

2009 Expedited Tax Preference Performance Reviews

Preliminary Report

July 22, 2009



STATE OF WASHINGTON
JOINT LEGISLATIVE AUDIT AND
REVIEW COMMITTEE

STUDY TEAM

Mary Welsh
Gary Benson
Stacia Hollar
David Dean

PROJECT SUPERVISOR

Keenan Konopaski

LEGISLATIVE AUDITOR

Ruta Fanning

Copies of Final Reports and Digests are
available on the JLARC website at:

www.jlarc.leg.wa.gov

or contact
Joint Legislative Audit & Review
Committee
1300 Quince St SE
Olympia, WA 98504-0910
(360) 786-5171
(360) 786-5180 FAX

REPORT SUMMARY

What Is a Tax Preference?

Tax preferences are 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 more than 580 tax preferences.

Why a JLARC Review of Tax Preferences?

Legislature Creates a Process to Review Tax Preferences

In 2006, the Legislature expressly 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. The legislation assigns specific roles in the process to two different entities. The Legislature assigns the job of scheduling tax preferences, holding public hearings, and commenting on the reviews to the Citizen Commission for Performance Measurement of Tax Preferences. The Legislature assigns responsibility for conducting the reviews to the staff of the Joint Legislative Audit and Review Committee (JLARC).

Citizen Commission Sets the Schedule

EHB 1069 directs the Citizen Commission for Performance Measurement of Tax Preferences to develop a schedule to accomplish a review of tax preferences at least once every ten years. The legislation directs the Commission to omit certain tax preferences from the schedule such as those required by constitutional law.

The Legislature also directs the Commission to consider two additional factors in developing its schedule. First, the Commission is to schedule tax preferences for review in the order in which the preferences were enacted into law, except that the Commission must schedule tax preferences that have a statutory expiration date before the preference expires. This means that Washington's longest-standing tax preferences are evaluated first.

The Commission has identified three categories of review, based on each tax preference's estimated biennial fiscal impact:

1. Full reviews (over \$10 million)
2. Expedited reviews (between \$2 million and \$10 million)
3. Expedited light reviews (\$2 million or less)

However, at their discretion, the Commission may elect to subject a tax preference with a fiscal impact of \$2 million or less to the expedited review process.

In September 2008, the Commission adopted its third ten-year schedule for the tax preference reviews. The schedule for 2009 includes a total of 25 tax preferences under the business and occupation tax, public utility tax, sales tax, use tax, aircraft excise tax, and the insurance premiums tax. Of these 25 tax preferences, the law allowed 13 tax preferences to have an expedited review process, which are included in this report.

JLARC Staff Conduct the Tax Preference Reviews

JLARC's assignment from EHB 1069 is to conduct the reviews of tax preferences according to the schedule developed by the Commission and consistent with the guidelines set forth in statute. This report presents JLARC's reviews of the 13 tax preferences scheduled by the Commission for expedited review. Twelve full tax preference reviews are included in a separate report.

JLARC's Approach to the Tax Preference Reviews

Consistent with the Scope and Objectives for conducting the expedited tax preference reviews, JLARC has evaluated the answers to a set of four questions for each tax preference:

- **Public Policy Objectives:**

- 1) What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?
- 2) Is there any readily available evidence related to the achievement of any of these public policy objectives?

- **Beneficiaries:**

- 3) Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

- **Revenue and Economic Impacts:**

- 4) What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

Methodology

JLARC staff analyzed the following evidence in conducting these expedited reviews: 1) legal and public policy history of the tax preferences; 2) beneficiaries of the tax preferences; 3) government data pertaining to the utilization of these tax preferences and other relevant data; and 4) revenue impacts of the tax preferences.

Staff placed particular emphasis on the legislative history of the tax preferences, researching the original enactments as well as any subsequent amendments. Staff reviewed State Supreme Court, lower court, and Board of Tax Appeals decisions relevant to each tax preference. Staff interviewed the agencies that administer the tax preferences (primarily the Department of Revenue, the Department of Transportation, and the Office of the Insurance Commissioner). These parties provided data on the value and usage of the tax preference and the beneficiaries. JLARC staff also

obtained data from other state and federal agencies to which the beneficiaries are required to report. In a few cases, beneficiaries and other agencies provided additional information.

It is not within the purview of these reviews to resolve or draw definitive conclusions regarding any legal issues discussed within the reviews.

Summary of the Results from JLARC's Reviews

The table on page 4 provides a summary of the recommendations from JLARC's analysis of the tax preferences scheduled for expedited review in 2009. Of the 13 tax preferences included in this volume, this report recommends that the Legislature continue three tax preferences as they are, and continue two other tax preferences by modifying their expiration dates. The expedited report raises issues for the Legislature's consideration for four of the current tax preferences. The report recommends terminating four tax preferences.

The tables on pages 5 and 6 provide a summary of JLARC's recommendations for the expedited reviews completed last year in 2008 and in 2007. Given the fact that these tax preference reviews are part of an ongoing examination of all state tax preferences in Washington, the 2008 and 2007 recommendations for the expedited reviews are included in this 2009 expedited report.

Organization of This Report

This report includes 13 separate chapters. Each chapter consists of a review of one or more related tax preferences. There are three chapters (Rural County Software and Help Desk Firms, Field Burning Equipment, and Aluminum Industry) which contain an evaluation of multiple related tax preferences. The other 10 chapters review a single tax preference.

Each chapter begins with a summary of the findings and recommendations from JLARC's analysis of the individual tax preferences. Then, each chapter provides additional detail, including additional information supporting the answers to the questions outlined in the approach. The current appendices in the preliminary report provide the Scope and Objectives and the text of current law for each preference.

Summary of Recommendations—2009 Expedited Tax Preference Reviews

Tax Preference	Year Enacted	RCW Citation	# of Claimants in 2008 (\$ amount)	Summary of Recommendation
Municipal Utilities	1935	RCW 82.16.050(1)	Unknown* (\$700,000)	Legislature should continue the tax preference
Commercial Aircraft	1949	RCW 82.48.100	Unknown* (\$700,000)	
Aircraft Held for Sale / Aircraft Owned by Non-Residents	1955	RCW 82.48.100	Unknown* Unknown	
Electricity for Electrolyte Firms	2004	RCW 82.16.0421	2 (\$2.2 million)	Legislature should continue the tax preference and modify the expiration date
Aluminum Industry	2004	RCW 82.04.4481 RCW 82.12.022(5) RCW 82.08.805 RCW 82.12.805 RCW 82.04.2909	3 (\$3.6 million)	
Fraternal Benefit Societies	1911	RCW 48.36A.240	24 (\$1.1 million)	Legislature should re-examine or clarify the intent of the tax preference**
Nursing Homes	1945	RCW 82.04.4289	96 (\$2.5 million)	
Ocean Marine Insurance	1947	RCW 48.14.020(3)	51 (\$2.2 million)	
Manufacturers of Flour and Oil	1949	RCW 82.04.260(1)(a)	11 (\$400,000)	
Rural Electric Utility Contributions	1999	RCW 82.16.0491	17 (\$330,000)	Legislature should allow the tax preference to expire
Rural County Software Development and Help Desk Firms	2004	RCW 82.04.4483; RCW 82.04.4484	68 (\$250,000)	
Field Burning Equipment	2005	RCW 82.08.841; RCW 82.12.841	Unknown* (\$2 million)	
Patient Lifting Devices	2006	RCW 82.04.4485	67 (\$2.3 million)	

*No specific data maintained and no annual reporting requirement for preference.

**See specific sections for detail on the issues recommended for the Legislature's consideration.

Summary of Recommendations—2008 Expedited Tax Preference Reviews

Tax Preference	Year Enacted	RCW Citation	# of Claimants in 2007 (\$ amount)	Summary of Recommendation
Public Utility Tax Credit Losses (p. 7)	1935	RCW 82.16.050(5)	170 (\$2 million)	Legislature should continue the tax preference
Processing Horticultural Products (p. 17)	1935	RCW 82.04.4287	Unknown* (\$1 million)	
Fraternal Insurance (p. 27)	1935	RCW 82.04.370	23 (\$2 million)	
Sales for Resale by Water and Gas Utilities (p. 49)	1935	RCW 82.16.050(2)	81 (\$2 million)	
Minimum Income Threshold (p. 71)	1935	RCW 82.16.040	Unknown* (\$1.2 million)	
Public Utility Operating Property (p. 83)	1935	RCW 82.08.0256; RCW 82.12.0257	Unknown* (\$244,000)	
Alcohol and Biodiesel Fuel Production (p. 143)	2003	RCW 82.04.260(1e); RCW 84.36.635; RCW 82.29A.135	See detailed report	Legislature should continue the tax preference and modify the expiration date
Wood Biomass Fuel: Production Facilities/Sales / Distribution (p.127)	2003	RCW 82.08.960; RCW 84.36.640; RCW 82.29A.135; RCW 82.12.960; RCW 82.04.4335	0 (\$0)	
Irrigation Water (p. 37)	1935	RCW 82.16.050(7)	Unknown* (\$669,000)	Legislature should re-examine or clarify the intent of the tax preference**
Radio and TV Broadcasting (p. 57)	1935	RCW 82.04.280(6)	65 (\$2 million)	
Farm Auction sales (p. 117)	1943	RCW 82.08.0257 RCW 82.12.0258	Unknown* (\$2 million)	
Gas Tax Exemption for Handling Losses (p. 93)	1939	RCW 82.36.029	179 (\$2.5 million)	Legislature should terminate the tax preference
Airports Owned by Cities in Other States (p. 111)	1941	RCW 84.36.130	0 (\$0)	

*No specific data maintained and no annual reporting requirement for preference.

**See specific sections for detail on the issues recommended for the Legislature's consideration.

Summary of Recommendations—2007 Expedited Tax Preference Reviews

Tax Preference	Year Enacted	RCW Citation	# of Claimants in 2006 (\$ amount)	Summary of Recommendation
Nonprofit Libraries	1854	RCW 84.36.040(1)(b)	10 (\$36,000)	Legislature should continue the tax preference
Fire Companies	1890	RCW 84.36.060(1)(c)	1 (\$5,500)	
Growing Crops	1890	RCW 84.40.030(3)	1,179 (\$2.6 million)	
Humane Societies	1915	RCW 84.36.060(1)(d)	22 (\$170,000)	
Collections and Museums	1915	RCW 84.36.060(1)(a)	145 (\$3.1 million)	
Veterans Organizations	1929	RCW 84.36.030(4)	159 (\$570,000)	
Nonprofit Youth Organizations	1933	RCW 84.36.030(3)	115 (\$1.9 million)	
Contributions and Donations	1935	RCW 82.04.4282	Unknown (\$56 million)	
Boxing and Wrestling Matches	1935	RCW 82.04.340	14 (\$18,000)	
Lost or Destroyed Fuel	1923	RCW 82.36.370 RCW 82.38.180(4)-(6)	*	
Historic Auto Museums	2005	RCW 82.32.580	0 (\$0)	
Nonprofit Nursing Homes	1891	RCW 84.36.040(1)(d)	42 (\$2.8 million)	Legislature should re-examine or clarify the intent of the tax preference**
Membership Dues and Fees	1935	RCW 82.04.4282	218 (\$2 million)	
Horse Racing	1933	RCW 82.04.350	5 (\$2 million)	
Refunded Fuel Tax for Nonhighway Use	1923	RCW 82.36.280 RCW 82.38.180(1)	4,967 (\$20.3 million)	
Orphanages	1891	RCW 84.36.040(1)(c)	2 (\$138,000)	Legislature should terminate the tax preference and allow beneficiaries to qualify for another tax preference

*No specific data maintained; there are very few claims for refunds of lost or destroyed fuel in a given year, and the fiscal impact is in the hundreds or low thousands of dollars.

** See specific sections for detail on the issues recommended for the Legislature’s consideration.