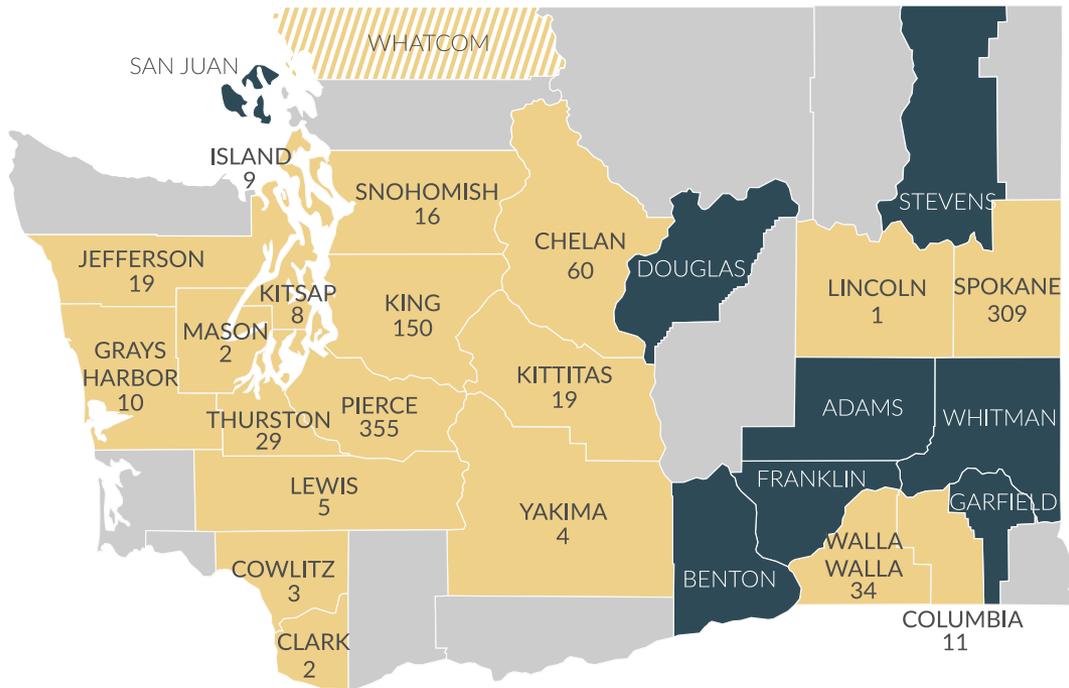
Lasts 10 years

Two 7-year extensions available for properties located in cities with less than 20,000 people in distressed counties.

Property owners saved \$56.8 million on 1,046 historic properties

2013-2022

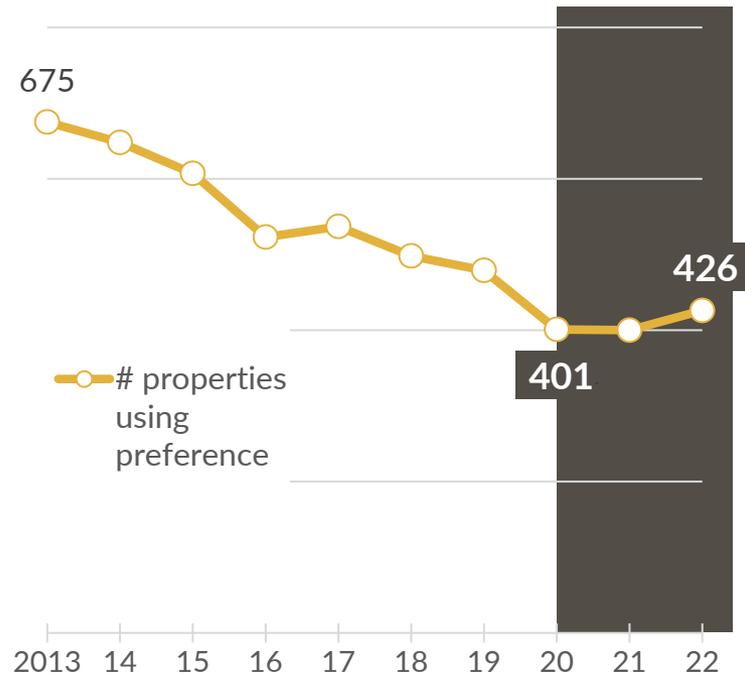
Used in 19 counties



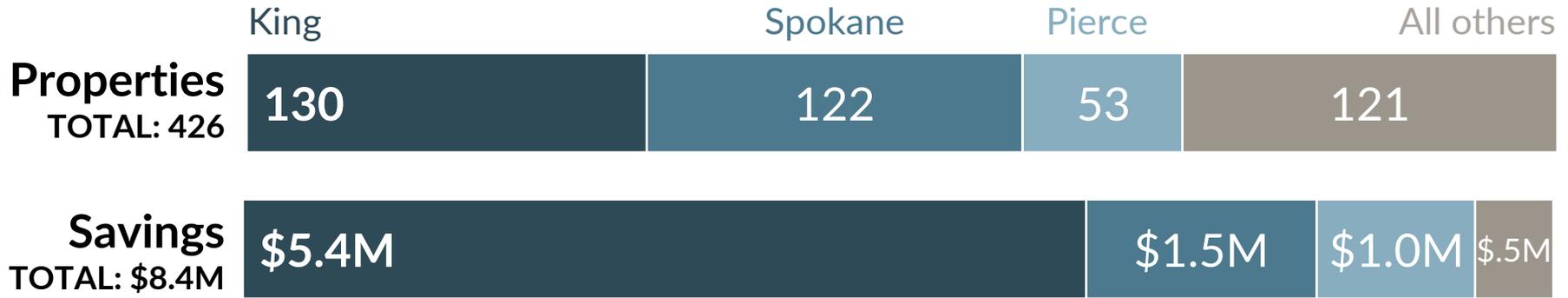
- Whatcom county assessor did not provide data
- Adopted but not used
- Not adopted

Use declined from 2013-22

- Use increased 6% from 2020-22

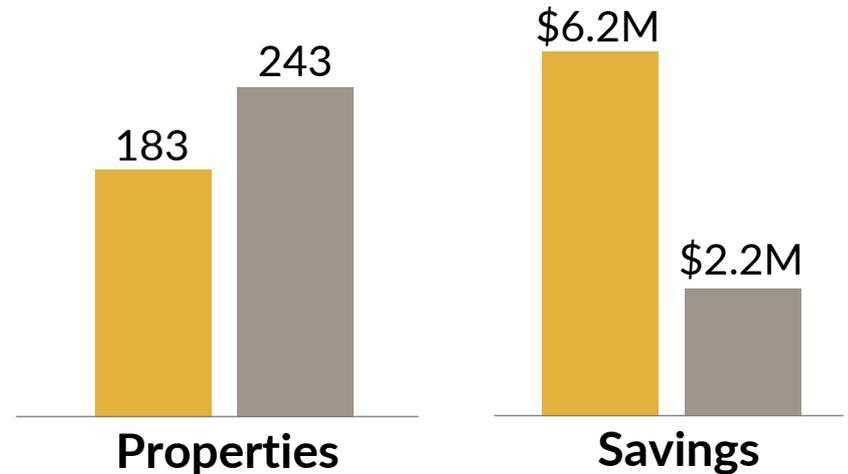


In 2022, beneficiary savings were concentrated in King County...



... and in commercial properties

■ Commercial
■ Residential





Legislative Auditor's Recommendation

Continue because the preference is meeting the objective of promoting historic property revitalization.

JLARC staff will review the preference again prior to the January 1, 2031, expiration date to provide updated detail.



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