State of Washington
Joint Legislative Audit & Review Committee (JLARC)

2014 Tax Preference Performance Reviews

Preliminary Report

July 2014

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

JLARC's non-partisan staff auditors, under the direction of the Legislative Auditor, conduct performance audits, program evaluations, sunset reviews, and other analyses assigned by the Legislature and the Committee.

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 auditors 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 enclosed findings and conclusions, and any exceptions to the application of audit standards have been explicitly disclosed in the body of this report.

TABLE OF CONTENTS

Report Summary 1

Aerospace Industry Tax Preferences (B&O, Sales and Use, Property, and Leasehold Excise Taxes) 15

Supplement to Aerospace Industry Tax Preference Economic Impact Analysis 45

Certified Aircraft Repair Firms (B&O Tax) 49

Commercial Airplane Part Place of Sale (B&O Tax) 59

Aircraft Part Prototypes (Sales and Use Tax) 67

Dairy Product Processors - B&O Tax Deduction and Preferential Rate 73

Fresh Fruit and Vegetable Processors - B&O Tax Exemption and Preferential Rate 91

Seafood Product Processors and Certain Sellers - B&O Tax Exemption and Preferential Rate 111

Electric Power Exported or Resold (Public Utility Tax, B&O Tax) 129

International Investment Management Services (B&O Tax) 147

Sales Subject to Public Utility Tax (Sales Tax, Sales and Use Tax) 157

Appendix 1 – Scope and Objectives 165

Appendix 2 – Agency Responses 169

Appendix 3 – Current Law 171

2014 Tax Preference Performance Reviews

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STATE OF WASHINGTON

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REPORT SUMMARY

What Is a Tax Preference?

Tax preferences are defined in statute 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 (now found in Chapter 43.136, Revised Code of Washington). Statute assigns specific roles in the process to two different entities.

- The Citizen Commission for Performance Measurement of Tax Preferences 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 Citizen Commission for Performance Measurement of Tax Preferences 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 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. This volume includes 24 preference reviews (similar preferences may be combined in one chapter) completed by JLARC staff in 2014. Analysis of preferences completed in previous years is found on the Commission's website: http://www.citizentaxpref.wa.gov/

JLARC Staff's Approach to the Tax Preference Reviews

Statute guides the 11 questions 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))

Depending on the tax preference, certain questions may be excluded. For instance, question #4 relates to modifying a preference if the public policy is not being fulfilled. If the preference is fulfilling its public policy, this question is skipped.

JLARC Staff's Analysis Process

JLARC staff carefully analyze a variety of evidence in conducting these reviews: 1) the legal and public policy history of the tax preferences; 2) the beneficiaries of the tax preferences; 3) government data pertaining to the utilization of these tax preferences and other relevant data; 4) the economic and revenue impact of the tax preferences; and 5) other states' laws to identify similar tax preferences.

When a preference's public policy objective is identified in statute, staff are able to affirmatively state the public policy objective. This is sometimes found in intent statements or in other parts of statute.

However, for many of the preferences, the Legislature did not state the public policy objective. In such instances, staff may be able to *infer* what the implied public policy objective might be.

To arrive at this inferred policy objective we go through the following step-by-step process:

- Review final bill reports for any statements on the intent or public policy objectives.
- Review bills prior to the final version and legislative action on bills related to the same topic.
- Review bill reports and testimony from various versions of the bill.
- Review records of floor debate.
- Review whether there were court cases that provide information on the objective.
- Review any information available through the Department of Revenue's files on the history of tax preferences, including rules, determinations, appeals, audits, and taxpayer communication.
- Review any press reports during the time of the passage of the bill which may indicate the intention of the preference.
- Review any other historic documents, such as stakeholder statements, that may address the issue addressed by the tax preference.

If there is sufficient information in this evidence to *infer* a policy objective, we state that in our reviews. In these instances, though, the purpose may be a more generalized statement than can be made compared to instances that have explicit statutory language.

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 are required to report to other state or federal agencies, JLARC staff will also obtain data from those agencies.

A Change in 2013: Policy Purpose Statement Now Required

Beginning in August 2013, new, extended, or expanded preferences now require a tax preference performance statement. The performance statement is to include a statement of legislative purpose as well as metrics to evaluate the effectiveness of the preference. (RCW 82.32.808). Most of the preferences included in this report were passed before this requirement was established.

Summary of the Results from JLARC Staff's Reviews

The table beginning on page 5 provides a summary of the recommendations from JLARC staff's analysis and includes the Citizen Commission's comments on those recommendations. Of the preferences, JLARC staff recommends the Legislature:

- Terminate one preference;
- Review and clarify the intent of twenty preferences; and
- Continue three preferences.

Organization of this Report

The report begins with summary information for each of the 24 preferences, followed by detailed reports. Since the Commission selected several preferences related to aerospace for JLARC staff to review in 2014, both the summary and detail begin with aerospace related preferences. The appendices provide the Scope and Objectives for the preference reviews and the text of current law for each preference.

In addition to the preferences reviewed in this report, information on 62 other preferences considered by the Commission in 2014 can be found in the 2014 Expedited Tax Preferences. Information on these preferences was provided by the Department of Revenue.

Summary of 2014 Tax Preference Performance Reviews			
What the Preference Does	**Public Policy Objective**	**Est. Beneficiary Savings**	**Legislative Auditor Recommendation**
Aerospace Industry Preferences			
A Commercial Airplane Products and Services B&O Tax Preferential Rates			
Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) RCW 82.04.260(11)			Detail on page 15
Provides a preferential B&O tax rate of 0.2904 percent to manufacturers and processors for hire of commercial airplanes and their components and to manufacturers of tooling specifically designed for use in manufacturing aerospace products.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$238.5 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
Aerospace Product Development – Preferential Rate (B&O Tax) RCW 82.04.290(3)			Detail on page 15
Provides a preferential B&O tax rate of 0.9 percent to businesses that research, design, or engineer aerospace products for commercial airplanes for others to manufacture.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$6.5 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
B Aerospace Product Development Expenditures B&O Tax Credit			
Airplane Pre-Production Expenditures (B&O Tax) RCW 82.04.4461			Detail on page 15
Provides a B&O tax credit equal to 1.5 percent of qualifying expenditures for businesses that develop aerospace products. Qualifying expenditures include wages and benefits, supplies, and computer expenses, but not capital costs and overhead.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$197.9 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.

What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
C **Aerospace Product Development Computer Expenditures Sales and Use Tax Exemptions**			
Aerospace Pre-Production Computer Expenditures (Sales and Use Tax) RCWs 82.08.975; 82.12.975 Detail on page 16			
Provides sales and use tax exemptions for sales of computer hardware, computer peripherals, and software used primarily in developing, designing, and engineering aerospace products and providing aerospace services.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$13.6 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
D **Aerospace B&O Tax Credit for Property/Leasehold Excise Taxes Paid and Superefficient Airplane Facility Leasehold Excise Tax/Property Tax Exemptions**			
Commercial Airplane Manufacturing – Credit for Taxes Paid (B&O Tax) RCW 82.04.4463 Detail on page 16			
Provides a B&O tax credit for property taxes or leasehold excise taxes paid on property used exclusively in manufacturing aerospace products or at aviation repair stations. The credit applies to new buildings, the land on which the buildings are located, and on the increase in assessed value from renovations and expansions. The credit is also available for property taxes paid on certain personal property.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$31.6 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
Superefficient Airplane Production Facilities (Leasehold Excise Tax) RCW 82.29A.137 Detail on page 17			
Provides a leasehold excise tax exemption to the manufacturer of a "superefficient airplane" (Boeing 787) for a facility located on port property.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$0 million in the 2015-17 Biennium. Boeing located the 787 facility on private property instead of port property.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.

What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
Superefficient Airplane Production Facilities (Property Tax) RCW 84.36.655			Detail on page 17
Provides a property tax exemption for all personal property such as equipment and computers to the manufacturer of a "superefficient airplane" (Boeing 787) at a facility located on port property.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$0 million in the 2015-17 Biennium. Boeing located the 787 facility on private property instead of port property.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
E Airplane Facilities Sales and Use Tax Exemptions			
Airplane Facilities (Sales and Use) RCWs 82.08.980; 82.12.980			Detail on page 17
Provides an exemption from sales and use taxes on labor, services, and materials to construct new buildings used exclusively for manufacturing superefficient airplanes. Contingent on the siting of the 777X, the exemption is expanded to new buildings for manufacturing any commercial airplane, the wings, or the fuselage.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$0 million in the 2015-17 Biennium. If the contingency is met, beneficiary savings are estimated at $12.7 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
Other Aerospace			
Certified Aircraft Repair Firms (B&O Tax) RCW 82.04.250(3)			Detail on page 49
Provides a preferential tax rate of 0.2904 percent to federally certified aviation repair stations.	The Legislature stated the public policy objectives: • To encourage the continued presence of suppliers and vendors that support the Washington aerospace industry; • To reduce the cost of doing business in Washington for aerospace suppliers and vendors; and • To provide jobs with good wages and benefits for aerospace suppliers and vendors.	$1.3 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired number of jobs would facilitate future reviews of the preference.

What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
Commercial Airplane Part Place of Sale (B&O Tax) RCW 82.04.627			Detail on page 59
Provides a B&O tax exemption for sales of certain airplane parts made by an out-of-state manufacturer if they are sold to a Washington manufacturer of a commercial airplane.	The Legislature stated the public policy objectives in a larger package of aerospace preferences containing this exemption: • To encourage the continued presence of suppliers and vendors that support the Washington aerospace industry; • To reduce the cost of doing business in Washington for aerospace suppliers and vendors; and • To provide jobs with good wages and benefits for aerospace suppliers and vendors	Unknown because beneficiaries are not required to report amount of exemption claimed.	**Review and clarify:** Because it seems to run counter to the Legislature's stated policy objective of reducing the cost of doing business in Washington compared to locations in other states. In addition, the Legislature may want to consider adding reporting or other accountability requirements that would provide better information on out-of-state manufacturers' use of this preference.
Aircraft Part Prototypes (Sales and Use Tax) RCWs 82.08.02566; 82.12.02566			Detail on page 67
Provides sales and use tax exemptions for sales of materials incorporated into a prototype for aircraft parts, auxiliary equipment, or modifications.	The Legislature stated the public policy objectives: • To encourage, develop, and expand opportunities for family wage employment in manufacturing industries; • To solidify and enhance the state's competitive position.	$0 million in the 2015-17 Biennium No taxpayers are claiming the preference.	**Terminate:** Because the tax preferences are not being used and have not contributed to the stated public policy objectives.

What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
Fresh Food Processing Preferences			
Dairy Product Processors – Deduction (B&O Tax) RCW 82.04.4268			Detail on page 73
Provides a B&O tax deduction to dairy product processors for: • Manufacturing activities for certain dairy products; • Sales of dairy products (wholesale or retail) by the processor to purchasers that receive the products in-state and transport them outside the state; and • Wholesale sales of dairy products by the processor for use as an ingredient to manufacture dairy products. Expires July 1, 2015.	The Legislature did not explicitly state a public policy objective for this preference in 2006 when it enacted the preference or when it extended it in 2012. JLARC staff infer the public policy objective was related to jobs. In 2013 when the preference was expanded to wholesale dairy product sales for use as an ingredient in manufacturing dairy products, the Legislature specifically stated it intended to provide incentives to create additional jobs in Washington's dairy industry and related dairy-based product manufacturing industry, and specifically to encourage infant formula producers to locate new facilities or expand existing ones in the state. Additionally, the Legislature noted that the actual fiscal impact of the expanded deduction should substantially conform with the fiscal note estimate.	$8.9 million in the 2013-15 Biennium.	**Review and clarify:** Because the Legislature indicated extension of the expiration date was directly related to jobs but has not yet identified job-related performance metrics, the Legislature should: 1) identify performance targets and metrics for the number and quality of jobs in the dairy processing industry; and 2) establish criteria for when to transition from the deduction to the preferential rate.

What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
Dairy Product Processors – Preferential Rate (B&O Tax) RCW 82.04.260(1)(c)			Detail on page 73
Effective July 1, 2015, provides a preferential B&O tax rate (0.138 percent) to dairy processors for: • Manufacturing activities for certain dairy products; • Sales of dairy products (wholesale or retail) by the processor to purchasers that receive the products in-state and transport them outside the state; or • Wholesale sales of dairy products by the processor for use as an ingredient to manufacture dairy products. The wholesale sales for use as an ingredient portion of the preference expires July 1, 2023.	When the Legislature first enacted a preferential B&O tax rate for dairy processors prior to establishing an exemption, the stated public policy objective was to provide a tax rate consistent with the rate provided to other fresh food processors. In 2013 when the preference was expanded to wholesale dairy product sales for use as an ingredient in manufacturing dairy products, the Legislature specifically stated it intended to provide incentives to create additional jobs in Washington's dairy industry and related dairy-based product manufacturing industry, and specifically to encourage infant formula producers to locate new facilities or expand existing ones in the state. Additionally, the Legislature noted that the actual fiscal impact of the expanded deduction should substantially conform with the fiscal note estimate.	$9.1 million in the 2015-17 Biennium.	**Review and clarify:** To clarify, before the preference takes effect, whether the Legislature intends there to be parity among all the different food processor manufacturing and sales activities.
Fruit and Vegetable Processors – Exemption (B&O Tax) RCW 82.04.4266			Detail on page 91
Provides a B&O tax exemption to fruit and vegetable processors for: • Manufacturing activities for fresh fruit and vegetable products, or • Wholesale sales of fruit or vegetable products by the processor to purchasers that receive the products in-state and transport them outside the state.	The Legislature did not explicitly state a public policy objective for this preference in 2005 when it first enacted the preference or when it extended it in 2012. JLARC staff infer the public policy objective was related to jobs.	$39.3 million in the 2013-15 Biennium.	**Review and clarify:** Because the Legislature indicated extension of the expiration date was directly related to jobs but has not yet identified job-related performance metrics, the Legislature should: 1) identify performance targets and metrics for the number and quality of jobs in the fruit and vegetable processing industry; and 2) establish criteria for when to transition from the deduction to the preferential rate.

What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
Fruit and Vegetable Processors – Preferential Rate (B&O Tax) RCW 82.04.260(1)(d)			Detail on page 91
Effective July 1, 2015, provides a preferential B&O tax rate (0.138 percent) to fruit and vegetable processors for: • Manufacturing activities for fresh fruit and vegetable products, or • Wholesale sales of fruit or vegetable products by the processor to purchasers that receive the products in-state and transport them outside the state.	The Legislature did not explicitly state a public policy objective for this preference. JLARC staff infer the policy objective is to treat fruit and vegetable processors consistently with other fresh food processors.	$30.8 million in the 2015-17 Biennium.	**Review and clarify:** To clarify, before the preference takes effect, whether the Legislature intends there to be parity among all the different food processor manufacturing and sales activities.
Seafood Product Processors and Certain Sellers – Exemption (B&O Tax) RCW 82.04.4269			Detail on page 111
Provides a B&O tax exemption to the seafood industry for: • Manufacturing activities for certain seafood products; or • Sales of certain seafood products (retail or wholesale) to purchasers that receive the products in-state and transport them outside the state.	The Legislature did not explicitly state a public policy objective for this preference. JLARC staff infer that the policy objective was related to jobs.	$4.4 million in the 2013-15 Biennium.	**Review and clarify:** Because the Legislature indicated extension of the expiration date was directly related to jobs but has not yet identified job-related performance metrics, the Legislature should: 1) identify performance targets and metrics for the number and quality of jobs in the seafood processing industry; and 2) establish criteria for when to transition from the deduction to the preferential rate.
Seafood Product Processors and Certain Sellers – Preferential Rate (B&O Tax) RCW 82.04.260(1)(b)			Detail on page 111
Effective July 1, 2015, provides a preferential B&O tax rate (0.138 percent) to the seafood industry for: • Manufacturing activities for certain seafood products; or • Sales of certain seafood products (retail or wholesale) to purchasers that receive the products in-state and transport them outside the state.	The Legislature did not explicitly state a public policy objective for this preference. JLARC staff infer the policy objective is to treat seafood processors consistently with other fresh food processors.	$3.5 million in the 2015-17 Biennium.	**Review and clarify:** To clarify, before the preference takes effect, whether the Legislature intends there to be parity among all the different food processor manufacturing and sales activities.

What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
Miscellaneous Preferences			
Electric Power Exported or Resold (Public Utility Tax, B&O Tax) RCWs 82.16.050(11) (Amended in SB 6505 – not yet codified); 82.04.310(2) (Amended in ESSB 6440 – not yet codified) Detail on page 129			
These two preferences provide: **Public utility tax deductions** for four types of electricity sales made by light and power (L&P) businesses: • Direct (to end user) sales delivered out-of-state; • Wholesale sales between L&P businesses delivered in-state; • Wholesale sales to non-L&P businesses delivered in-state; and • Wholesale sales delivered out-of-state. **B&O tax exemptions** for non-L&P businesses for wholesale electricity sales delivered in-state and out-of-state.	The Legislature did not state the public policy objectives for the public utility tax (PUT) deductions to L&P businesses for four types of electricity sales or the B&O tax exemptions for non-L&P businesses for two types of electricity sales. JLARC staff infer the public policy objectives were **PUT deductions:** • Direct sales delivered out-of-state – to ensure the state complied with federal limitations on taxing goods in interstate commerce. • In-state wholesale sales between L&P businesses – to ensure the PUT did not pyramid, while facilitating transfers of electricity between L&P companies to help meet customer demand. • In-state wholesale sales to non-L&P companies – to provide consistent PUT treatment for wholesale sales by L&P companies regardless of the purchaser. • Out-of-state wholesale sales – to provide consistent tax treatment with wholesale sales delivered in-state to comply with federal requirements. **B&O tax exemptions:** • In-state sales – to provide similar tax treatment to wholesale electricity sales by non-L&P businesses as to L&P businesses, and to keep electricity marketers from moving outside the state; and • Out-of-state wholesale sales – to provide consistent tax treatment for wholesale electricity delivered in-state and out-of-state to comply with federal requirements.	**PUT deductions:** $111.9 million in the 2015-17 Biennium **B&O tax exemptions:** Cannot be reliably estimated	**PUT deductions:** **Continue:** Because the preference is achieving the inferred public policy objectives. **B&O tax exemptions:** **Review and clarify:** Because: 1) the Legislature may want to consider adding reporting or other accountability requirements to provide better information on use of the preference; 2) it is unclear whether the preference is still needed to keep electricity marketers from moving out-of-state due to 2010 changes in how service businesses calculate their taxable income; and 3) it is unclear whether the Legislature intended the preference to apply to commission or fee income from electricity brokering.

What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
International Investment Management (B&O Tax)	RCW 82.04.290(1)		Detail on page 147
Provides a preferential B&O tax rate (0.275 percent) to businesses conducting international investment management services.	The Legislature did not state the public policy objective for this preference. JLARC staff infer the preferential B&O tax rate has two public policy objectives: 1) To reduce a perceived competitive disadvantage for IIMS businesses located in Washington; and 2) To attract new international trade and finance business to the state.	$26.6 million in the 2015-17 Biennium.	**Review and clarify:** To determine if the preference is still necessary, since Washington's 2010 adoption of an economic nexus and apportionment standard has reduced the competitive disadvantage for international investment management businesses located in-state as compared to those located out-of-state. If the Legislature determines it wants to maintain this tax preference, then the Legislature should consider clarifying the law to identify which businesses qualify for the preference and what income is subject to the preferential rate.
Sales Subject to Public Utility Tax (Sales Tax, Sales and Use Tax)	RCWs 82.08.0252, 82.08.950, 82.12.950		Detail on page 157
Two tax preferences provide: • A sales tax exemption for any income from activities specifically taxed under public utility tax (applies to electricity, water, and natural or manufactured gas); and • A more narrow sales and use tax exemption for sales of steam, electricity, or electrical energy.	The Legislature did not state the public policy objective for this preference. JLARC staff infer: • The public policy objective for the sales tax exemption was to avoid double taxation by ensuring that sales or distribution of items defined as "tangible personal property" that are taxed under public utility tax are not also subject to sales tax. • The public policy objective for the more narrow sales and use tax preference was to ensure Washington tax law conformed with National Streamlined Sales and Use Tax Agreement.	$1.85 billion in the 2015-17 Biennium.	**Continue:** Because the preferences are meeting the inferred public policy objectives of avoiding double taxation and ensuring Washington tax statutes conform with the National Streamlined Sales and Use Tax Agreement.

AEROSPACE INDUSTRY TAX PREFERENCES (B&O, SALES AND USE, PROPERTY, AND LEASEHOLD EXCISE TAXES)

Report Summary			
What the Preference Does	**Public Policy Objectives**	**Estimated Beneficiary Savings**	**Auditor Recommendation**
Aerospace Industry Preferences			
A Commercial Airplane Products and Services B&O Tax Preferential Rates			
Commercial Airplane Manufacturing – Preferential Rate (B&O Tax)			
Provides a preferential B&O tax rate of 0.2904 percent to manufacturers and processors for hire of commercial airplanes and their components and to manufacturers of tooling specifically designed for use in manufacturing aerospace products.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$238.5 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
Aerospace Product Development – Preferential Rate (B&O Tax)			
Provides a preferential B&O tax rate of 0.9 percent to businesses that research, design, or engineer aerospace products for commercial airplanes for others to manufacture.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$6.5 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
B Aerospace Product Development Expenditures B&O Tax Credit			
Airplane Pre-Production Expenditures (B&O Tax)			
Provides a B&O tax credit equal to 1.5 percent of qualifying expenditures for businesses that develop aerospace products. Qualifying expenditures include wages and benefits, supplies, and computer expenses, but not capital costs and overhead.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$197.9 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.

Report Summary

What the Preference Does	Public Policy Objectives	Estimated Beneficiary Savings	Auditor Recommendation
C **Aerospace Product Development Computer Expenditures Sales and Use Tax Exemptions**			
Aerospace Pre-Production Computer Expenditures (Sales and Use Tax)			
Provides sales and use tax exemptions for sales of computer hardware, computer peripherals, and software used primarily in developing, designing, and engineering aerospace products and providing aerospace services.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$13.6 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
D **Aerospace B&O Tax Credit for Property/Leasehold Excise Taxes Paid and Superefficient Airplane Facility Leasehold Excise Tax/Property Tax Exemptions**			
Commercial Airplane Manufacturing – Credit for Taxes Paid (B&O Tax)			
Provides a B&O tax credit for property taxes or leasehold excise taxes paid on property used exclusively in manufacturing aerospace products or at aviation repair stations. The credit applies to new buildings, the land on which the buildings are located, and on the increase in assessed value from renovations and expansions. The credit is also available for property taxes paid on certain personal property.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$31.6 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.

Report Summary			
What the Preference Does	**Public Policy Objectives**	**Estimated Beneficiary Savings**	**Auditor Recommendation**
Superefficient Airplane Production Facilities (Leasehold Excise Tax)			
Provides a leasehold excise tax exemption to the manufacturer of a "superefficient airplane" (Boeing 787) for a facility located on port property.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$0 million in the 2015-17 Biennium. Boeing located the 787 facility on private property instead of port property.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
Superefficient Airplane Production Facilities (Property Tax)			
Provides a property tax exemption for all personal property such as equipment and computers to the manufacturer of a "superefficient airplane" (Boeing 787) at a facility located on port property.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$0 million in the 2015-17 Biennium. Boeing located the 787 facility on private property instead of port property.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
E Airplane Facilities Sales and Use Tax Exemptions			
Airplane Facilities (Sales and Use)			
Provides an exemption from sales and use taxes on labor, services, and materials to construct new buildings used exclusively for manufacturing superefficient airplanes. Contingent on the siting of the 777X, the exemption is expanded to new buildings for manufacturing any commercial airplane, the wings, or the fuselage.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$0 million in the 2015-17 Biennium. If the contingency is met, beneficiary savings are estimated at $12.7 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.

AEROSPACE INDUSTRY TAX PREFERENCES (B&O, SALES AND USE, PROPERTY, AND LEASEHOLD EXCISE TAXES)

Introduction

This review covers a package of tax preferences for the aerospace industry. The preferences are grouped under the following five headings:

A	**Commercial Airplane Products and Services B&O Tax Preferential Rates**

These are two tax preferences for businesses that manufacture aerospace products or provide aerospace services.

B	**Aerospace Product Development Expenditures B&O Tax Credit**

This is one tax preference for businesses that develop aerospace products.

C	**Aerospace Product Development Computer Expenditures Sales and Use Tax Exemptions**

This is a set of tax preferences for businesses that develop aerospace products or provide aerospace services.

D	**Aerospace B&O Tax Credit for Property/Leasehold Excise Taxes Paid and Superefficient Airplane Facility Leasehold Excise Tax/Property Tax Exemptions**

These three tax preferences relate to the location of an aerospace facility. The preferences are based on whether the facility is on private or public port property.

E	**Airplane Facilities Sales and Use Tax Exemptions**

This is a set of tax preferences related to construction of a new aerospace manufacturing facility.

The Preferences Share Common Definitions

Statute defines a ***"commercial airplane"*** as an airplane certified by the Federal Aviation Administration for transporting persons or property, and any military derivative of a commercial airplane. Private airplanes, helicopters, and military fighter aircraft do not qualify for the preferences. Qualifying components must be federally certified for installation or assembly into a commercial airplane.

The statute defines a ***"superefficient airplane"*** as a twin aisle airplane that uses 15 to 20 percent less fuel than similar airplanes on the market. The statute also includes specifications that uniquely describe Boeing's 787 line of commercial airplanes.

Statute defines ***"aerospace products"*** as:

- Commercial airplanes and their components;
- Machinery and equipment designed and used primarily for the maintenance, repair, overhaul, or refurbishing of commercial airplanes or their components by federally certified aviation repair stations; and
- Tooling specifically designed for use in manufacturing commercial airplanes or their components.

Generally, the preferences that apply to airplane manufacturers also apply to "processors for hire." A processor for hire is a business that manufacturers products from materials owned by another business.

The Preferences Share a Common Expiration Date

Currently the aerospace preferences expire on July 1, 2024. In 2013, the Legislature extended the expiration dates for the preferences to July 1, 2040, if a new commercial airplane manufacturing program is sited in Washington by June 30, 2017.

The Preferences Share Common Accountability Reporting

Beneficiaries of the aerospace tax preferences must file an annual report with the Department of Revenue (DOR) providing information on employment and wages. The annual reports are disclosable, but the amount of preference taken by an individual taxpayer is confidential.

Additional Aviation Tax Preferences Reviewed in 2014

In addition to the package of aerospace preferences reviewed here, the 2014 tax preference report also includes separate reviews of other preferences with an aviation connection: sales and use tax exemptions for aircraft part prototypes; a preferential B&O tax rate for services provided at federally certified aviation repair stations; and a B&O tax exemption for commercial airplane parts made by out-of-state manufacturers.

Current Law

A	Commercial Airplane Products and Services B&O Tax Preferential Rates

Current law provides reduced business and occupation (B&O) tax rates for businesses that manufacture qualifying aerospace products and provide qualifying aerospace services as follows:

- ***Manufacturers and processors for hire*** of commercial airplanes and their components, and ***manufacturers of tooling*** specifically designed for use in manufacturing aerospace products are taxed at the aerospace manufacturing B&O tax rate of 0.2904 percent. When the manufacturer sells the product either at wholesale or retail in-state, the manufacturer owes aerospace retailing or wholesaling B&O tax at the same preferential rate of 0.2904 percent. In general, manufacturers, wholesalers, and retailers of interstate transportation pay B&O tax at the rate of 0.484 percent.
- ***Non-manufacturers that research, design, or engineer aerospace products*** for commercial airplanes for others to manufacture are taxed at 0.9 percent. Firms providing research, design, and engineering services for others are generally taxed at the rate of 1.5 percent.

Exhibit 1 below compares how general industry-wide rates and aerospace preferential rates differ.

Exhibit 1 – General B&O Tax Rates Compared to Preferential Aerospace Rates

Beneficiaries	Preferential Rate	General Classifications	General Rate
Manufacturing and Selling			
Manufacturers or processors for hire of commercial airplanes and components	0.2904%	Manufacturing, wholesaling, or retailing	0.484%
Manufacturers of tooling for use in manufacturing commercial airplanes and components	0.2904%	Manufacturing, wholesaling, or retailing	0.484%
Providing Services			
Researchers, designers, and engineers of aerospace products	0.9%	Service and other	1.5%

Source: JLARC staff analysis of tax law.

B Aerospace Product Development Expenditures B&O Tax Credit

Current law provides a B&O tax credit equal to 1.5 percent of qualifying expenditures for businesses that develop aerospace products. Qualifying expenditures include wages and benefits, supplies, and computer expenses, but not capital costs and overhead, such as expenses for land, structures, or depreciable property. The credit must be taken in the year in which the qualifying expenditures occur, except for credits earned before July 1, 2005 which can be carried over and used at a later date. If the amount of credit exceeds tax liability, the credit cannot be carried over to reduce tax liability in subsequent years, and cannot be refunded.

C Aerospace Product Development Computer Expenditures Sales and Use Tax Exemptions

Current law provides sales and use tax exemptions for sales of computer hardware, computer peripherals, and software used primarily in developing, designing, and engineering aerospace products and providing aerospace services. Aerospace services are defined in statute as maintenance, repair, overhaul, or refurbishing of commercial airplanes or their components by federally certified repair stations. Sales of or charges made for labor and services for installing the computer hardware, computer peripherals, and software are also exempt.

D Aerospace B&O Tax Credit for Property/Leasehold Excise Taxes Paid and Superefficient Airplane Facility Leasehold Excise Tax/Property Tax Exemptions

Under current law, certain property owned or leased by aerospace businesses is eligible for a B&O tax credit or a leasehold excise tax exemption. In general, all real property and personal property are subject to property tax unless a specific exemption is provided by law. Private lessees of government property are subject to the leasehold excise tax in place of the property tax.

The aerospace business is eligible for the credits or exemptions depending on ***the type of plane*** and ***the type of property*** on which the manufacturing facility is located.

1) For any commercial airplane facility located on private property, businesses that are eligible for the B&O aerospace preferential rate may receive a B&O tax credit for property or leasehold excise taxes paid on new buildings and the land on which the new buildings are located, and on the increase in assessed value from renovations and expansions. The credit is also available for property taxes paid by manufacturers on ***certain*** personal property;
2) For a "superefficient airplane" (Boeing 787) facility located on port property, the manufacturer may receive:
    - A leasehold excise tax exemption that applies to facilities located on port property; ***and***
    - A property tax exemption for ***all*** personal property, including machinery, equipment, and computers.

To receive the B&O tax credit, buildings must be used exclusively in manufacturing commercial airplanes or their components, or tooling specifically designed for use in manufacturing. The credit may also be claimed for new buildings and land, renovations, and expansion for facilities used for aerospace product development and for maintenance, repair, overhaul, or refurbishing commercial airplanes or their components by federally certified aviation repair stations.

The B&O tax credit provided to aerospace businesses applies to manufacturing machinery and equipment, computer hardware, computer peripherals, and software if these items are exempt from sales and use taxes. The B&O tax credit for manufacturing machinery and equipment is calculated based on a firm's aerospace product income as a percentage of its total manufactured goods income.

The B&O tax credit cannot be claimed until the real and personal property taxes have been paid. If the credit exceeds B&O tax owed, it may be carried forward one year. Unused credits are not refundable.

Boeing chose to build its 787 final assembly facility on private property rather than property leased from a port.

E Airplane Facilities Sales and Use Tax Exemptions

Current law provides an exemption from sales and use taxes on labor, services, and materials to construct ***new*** buildings used exclusively for manufacturing superefficient airplanes. The exemption also includes labor and services for installation of fixtures during construction of the new building. The exemption applies to either a manufacturer of superefficient airplanes or a port district leasing property to a manufacturer of superefficient airplanes.

Boeing retooled an existing facility at its manufacturing site in Everett, and did not construct a new facility.

Legal History

This section of the review provides the legal history for the package of aerospace preferences. The color markers and letters from the previous section serve as a guide to identify the preferences involved in any given year.

What this history illustrates is that the Legislature has expanded the beneficiaries of the aerospace tax preferences over time:

- The original package applied to ***manufacturers or processors for hire of commercial airplanes and their components*** and to retailing and wholesaling activities of the manufacturer.
- The Legislature then expanded the pool of beneficiaries to include ***non-manufacturers that research, design, or engineer aerospace products*** for others to manufacture.
- The Legislature once again expanded the pool of beneficiaries to include ***manufacturers that supplied aerospace tooling and providers of services at federally certified aviation repair stations***.

2003 Legislature Established the Package of Aerospace Tax Preferences

The original package benefited ***manufacturers or processors for hire of commercial airplanes and their components*** and to retailing and wholesaling activities of the manufacturer. The Legislature chose a July 1, 2024, expiration date for the package.

The Legislature enacted this package of aerospace preferences contingent on the siting of a facility for assembling a superefficient airplane in Washington. On December 19, 2003, Governor Locke signed an agreement with The Boeing Company to build the 7E7 airplane in Everett, which met the conditions for the preferences to become effective.

Phasing in the B&O Preferences

The Legislature phased in the B&O preferential rate for commercial airplane products and services as follows:

- On October 1, 2005, the tax rate dropped from 0.484 percent to 0.4235 percent; and
- On July 1, 2007, the tax rate dropped to 0.2904 percent.

With regard to the B&O tax credit for aerospace product development expenditures, businesses could earn credits beginning December 1, 2003, and could claim those credits beginning July 1, 2005. After July 1, 2005, credits had to be taken in the calendar year in which they were accrued.

The sales and use tax exemptions for sales of computer hardware, computer peripherals, and software became effective December 1, 2003.

Uncertainty over Location for the 7E7 Facility

At the time the Legislature was crafting the package of aerospace preferences, Boeing had identified a number of sites in other states and two sites in Washington as potential locations

for its 7E7 manufacturing facility. The two options in Washington were 1) the retooling of an existing Boeing manufacturing plant at Everett, or 2) construction of a new facility on property owned by the Port of Moses Lake.

The aerospace package adopted by the Legislature included preferences for airplane manufacturers that covered either of the Washington options:

For a facility located on private property, an airplane manufacturer would receive a B&O tax credit for property taxes paid;

For a facility located on port property, a manufacturer of superefficient airplanes would receive both a leasehold excise tax exemption and a personal property tax exemption.

In addition, if the choice was to build a ***new*** facility (at the Port of Moses Lake), the manufacturer of superefficient airplanes would receive sales and use tax exemptions for material and labor services used in constructing the new building.

Boeing eventually chose to retool an existing facility on private property it owned in Everett, a location qualifying for the B&O tax credit for property taxes paid. The pair of preferences associated with the facility being located on port property and the sales and use tax exemptions associated with building a new facility did not apply to the Everett property.

2005 Narrowing the B&O Tax Credit for Property Taxes Paid

The Legislature limited the B&O tax credit for property taxes paid to apply only to land and buildings used "exclusively" for manufacturing airplanes. For property taxes paid on manufacturing machinery and equipment, the B&O credit applied based on the "proportion" used for manufacturing airplanes.

2006 Expansion of the B&O Tax Credit for Property Taxes Paid

The Legislature enacted a bill expanding the B&O tax credit for property taxes paid to include leasehold excise taxes paid. The B&O tax credit for leasehold excise taxes applied broadly to all manufacturers of airplanes and their components, not just manufacturers of superefficient airplanes.

First Expansion of Preferences to Non-Manufacturers

The Legislature expanded the pool of beneficiaries for the aerospace product development expenditures B&O tax credit and the computer expenditure sales and use tax exemptions to non-manufacturers. The new beneficiaries were ***non-manufacturers that designed or engineered aerospace products*** for commercial airplanes and components that others manufacture.

2008 Expansion of B&O Preferential Rate to Non-Manufacturers

As it had in 2006 for two of the other aerospace preferences, the Legislature expanded the commercial airplane products and services preferential B&O rate to ***non-manufacturers that research, design, or engineer aerospace products for commercial airplanes*** but do not

manufacture the products themselves. The non-manufacturers received a preferential rate of 0.9 percent, rather than the regular service rate of 1.5 percent.

Expansion of Preferences to Suppliers

The Legislature expanded the pool of beneficiaries of these preferences to include manufacturers that ***supplied related aerospace products***. The Legislature defined these related products as:

- Tooling specifically designed for use in manufacturing commercial airplanes and their components; and
- Machinery and equipment designed and used primarily for maintenance, repair, overhaul, or refurbishing of commercial airplanes or their components by federally certified aviation repair stations.

2013 Legislature Extends Expiration Date of Aerospace Package

The Legislature extended the expiration date for the whole package of aerospace preferences from July 1, 2024, to July 1, 2040. The extension is ***contingent*** on a significant commercial airplane manufacturing program being sited in Washington by June 30, 2017. A "significant program" includes the manufacture of a new or variation of an existing airplane, the fuselage, and the wings. Press releases indicate the legislation was intended to ensure the 777X project will be built in Washington.

The 2013 legislation requires the Department of Revenue to determine whether the contingency occurs and a project has been sited. As of July 2014, DOR has not made such a determination, and the new expiration date is not in effect.

Special Provision for the Preferential B&O Rate

The 2013 bill provides that the preferential B&O rate for manufacturing and selling commercial airplanes expires on July 1 of the year that any final assembly or wing assembly of a "significant airplane" is sited outside of Washington. The other preferences in the aerospace package would continue until the 2040 expiration date.

Special Provision for Airplane Facilities Sales and Use Tax Exemptions

In addition, the 2013 bill extended the exemption from sales and use taxes on labor, services, and materials to construct new buildings to any manufacturer of commercial airplanes, or their fuselages or wings. A port district, municipal, or other political subdivision could also construct the facility for the manufacturer and receive the exemptions. The bill did not specify what kind of commercial airplane qualified for the tax preferences as it had done in 2003 for the superefficient airplanes.

Other Relevant Background

Events prior to enactment of the 2003 tax preferences had an impact on Washington's aerospace industry and its largest employer, the Boeing Company. In 1997, Boeing merged with McDonnell Douglas and acquired employees in California and Missouri. In September 2001, Boeing moved its corporate headquarters from Seattle to Chicago. Then, after the terrorist attacks in the same month, Boeing announced it would lay off up to 30,000 employees due to the resulting decline in airline travel.

In 2003 and 2013, Boeing announced its intentions to manufacture new lines of commercial airplanes. Subsequently, in both years, the Legislature passed tax preferences for the aerospace industry. In 2003, Boeing announced Everett as the location of the 787 assembly facility, and plans are in place to expand that facility to build the 777X.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preferences? Is there any documentation on the purpose or intent of the tax preferences?

The Legislature stated public policy objectives in 2003 when it adopted the original package of tax preferences for manufacturers and processors for hire of commercial airplanes and components and again in 2008 when it expanded the tax preferences to suppliers of aerospace-related products:

1) *To encourage the continued presence* of the aerospace industry in Washington;
2) *To reduce the cost of doing business* in Washington for the aerospace industry compared to locations in other states; and
3) *To provide jobs with good wages and benefits.*

The Legislature stated that the 2008 expansion of the preferences to suppliers recognized that "key elements of Washington's aerospace industry cluster were afforded few, if any, of the aerospace tax incentives enacted in 2003 and 2006" (RCW 82.08.975).

In 2013, with the extension of the aerospace tax incentives to July 1, 2040, the Legislature added to the previous public policy objectives. The Legislature included a performance statement as required under ESSB 5882 (2013, 2nd sp. Sess.) and declared its "specific public policy objective is to maintain and grow Washington's aerospace industry workforce."

What evidence exists to show that the tax preferences have contributed to the achievement of any of these public policy objectives?

Evidence indicates that the original public policy objectives are being achieved. JLARC staff do not assert whether there is a causal relationship between these outcomes and the package of tax preferences.

JLARC staff interviewed private and public sector economists familiar with Washington's aerospace industry to determine the feasibility of conducting an evidence-based analysis to identify whether there is a causal relationship between the preferences and the achievement of the public policy

objectives. The consensus of the economists was that it would be difficult to isolate the influence of any one factor, such as the aerospace tax preferences, on achieving the public policy objective of encouraging a continued aerospace presence, and in particular, on Boeing's decision to locate in Washington.

The Legislature enacted the 2003 aerospace tax preferences as part of the effort to win the competition between a number of sites in other states for Boeing's final assembly facility for the 787 airplane. According to the economists, other factors in location decisions include availability of a skilled labor force, the need to reduce its costs, and the risks associated with concentrating its operations in any one state.

In addition, when considering the extent to which the tax preferences influence business decisions, the amount of the tax preference savings should be considered in relation to gross sales of the business. Beneficiaries of the tax preferences reported $60 billion in gross sales in 2012 and claimed $190 million in taxpayer savings. The aerospace tax incentives were 0.3 percent of total beneficiary sales in 2012.

1) Continued presence of aerospace industry and suppliers supporting the industry

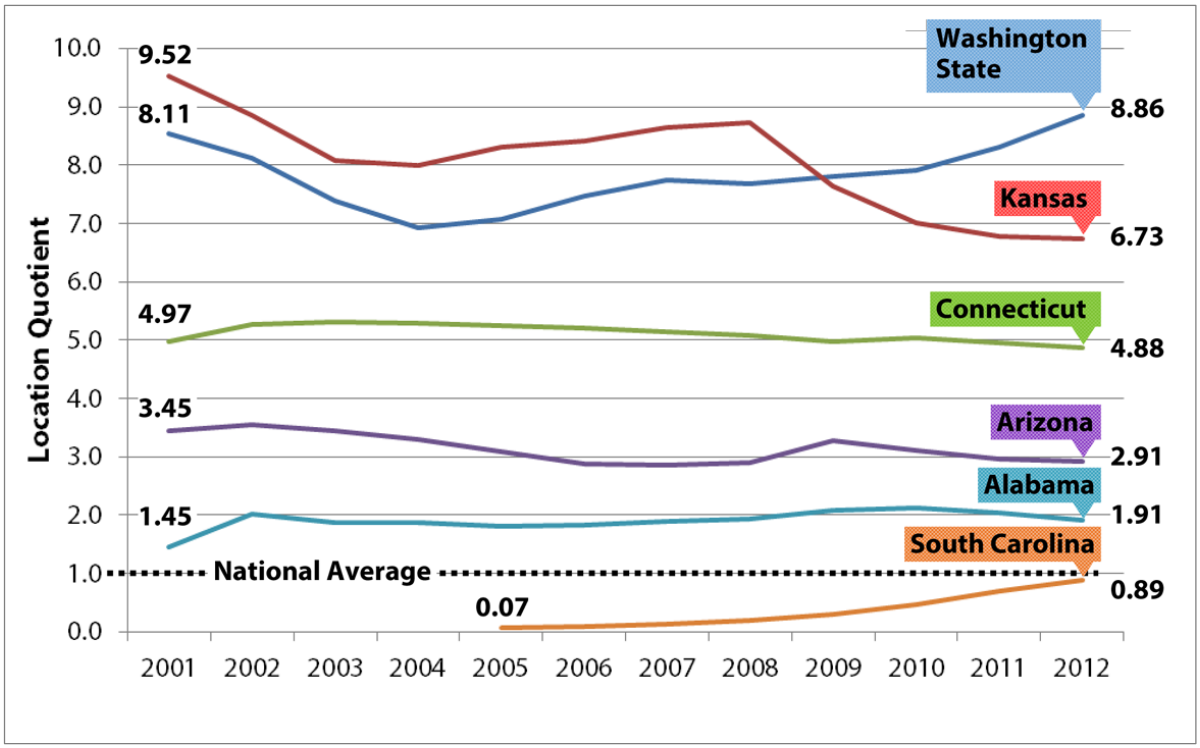
Evidence shows that Washington's aerospace industry has maintained a continued and a growing presence in terms of employment. Positive indicators include:

- Aircraft and parts manufacturing employment in Washington in proportion to other states; and
- Washington's share of Boeing employment relative to other locations where Boeing operates.

A way to illustrate aerospace presence in Washington is to measure industry employment concentration in Washington compared to other states. JLARC staff measured employment concentration for aircraft and parts manufacturing by using Bureau of Labor Statistics location quotients. Location quotients compare a state's share of employment in an industry to the total national share of employment in that industry. A location quotient of 1.0 means an industry is equally concentrated in the state as in the nation.

Exhibit 2 below shows five states with the nation's highest aircraft and parts manufacturing location quotients from 2001 through 2012 and one state, South Carolina, which has a growing location quotient and contains Boeing facilities. Washington's location quotient has grown since 2003 while location quotients for the other highest states have declined or remained stable. South Carolina's location quotient has grown but is still below the national average.

Exhibit 2 – WA Concentration of Aircraft and Parts Manufacturing Is Growing Relative to Other States and National Average, 2001–2012

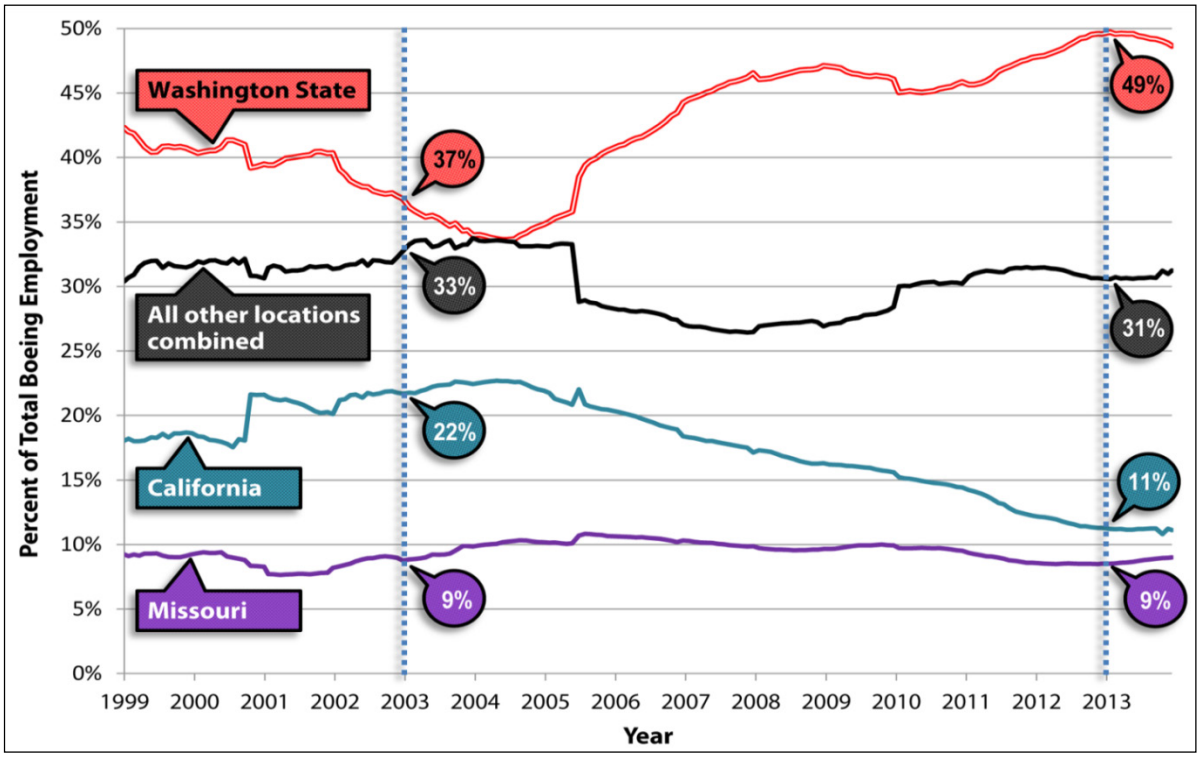


Source: Bureau of Labor Statistics location quotient calculator.

Another approach to check for a continued aerospace presence is to review change over time in the share of ***Boeing*** employment in Washington compared to other locations where Boeing operates.

Exhibit 3 on the following page illustrates a continued Boeing presence in Washington. The exhibit shows change in employment share from 1999 through 2013 for three states with the highest share of Boeing employment: Washington, California, and Missouri, and all other locations combined. As of December, 2013, Boeing employed 82,000 workers in Washington. Employment percentage is shown for the year aerospace preferences were enacted in 2003 and 2013.

Exhibit 3 – WA Share of Boeing Employment Has Grown Relative to Other Locations Worldwide Where Boeing Operates, 1999–2013



Source: JLARC staff analysis of data made available by The Boeing Company.

2) Cost of doing business in Washington compared to locations in other states

The tax preferences have reduced the cost of doing aerospace business in Washington. According to a recent study by the Washington Aerospace Partnership, a non-profit organization including business and government representatives, the entire package of aerospace preferences enacted in 2003, 2006, and 2008 is estimated to have reduced tax liability by ***$1.2 billion*** over a nine-year period ending in 2012. According to the study, the closest competitor in amount of incentives offered is South Carolina with aerospace industry preferences totaling an estimated ***$0.54 billion*** over the same time period.

The Aerospace Partnership study did not look at the amount of tax paid by aerospace businesses or other costs of doing business in competitor states. JLARC staff analysis cannot determine if Washington's cost of doing business is the least of the states because of the complexity of determining variation in all the factors that contribute to costs such as regulation, energy, transportation, labor, and infrastructure.

3) Jobs with good wages and benefits

This section reviews evidence of whether aerospace beneficiaries offer jobs with "good" wages and benefits. The exhibits provide information on the number of jobs, average wages, and the extent to which employees of the aerospace beneficiaries are offered medical and retirement benefits. The comparisons in the exhibits are made to the manufacturing sector as a whole because the aerospace industry is contained within the manufacturing sector.

Exhibit 4 below shows that employment grew for both aerospace beneficiaries and the manufacturing industry as a whole. Average wages are higher for the aerospace beneficiaries as compared to wages for all manufacturers. Additional data will be needed to determine if the one-year decrease in beneficiaries' average wages in 2012 indicates a downward trend.

Exhibit 4 – Aerospace Beneficiaries' and All Manufacturers' Employment Grew, 2010–2012

Calendar Year	Aerospace Beneficiaries		All Manufacturers	
	Employment	Average Wage	Employment	Average Wage
2010	89,728	$89,195	254,853	$64,925
2011	95,100	$94,147	265,669	$68,065
2012	98,186	$91,318	277,366	$69,306

Source: JLARC staff analysis of Employment Security Department employment and wage data, Department of Revenue Annual Reports, and Bureau of Labor Statistics data. Limitations in the data do not allow comparable analysis of years 2009 and earlier.

Medical coverage provided by beneficiaries of the tax preferences is similar to coverage provided by the manufacturing industry as a whole based on two measures: 1) the percent of ***employees*** offered coverage, and 2) the percent of ***firms*** offering coverage. While the percentage offering health insurance is similar, beneficiaries offer retirement coverage to a higher percentage of their employees using both measures compared to the manufacturing industry. See Exhibit 5 below.

Exhibit 5 – Aerospace Beneficiaries Provide Medical Benefits to a Similar Percentage of Employees and Retirement Benefits to a Higher Percentage of Employees Than All Manufacturers, 2012

	Beneficiaries	All Manufacturers
Medical Benefits		
Percent of ***Employees*** Offered Health Insurance	96%	97%
Percent of ***Firms*** Offering Health Insurance	69%	69%
Retirement Plans		
Percent of ***Employees*** Offered Retirement Plans	95%	86%
Percent of ***Firms*** Offering Retirement Plans	61%	47%

Source: JLARC staff analysis of DOR Annual Reports and ESD 2012 Employee Benefits Survey.

Exhibit 6 below shows that the percentage of beneficiary employees receiving medical and retirement coverage has remained about the same (between 93 percent and 96 percent) over a three-year period, 2010 through 2012. Additional years of data will be needed to determine if the three-year decline in the percent of firms offering coverage in 2012 indicates a downward trend.

Exhibit 6 – Percentage of Beneficiary Employees Offered Benefits Over Time Shows Little Change, 2010–2012

	2010	2011	2012
Medical Benefits			
Percent of ***Employees*** Offered Medical Benefits	96%	93%	96%
Percent of ***Firms*** Offering Medical Benefits	71%	71%	69%
Retirement Plans			
Percent of ***Employees*** Offered Retirement Plans	96%	92%	95%
Percent of ***Firms*** Offering Retirement Plans	66%	65%	61%

Source: JLARC staff analysis of DOR annual reports and tax returns. Limitations in the data do not allow comparable analysis of years 2009 and earlier.

To what extent will continuation of the tax preferences contribute to these public policy objectives?

Evidence shows that the original public policy objectives are being achieved. However, JLARC staff do not assert whether there is a causal relationship between these outcomes and the tax preferences. As explained earlier, economists familiar with Washington's aerospace industry advised JLARC staff that it would be difficult to isolate the influence of any one factor, such as the aerospace tax preferences, on aerospace business decisions. Therefore, it is not known if continuation of the tax preferences will contribute to the public policy objectives.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

The beneficiaries of the package of aerospace preferences are:

- Manufacturers or processor for hire (also manufacturers) of commercial airplanes and their components;
- Non-manufacturers that research, design, or engineer aerospace products;
- Manufacturers that supply tooling; and
- Providers of services at federally certified aviation repair stations.

A total of 435 firms took one or more of the aerospace industry tax preferences in 2012.

In terms of which preferences the aerospace businesses are using, Exhibit 7 below shows that 435 firms took the preferential rate available to manufacturers, non-manufacturers that develop aerospace products, and suppliers of aerospace-related tooling and repair services. Some of the 435 firms also took B&O tax credits: 68 firms took the product development credit, and 17 firms took a credit for property taxes or leasehold excise taxes paid. The number of beneficiaries of the sales and use tax exemptions for computers is unknown because taxpayers are not required to report the amount of sales or use tax savings.

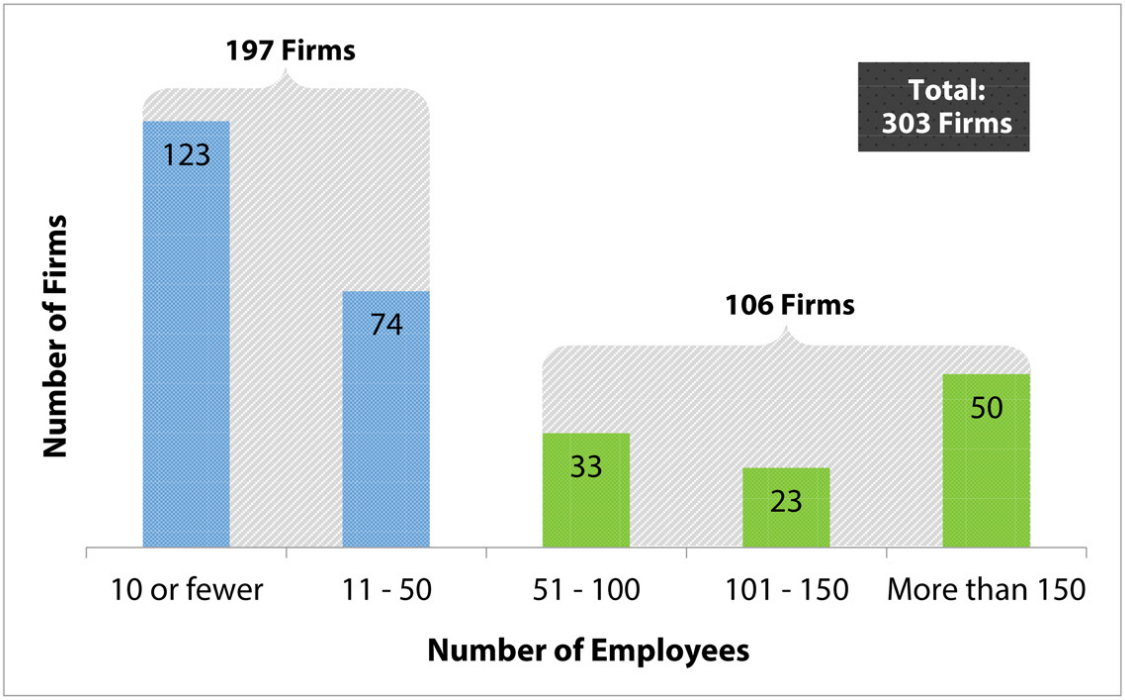
Exhibit 7 – 435 Aerospace Beneficiaries Took the Preferential Tax Rate in 2012, While Fewer Took B&O Tax Credits

	B&O Tax Preferential Rate	B&O Product Development Credit	B&O Credit for Property Taxes Paid
Manufacturers of commercial airplanes and components	260	24	17
Non-manufacturers that develop products	92	38	0
Suppliers that manufacturing tooling and provide repair services	83	6	0
Totals	**435**	**68**	**17**

Source: JLARC staff analysis of Department of Revenue Tax Returns and Annual Reports.

Information is also available on the relative size of the businesses using the aerospace preferences. Exhibit 8 on the following page shows that in 2012, of the firms claiming the aerospace industry preferences, 303 reported employees to the Employment Security Department. Of these, 197 firms employed 50 workers or fewer, and 106 firms employed more than 50 workers.

Exhibit 8 – Number of Aerospace Firms With 50 or Fewer Employees Exceeds Number of Firms With Greater Than 50 Employees, 2012



Source: JLARC staff analysis of DOR tax returns and Employment Security Department employment data. Firms not reporting employees may include sole proprietorships or partnerships without employees, or out-of-state firms selling into Washington but having no in-state employees.

Revenue and Economic Impacts

What are the past and future tax revenue and economic impacts of the tax preferences to the taxpayer and to the government if they are continued?

Beneficiaries of aerospace industry tax preferences claimed a total of $120.9 million in taxpayer savings during Fiscal Year 2013, the latest year for which data is available. Total beneficiary savings from the aerospace tax preferences are estimated at $500.8 million in the 2015-17 Biennium. Estimates of future tax savings are based on the DOR fiscal note on ESSB 5952 (2013, 3rd sp. sess.) which used proprietary information. See Exhibit 9 on the following page.

Exhibit 9 – Estimated 2015-17 Beneficiary Savings for Aerospace Industry Tax Preferences ($Millions)

Fiscal Year	B&O Tax Preferential Rates		B&O Tax Credits		Sales & Use Tax Exemptions		Total
	Manu-facturers	Non Manu-facturers	Prod. Dev. Expenditures	Prop. Tax Paid	Computers	Airplane Facilities	
2013	$101.2	$1.3	Not disclosable	$13.7	$4.8	$0.0	$120.9
2014	$88.9	$2.4	$73.7	$11.8	$5.1	$0.0	$181.9
2015	$101.3	$2.8	$84.1	$13.4	$5.8	$0.0	$207.4
2016	$113.8	$3.1	$94.4	$15.1	$6.5	$12.7	$245.6
2017	$124.7	$3.4	$103.5	$16.5	$7.1	$0.0	$255.2
2015-17 Bien.	$238.5	$6.5	$197.9	$31.6	$13.6	$12.7	$500.8

Source: Department of Revenue tax returns and Fiscal Note on ESSB 5952 (2013, 3rd sp. sess.).

If the tax preferences were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preferences and the extent to which the resulting higher taxes would have an effect on employment and the economy?

For those preferences enacted for economic development purposes, what are the economic impacts of the tax preferences compared to the economic impact of government activities funded by the tax?

This section of the chapter responds to both of these questions:

The economic effects on the current beneficiaries and the economy if the preferences were to be terminated: It is not known whether the termination of the tax preferences would drive decisions about locating aerospace production outside of Washington State. JLARC staff modeled the impact of a scenario that was provided to the Legislature by the Office of Financial Management (OFM) at the time that the 2003 statute was being considered. In this scenario, Boeing reduces 2003 level employment by 80 percent over a period of years. Staff estimated a long-run economy-wide employment loss of 190,790 jobs for this scenario.

The economic impacts of the tax preferences compared to the economic impact of government activities funded by the tax: JLARC staff also modeled the impacts of two scenarios where the Legislature provided aerospace tax incentives and reduced state spending by the same amount. Depending upon the scenario, JLARC staff estimated a long-run economy-wide employment impact ranging from an increase of 14,603 jobs to a decrease of 4,641 jobs. The likelihood that either of these scenarios occurred as a result of the 2003 tax preferences is unknown.

Tool to Review Economic Impact of Economic Development Tax Preferences

In 2003, the Legislature faced a number of uncertain outcomes regarding Boeing's proposed 787 assembly facility, including:

1) Washington could lose existing aerospace employment and future generations of Boeing commercial airplanes to other states;
2) A package of aerospace industry tax incentives might secure the 787 production line and generate new jobs specifically associated with the facility; or
3) A package of aerospace tax incentives might be passed without generating the new employees associated with the 787 production line.

JLARC staff used a model developed for Washington by Regional Economic Models, Inc., (REMI) to estimate the economic impacts for these three possible outcomes.

The REMI model is used by 30 state governments and a number of private sector consulting firms and research universities. The model incorporates aspects of four major modeling approaches: input-output, general equilibrium, econometric, and economic geography. The model is based on a complex set of mathematical equations designed to capture the interrelationships between sectors of Washington's economy including private industry, consumers, and government. The model can be used to estimate the direct, indirect, and induced effects of a policy change as these effects spread through the state's economy. The impact is measured as the difference between the baseline economic output and the estimated economic output after the policy change.

The REMI model includes features that make it particularly useful for this analysis:

- In consultation with staff from OFM, REMI staff customized the model to reflect the economy of Washington;
- The REMI model contains 170 industry sectors and forecasts effects multiple years into the future; and
- The REMI model includes state and local government as a sector within the model. This ability to estimate government's impact on the economy is a special feature of REMI.

Using the Tool to Analyze Three Scenarios

JLARC staff used key assumptions in the REMI model to analyze scenarios related to the three possible outcomes:

Scenario 1

Boeing builds the 787 production line and other new commercial airplane lines in other states.

JLARC staff modeled this scenario by removing 48,000 jobs (or 80 percent of Boeing employment in 2003) from the aerospace sector over 15 years. At the time the Legislature was considering the initial tax preference package, OFM estimated that, if Boeing built the 787 and other new generations of airplanes elsewhere, Washington could lose 48,000 direct aerospace jobs. Further evidence that the state faced competition for Boeing jobs comes from testimony in 2003 indicating Boeing had invited 14 states to submit proposals for the 787 assembly facility.

Scenario 2

The Legislature enacts a package of aerospace tax preferences, Boeing builds the 787 production line in the state, and generates new jobs.

This scenario assumes that government spending is reduced by the amount of the tax preference package provided to aerospace businesses. This scenario also assumes:

- Aerospace businesses create an additional 4,600 direct jobs, OFM's estimate of new jobs associated with the proposed 787 facility at full production. In fact, it is possible Boeing could shift employment from existing production lines without creating new jobs (see Scenario 3 below).
- Aerospace businesses would use tax preference revenues to reduce their in-state production costs. In fact, aerospace businesses could also spend new revenues for out-of-state purposes or for increasing shareholder returns.
- Government would respond to the revenue loss by reducing spending in the same proportions as current government spending. In fact, legislators could also target reductions in government funding to certain activities or raise other revenues.

Scenario 3

The Legislature enacts a package of aerospace tax preferences, Boeing builds the 787 production line in the state without generating new jobs specifically for new line.

Similar to Scenario 2, this scenario assumes that government spending is reduced by the amount of the tax preference package provided to aerospace businesses. It also assumes that aerospace businesses would use tax preferences to reduce their in-state production costs.

In contrast with Scenario 2, this scenario assumes that Boeing does not hire new employees in connection with the 787 production line, because of one of the following assumptions:

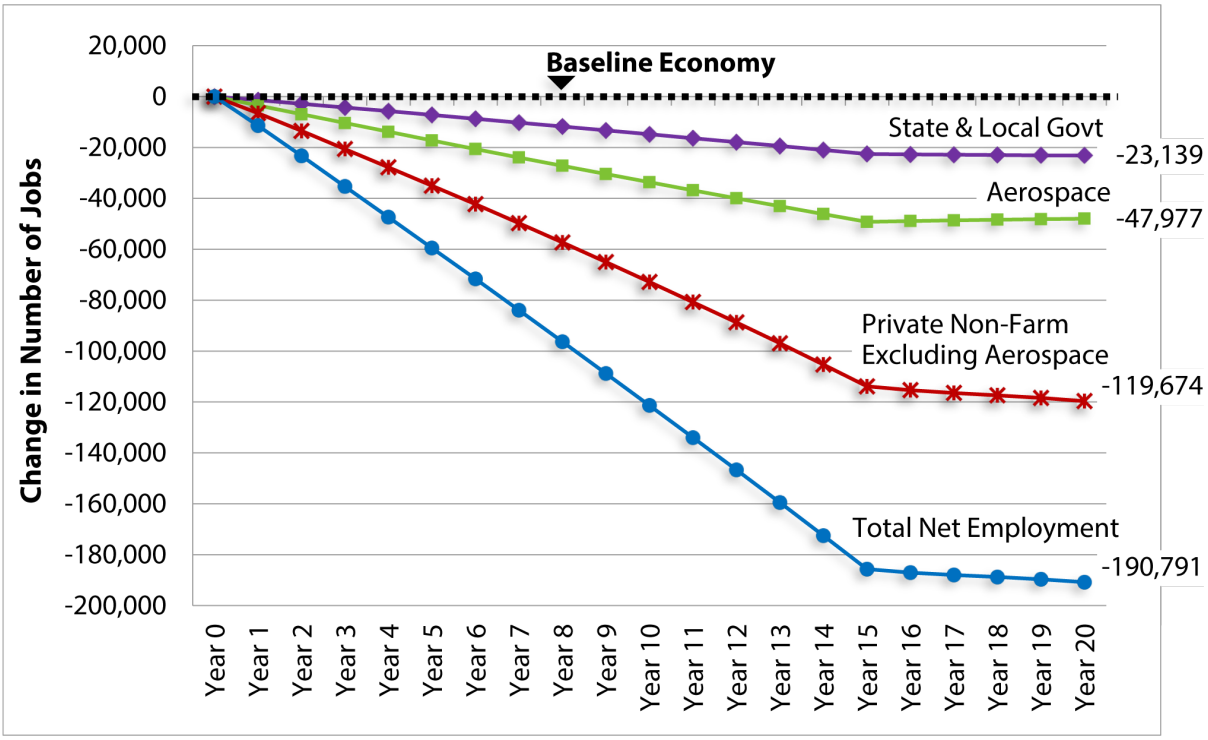
- The 787 production line is built by shifting employment from other production lines without adding new employees; or
- Growth in the employment would have occurred in Washington anyway, without regard to the 2003 package of aerospace tax preferences.

Results of Scenario 1

Boeing Builds the 787 and Other Facilities Elsewhere: Long-Term Job Loss Estimated at 199,790 and GDP Decline at $46 Billion

Exhibit 10 on the following page shows the employment estimates of Scenario 1, where Boeing builds facilities for assembling the 787 and other new generations of airplanes elsewhere. The exhibit includes four lines. One line shows the changes in the number of jobs in the aerospace sector. Another line shows employment changes for private, non-farm industries excluding aerospace. A third line shows employment changes in the state and local government sector. The line labeled as "Total Net Employment" combines all job losses for a total.

Exhibit 10 - Scenario 1: Loss of 47,977 Direct Aerospace Jobs Results in Estimated 190,790 Loss in Economy-Wide Jobs



Source: JLARC staff analysis using REMI. Farm and federal government gross domestic product is not included because the model estimates no impact on these sectors.

The REMI model estimates the total net job loss at 190,790 by Year 20, including direct, indirect, and induced jobs. The decline in the number of jobs in the aerospace sector is magnified by the decline in non-aerospace private sector employment, due to the multiplier effect of the aerospace job loss.

Another measure of economic impact is the change in the state's gross domestic product. State gross domestic product (GDP) represents the total dollar value of all the goods and services produced in the state over a one-year period. GDP is measured by the sum of household spending, business investment including construction and equipment, government spending, and net exports.

Using REMI, JLARC staff modeled the contribution of the private sector and the state and local government sector to Washington's GDP. Exhibit 11 on the following page shows the change in Washington GDP from the job loss simulated in Scenario 1. Both the private non-farm and the state and local government sectors' contributions to GDP decline in Year 1 and continue to decline over 20 years. Total decline in GDP is estimated to be $46.2 billion in Year 20 from the loss of the Boeing employment.

Exhibit 11 – Scenario 1: Loss of 48,000 Direct Aerospace Jobs Results in Estimated $46.2 Billion Decline in GDP

	Year 1	Year 20
Private Non-Farm Sector	-$1.4 billion	-$42.9 billion
WA State and Local Government Sector	-$112 million	-$3.3 billion
Change in State GDP	-$1.5 billion	-$46.2 billion

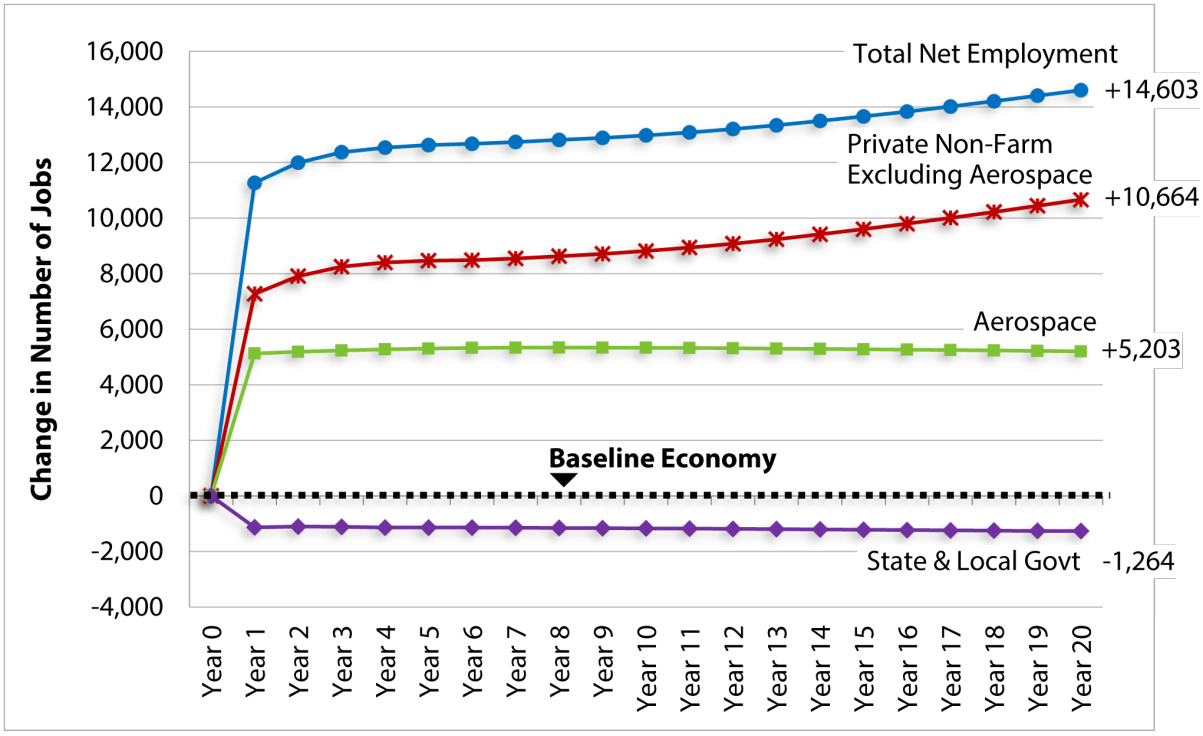
Source: JLARC staff analysis using REMI. Farm and federal government gross domestic product is not included because the model estimates no impact on these sectors.

Results of Scenario 2

The Legislature Enacts Aerospace Tax Preferences, Boeing Builds the 787 Facility in the State and Creates New Jobs: Long-Term Job Gain Estimated at 14,603 and GDP Increase at $4.1 Billion

Exhibit 12 below shows the employment estimates of Scenario 2, where the Legislature enacts a package of aerospace tax preferences, removes a corresponding amount of funding from government spending, and Boeing creates an additional 4,600 direct jobs associated with the 787 assembly line.

Exhibit 12 – Scenario 2: Gain of 4,600 Direct Aerospace Jobs Results in Estimated 14,603 Gain in Economy-Wide Jobs



Source: JLARC staff analysis using REMI. Farm and federal government gross domestic product is not included because the model estimates no impact on these sectors.

The Scenario 2 simulation shows employment growing in the aerospace sector and the non-aerospace private sector. State and local government employment declines. Total net employment increases by 14,603 jobs in the long run.

Exhibit 13 below illustrates that while the private sector's contribution to GDP increases, the state and local government sector's contribution declines. The net result is an increase in state GDP of $4.1 billion in the long run.

Exhibit 13 – Scenario 2: Gain of 4,600 Direct Aerospace Jobs Results in Estimated $4.1 Billion Increase in GDP

	Year 1	Year 20
Private Non-Farm Sector	+$1.8 billion	+$4.3 billion
WA State and Local Government Sector	-$90 million	-$178 million
Change in State GDP	+$1.7 billion	+$4.1 billion

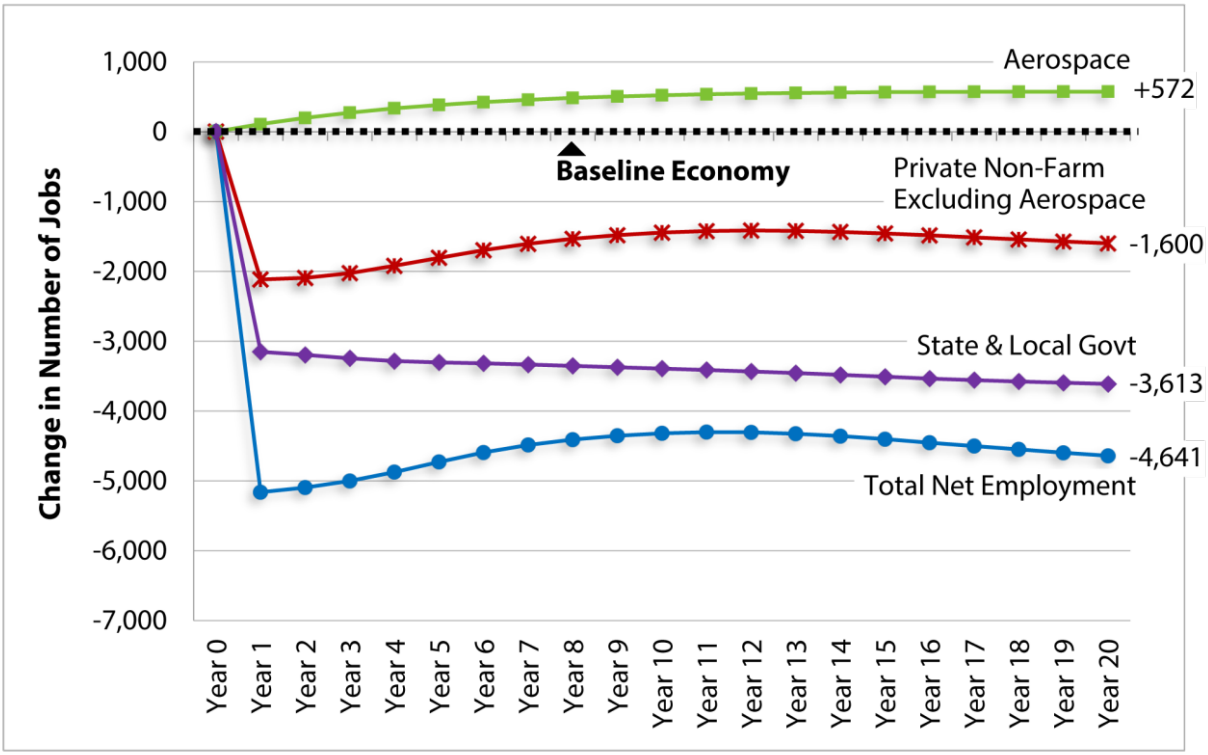
Source: JLARC staff analysis using REMI. Farm and federal government gross domestic product is not included because the model estimates no impact on these sectors.

Results of Scenario3

Boeing Does Not Add the Expected 787 Production Line Jobs: Long-Term Job Loss Estimated at 4,641 and GDP Decline at $494 Million

Exhibit 14 below shows the employment estimates of Scenario 3, where the Legislature enacts a package of aerospace tax preferences, but Boeing does not create new 787 production line jobs.

Exhibit 14 – Scenario 3: Aerospace Preferences Without Associated New 787 Production Line Jobs Result in Estimated 4,641 Loss in Economy-Wide Jobs



Source: JLARC staff analysis using REMI. Farm and federal government gross domestic product is not included because the model estimates no impact on these sectors.

The Scenario 3 simulation shows employment growing in the aerospace sector due to reduced production costs resulting from the tax preference, but this growth is more than offset by government sector job losses. Total net employment declines by 4,641 jobs in the long run.

Exhibit 15 below illustrates that the net result of the Scenario 3 simulation is a decline in in state GDP of $500 million in the long run.

Exhibit 15 – Scenario 3: Aerospace Preferences Without Associated New 787 Production Line Jobs Result in Estimated $500 Million Decline in GDP

	Year 1	Year 20
Private Non-Farm Sector	-$168 million	+$15 million
WA State and Local Government Sector	-$252 million	-$509 million
Change in State GDP	-$420 million	-$494 million

Source: JLARC staff analysis using REMI. Farm and federal government gross domestic product is not included because the model estimates no impact on these sectors.

Scenario 3 includes both private and public sector employment and shows a net loss of jobs for the following reasons:

- A reduction in spending results in greater job loss in labor-intensive sectors than in less labor-intensive sectors. Direct state and local government jobs are more labor intensive than aerospace jobs. For example, schools and prisons are less able to substitute machinery and equipment for teachers and prison guards. In contrast to government sector jobs, aerospace jobs are more capital intensive.
- In general, state and local government expenditures are made in Washington and these expenditures contribute to the state's economy. In contrast, the REMI model estimates aerospace product manufacturers import 50 percent of their component parts and materials from other states and nations.
- State and local government spending on goods and services creates jobs in the private sector, such as construction jobs through funding for the building of roads and schools. Reductions in government spending may result in private sector job losses in sectors that sell goods and services to government.
- Induced job effects occur as workers spend their job compensation on other purchases such as in retail stores and restaurants. The magnitude of induced job effects in response to changes in direct and indirect spending depends in part on how much of the expenditures in a given sector are used for employee compensation. REMI estimates that 56 percent of spending in the Washington state and local government sector is on employee compensation, compared to 34 percent in the aerospace industry.

The economists interviewed by JLARC staff advised us to consider sensitivity analysis on the impact of the preferences on reducing aerospace production costs. JLARC staff modeled two such alternatives, one where the impact of the preferences on reducing production costs are double what the original model simulation estimates, and a second where the aerospace sector responds to the reduced production costs by increasing business activity gradually over time.

These alternate scenarios also result in an increase in aerospace jobs and a decrease in economy-wide jobs resulting from the effects of government spending reductions without an increase in 787 jobs. In both cases, economy-wide employment declined, ranging from a loss of 1,500 jobs to a loss

of 6,500 jobs over the long run. More details on these two alternatives can be found in the Supplement to Aerospace Industry Tax Preference Economic Impact Analysis which follows this chapter.

Conclusion of the REMI Analysis

Scenario 2 represents the JLARC staff's best estimate of what would have happened to the state's economy if the tax reductions resulted in new in-state jobs for the 787 production line. Scenario 3, where Boeing builds the 787 production line in Washington without creating new jobs, may have also been a plausible outcome at the time. Boeing has increased its Washington employment since 2003, but JLARC staff cannot determine if those jobs are a direct cause of the tax preferences. We are not able to determine the likelihood that Scenario 1, the loss of 80 percent of Boeing employment over time, would have occurred in the absence of the tax preferences.

Other States

Do other states have similar tax preferences and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

JLARC staff based the analysis of other states' tax preferences on states with a location quotient ranking in the top five nationwide, as well as other states with Boeing employment. These seven states–Alabama, Arizona, California, Connecticut, Kansas, Missouri, and South Carolina–provide tax preferences broadly to all manufacturers including aerospace manufacturers. Washington provides tax preferences targeted to the aerospace industry.

Exhibit 16 on the following page shows that four comparison states provide tax credits for capital costs, including manufacturing facilities and machinery and equipment. All comparison states except Alabama offer tax credits for research and development expenses by manufacturers. All states offer property tax preferences to manufacturers except Arizona and Missouri. Kansas and California provide property tax relief only to firms that create jobs. All states except California exempt manufacturing machinery and equipment from sales and use taxes. Two states including Washington provide some sales and use tax exemptions for computers, while two states exempt construction. Kansas and South Carolina have the ability to offer direct cash subsidies which Washington's constitution forbids.

The preferential B&O tax rates for manufacturing aerospace products or providing aerospace services are not included in the exhibit because of the lack of comparable corporate net income tax data on the aerospace industry in other states.

Exhibit 16 – Washington's Tax Preferences Target Aerospace Industry
Other States' Tax Preferences Apply Broadly to All Manufacturing

	Tax Credits			Property Tax Preference		Sales Tax Exemptions		Cash Grants No Interest Loans
States	**Capital Costs**	**R&D Expenses**	**New Jobs**	**Duration**	**Type of Property / Criteria**	**Machinery Equip.**	**Other**	
Washington (aerospace)		*Yes*		*Until 7/1/2024*	*New plant, renovation expansion, machinery, equipment, computers*	*Yes*	*Computers*	*Not offered (Unconstitutional)*
Alabama	Plant and equipment		Yes	10 years	New investment	Yes	Facilities construction	Not offered
Arizona		Yes	Yes			Yes		Not offered
California	Machinery equipment	Yes		5 years	Personal property/ job creation			Not offered
Connecticut	Machinery equipment	Yes	Yes	5 years	Machinery and equipment	Yes		Not offered
Kansas	Plant and equipment	Yes		10 years	Real and personal/ Job creation	Yes	Construction	Cash grants No interest loans
Missouri		Yes	Yes			Yes		Not offered
South Carolina		Yes	Yes	5 years	Relocation, expansion	Yes	Computers	Cash grants

Source: JLARC staff analysis of other states tax laws.

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Comparing the total tax burden for the aerospace industry in other states is not possible. This is because JLARC staff do not have access to other states' tax records. Without these records, JLARC staff would need to make assumptions about many factors related to the nature and behavior of the aerospace industry across the seven states. The uncertainty related to these assumptions would make tax burden estimates unreliable. Factors impacting tax burdens include, among others: income apportionment across the states, magnitude of specific activities and investments in each state, total deductions available for determining income, and the amount of offsetting grants or loans.

Legislative Auditor Recommendation

There is evidence that the original public policy objectives the Legislature established for these preferences are being achieved:

- There is a continued presence of the aerospace industry and suppliers and vendors that support the aerospace industry;
- There has been a reduction in the cost of doing business in Washington for beneficiaries of these tax preferences; and
- Beneficiaries are providing jobs with good wages and benefits.

JLARC staff do not assert whether there is a causal relationship between these outcomes and the tax preferences.

In 2013, the Legislature specified a new public policy objective for these preferences: to maintain ***and grow*** Washington's aerospace industry workforce. The Legislature also directed JLARC to review these aerospace tax preferences in 2019 and every five years thereafter.

The Legislature would facilitate these future reviews by providing additional detail within the tax preference performance statement for these preferences. This additional detail would be consistent with the Legislative Auditor's January 2014 guidance for drafting performance statements in tax preference legislation. This additional detail would include:

- Identification of the tax preference logic chain and the specific target level the Legislature wants JLARC staff to use in future evaluations of the effectiveness of these preferences, such as a specific number or percentage increase in aerospace and support industry jobs;
- Direction to JLARC staff whether to evaluate the preferences' effectiveness based on achieving targets or determining causality. It is much more likely that an evaluation will have a conclusive answer to whether a target was achieved than an answer to whether there was a causal relationship between a tax preference and a target.

Legislative Auditor Recommendation: **The Legislature should review and clarify tax preferences for the aerospace industry and their suppliers because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.** The Legislative Auditor's guidance document for drafting performance statements provides information on what additional detail to include.

Legislation Required: Yes.

Fiscal Impact: Depends on legislative action.

SUPPLEMENT TO AEROSPACE INDUSTRY TAX PREFERENCE ECONOMIC IMPACT ANALYSIS

This supplement provides technical information about the economic analysis of the aerospace tax preferences reviewed in the main body of this report. Topics addressed in this supplement include:

1) Explanation of the process JLARC staff followed to develop the economic impact analysis, including soliciting advice from economists knowledgeable of the aerospace industry;
2) Selection of an appropriate economic model;
3) Details on the sensitivity analysis of the impact of the tax preferences on reducing aerospace production costs; and
4) Information on employment multipliers for the aerospace industry and for state and local government.

Process for Developing Economic Impact Estimates

JLARC staff included the following steps to analyze the aerospace tax preferences:

- Researched whether a causal analysis of the influence of taxes on aerospace industry location was feasible;
- Estimated economic impacts using the REMI model;
- Convened several private sector and government economists for advice on methodology and comments on preliminary results; and
- Measured opportunity costs of the tax preference by comparing the economic impact of the tax preferences to the economic impact of government spending.

JLARC staff first analyzed whether a causal analysis was feasible. In this instance, the causal analysis would seek to determine whether a statistically valid relationship existed between the tax preference and the Legislature's stated goal of maintaining an aerospace presence in Washington.

Expert economists advised us that it would be difficult to establish a causal relationship between the aerospace tax preferences and any economic outcomes because these outcomes were highly dependent on the Boeing Company's "yes or no" decision to build the 787 production line in Washington. The economists advised us that many indeterminate and unquantifiable factors entered into this location decision which, among others, includes the availability of a skilled labor force, the need to reduce costs, and the risks of concentrating the company's operations in any one state.

After further consultation, JLARC staff determined that a sound approach would be to model the economic impacts to the state using the REMI model, which is widely used by other state governments and research organizations, and contains private industry sectors as well as the state and local government sector. We convened the economists in a second round to comment on preliminary results from the REMI model. The economists advised us to consider sensitivity analysis, which is described in a subsequent section of this supplement.

Specifically, we wish to acknowledge the insightful comments and feedback provided by Timothy Bartik, the Upjohn Institute; Bob Baker and Fanny Roberts, Office of Financial Management; Dick Conway, Dick Conway & Associates; Steve Lerch, Economic and Revenue Forecast Council; Rick Peterson, Office of the State Treasurer; Steve Smith, Department of Revenue; Kriss Sjoblom, Washington Research Council; and Cathy Carruthers, consultant. In addition, we also thank consulting economist Greg Weeks for his ongoing assistance and contributions throughout this process.

Selection of an Economic Model

When conducting economic impact analysis, statute directs JLARC staff to use a model used by the Office of Financial Management (OFM). OFM currently uses two models to estimate the economic impacts of policy choices: REMI and the Washington Input/Output model. JLARC staff selected REMI for the following reasons:

- REMI contains 170 industry sectors compared to only 62 sectors for the WA I/O model.
- REMI includes state and local government as an industry sector within the model and measures its purchases of goods and services and supplies of goods and services to other industries using methods similar to other private sector industries. The WA I/O model does not treat the government sector the same as other sectors.
- REMI estimates numerous economic effects, including changes in economy-wide employment, personal and disposable income, migration, output, gross domestic product (GDP), and the value added of each sector including government. WA I/O only estimates employment, income, and output.
- REMI is widely used by other state governments and well-regarded research organizations. It is employed by 30 state governments across the nation, as well as numerous institutions of higher education and consulting firms.
- REMI uses multiple economic analysis methods in determining its estimates. These include aspects of four major modeling approaches: input-output, general equilibrium, econometric, and economic geography.

Sensitivity Analysis of the Impact of the Preferences on Production Costs

As described in the body of the report, REMI Scenario 3 simulates the aerospace industry response to the tax preferences by reducing aerospace production costs by an estimate of Washington's aerospace tax preferences. In this scenario, Boeing does not add the 4,600 jobs in connection with the 787 production line. The scenario includes the assumption that government spending is reduced by the same amount as the tax preferences.

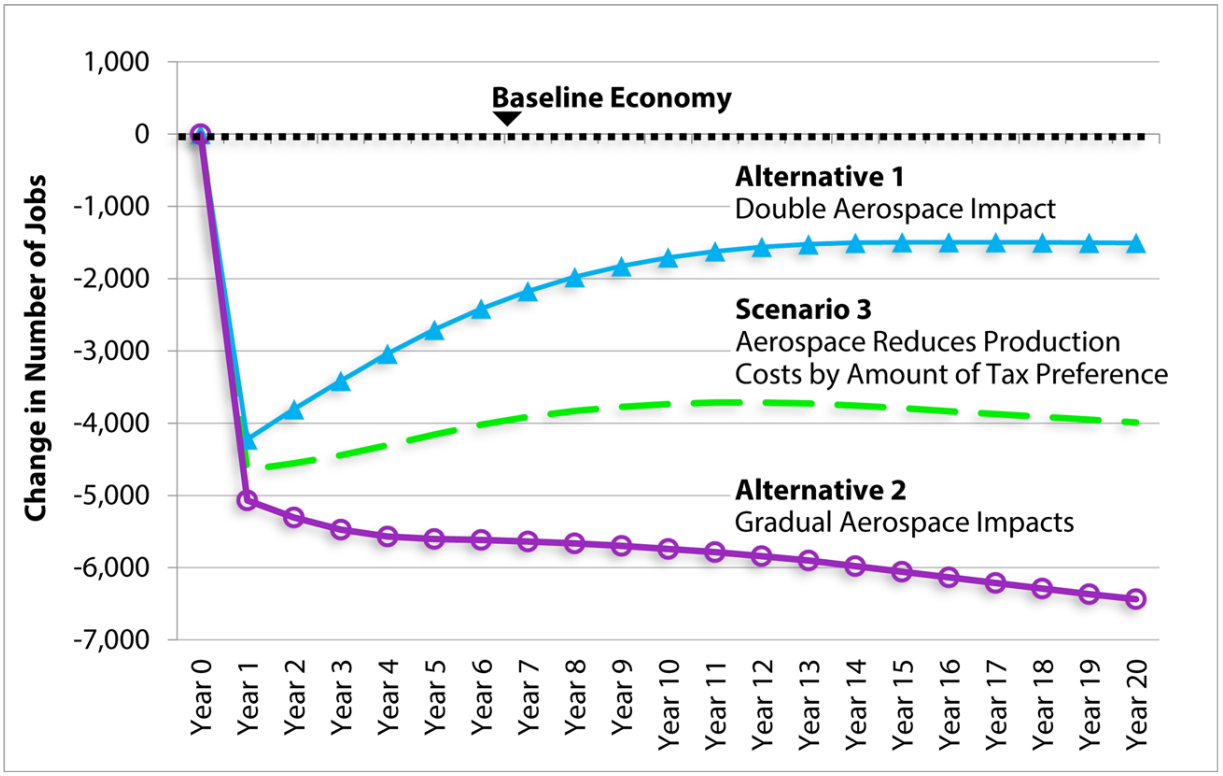
REMI defines production costs as costs that are undertaken in Washington, such as labor compensation and capital costs. In REMI, reductions in production costs increase in-state business activity.

JLARC staff tested the sensitivity of Scenario 3 by modeling two alternatives. The alternatives assume two different industry responses to reduced production costs, as follows:

Alternative One	The aerospace response to reduced production costs is double what the original model simulation estimates. That is, for every dollar the state forgoes in tax revenue, aerospace business activity increases by two dollars. Simultaneously, this alternative reduces state and local government spending by the amount of the tax preference.
Alternative Two	The aerospace industry responds to reduced production costs by increasing business activity gradually over time. This alternative draws on economic research that estimates a 10 percent reduction in business costs due to a tax cut increases business activity by 2 percent in the long run.[1] Simultaneously, this alternative reduces state and local government spending by the amount of the tax preference.

Exhibit 17 below shows that Scenario 3 and the two sensitivity alternatives all result in a long-run net decrease in economy-wide jobs. The job gains related to the reduction in aerospace production costs are more than offset by the simultaneous job loss of reduced government spending. Net employment losses range from 1,500 jobs under Sensitivity Analysis Alternative 1 to 6,500 jobs under Sensitivity Analysis Alternative 2 over the long run. The sensitivity analysis supports the overall conclusion that Scenario 3 results in net job losses.

Exhibit 17 – Sensitivity Tests of Change in Total Net Jobs (Private and Public)



Source: JLARC staff analysis using REMI.

[1] Timothy Bartik & George Erickcek, The Employment and Fiscal Effects of Michigan's MEGA Tax Credit Program, Upjohn Institute Working Paper, (2010)

Employment Multipliers

The estimated economic impacts shown for the various scenarios in the aerospace economic analysis depend in part on the effects of employment multipliers. Employment multipliers measure the direct, indirect, and induced jobs in the economy for each direct job in a given industry. As an example using the aerospace industry:

- A direct job is a worker assembling an airplane,
- An indirect job is an employee of an airplane design firm or a tire manufacturer, and
- An induced job is generated when direct and indirect workers spend their wages purchasing in the retail, service, real estate, or other sectors of Washington's economy.

Exhibit 18 below shows estimates of employment multipliers for the aerospace sector using REMI and Washington Input-Output (WA I/O). The most current version of REMI also includes an employment multiplier for state and local government.

Aerospace industry employment multipliers shown in Exhibit 18 range from a high of 3.96 in the 2009 REMI model to a low of 2.7 in the 2007 version of WA I/O. A multiplier of 3.96 means that for every one direct job, an additional estimated 2.96 indirect or induced jobs are also created within the state.

REMI employment multipliers for the industry tend to be higher than WA I/O multipliers. The 2014 REMI model used in the JLARC staff analysis also includes a multiplier for the government sector that is lower than the aerospace industry multiplier, meaning that a direct government job generates fewer indirect and induced jobs in the economy than an aerospace sector job.

Exhibit 18 – Multipliers Vary Depending on Type of Model Used and Year the Model was Developed

	2014 REMI	2009 REMI	2007 WA I/O	2002 WA I/O
Aerospace Industry	3.5	3.96	2.7	2.814
State and Local Government	2.0	NA	NA	NA

Source: JLARC staff using REMI and Washington Alliance for a Competitive Economy[2] and Community Attributes, Inc.,[3] data.

[2] Washington Alliance for a Competitive Economy, What if Boeing Left Washington? (2009)

[3] Community Attributes, Inc., for the Washington Aerospace Partnership, Washington State Aerospace Industry: Economic Impact (2013)

CERTIFIED AIRCRAFT REPAIR FIRMS (B&O TAX)

Report Summary			
What the Preference Does	**Public Policy Objectives**	**Estimated Beneficiary Savings**	**Auditor Recommendation**
Certified Aircraft Repair Firms (B&O Tax)			
Provides a preferential tax rate of 0.2904 percent to federally certified aviation repair stations.	The Legislature stated the public policy objectives: • To encourage the continued presence of suppliers and vendors that support the Washington aerospace industry; • To reduce the cost of doing business in Washington for aerospace suppliers and vendors; and • To provide jobs with good wages and benefits for aerospace suppliers and vendors.	$1.3 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired number of jobs would facilitate future reviews of the preference.

CERTIFIED AIRCRAFT REPAIR FIRMS (B&O TAX)

Current Law

Under current law, federally certified aviation repair stations are taxed at a preferential business and occupation (B&O) tax rate of 0.2904 percent on sales of repair services and component parts. Other interstate transportation equipment repair services and parts are taxed at the B&O rate of 0.484 percent.

For aviation repair stations to qualify for the preferential B&O tax rate, they must be certified by the Federal Aviation Administration (FAA) to perform maintenance, repair, and overhaul of aircraft and aircraft products. The repair services and component parts must be for transportation equipment used in interstate or foreign commerce or intrastate air transportation by a common carrier.

This tax preference and the other aerospace tax preferences expire on July 1, 2024. The expiration date is extended to July 1, 2040, if a significant commercial airplane manufacturing program is sited in Washington by June 30, 2017. A significant program includes the manufacture of a new or variation of an existing airplane, the fuselage, and the wings.

Certified aircraft repair stations also qualify for other aerospace tax preferences that are reviewed separately in this 2014 report:

1) Retail sales and use tax exemptions for computer hardware, peripherals, and software used in providing aerospace services (RCWs 82.08.975 and 82.12.975);
2) A B&O tax credit for aerospace product development expenditures (RCW 82.04.4461); and
3) A B&O tax credit for property or leasehold excise taxes paid on new buildings, renovations, and expansions and on computers and peripherals (RCW 82.04.4463).

Services and parts for aviation repair and repair of other interstate transportation equipment are also exempt from sales and use taxes. For details on these exemptions, see the 2010 JLARC review of Interstate Transportation Equipment (Sales Tax).

See Appendix 3 for the current statute, RCW 82.04.250(3).

Legal History

2003 The Legislature provided a lower B&O tax rate of 0.275 percent to ***a limited class of federally certified aviation repair stations***. Without the preference, these repair stations would have paid at a rate of 0.484 percent. According to the fiscal note, two aviation repair stations in Washington qualified for the tax preference. The bill required beneficiaries to report employment information each quarter to the Department of Revenue (DOR), but it did not require the agency to report on the performance of the tax preference. The lower tax rate took effect August 1, 2003, and was set to expire on July 1, 2006.

In the same year, the Legislature enacted a package of tax preferences for manufacturers of commercial airplanes or their components.

2006 The Legislature extended the expiration date of the preferential rate to July 1, 2011, as part of a larger bill benefiting the aerospace industry. The preferential rate was increased to 0.2904 percent to match the existing rate for commercial aircraft manufacturing, wholesaling, and retailing. The new rate became effective July 1, 2006, and was set to expire on July 1, 2011.

2008 The Legislature expanded the preferential rate to include ***all federally certified aviation repair stations***. In the same bill, the Legislature extended three existing aerospace tax preferences adopted in 2003 to aviation repair stations: sales and use tax exemptions for computer expenditures, a B&O tax credit for product development expenditures, and a B&O tax credit for property and leasehold excise taxes paid.

The legislation also required beneficiaries to file annual reports detailing employment, wage, and benefit information. The Legislature initially required the legislative fiscal committees to study the incentive by December 2010, but it later eliminated the study provision before the due date when it repealed studies duplicated by JLARC's reviews of tax preferences.

2010 The Legislature extended the expiration date of the preferential rate for aviation repair stations to July 1, 2024, the same expiration date as other aerospace incentives.

2013 In the third special session, the Legislature extended the expiration dates to July 1, 2040, for several aerospace tax preferences, including the certified aviation repair station preferential tax rate, contingent on the siting of a significant commercial airplane manufacturing program in Washington by June 30, 2017. A significant program includes the manufacture of a new or variation of an existing airplane, the fuselage, and the wings. The legislation requires JLARC to conduct reviews of the aerospace incentives every five years beginning December 1, 2019.

Public Policy Objectives

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?

In 2008, when the Legislature expanded eligibility for the preferential B&O rate to ***all federally certified aviation repair stations*** and provided them the same tax treatment as other aerospace industry tax preferences first adopted in 2003, the Legislature's stated objectives for the preferences were:

1) *To encourage the continued presence* of suppliers and vendors that support the Washington aerospace industry;
2) *To reduce the cost of doing business* in Washington for suppliers and vendors that support the Washington aerospace industry compared to locations in other states; and
3) *To provide jobs with good wages and benefits* for suppliers and vendors that support the Washington aerospace industry.

In 2013, with the extension of the aerospace tax incentives from 2024 to 2040, the Legislature added to the previous public policy objectives. The Legislature included a performance statement as

required under ESSB 5882 (2013, 2nd sp. Sess.) and declared its "specific public policy objective is ***to maintain and grow Washington's aerospace industry workforce***."

What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives?

Evidence shows that the 2008 public policy objectives are being met. However, JLARC staff do not assert whether there is a causal relationship between these outcomes and the tax preference.

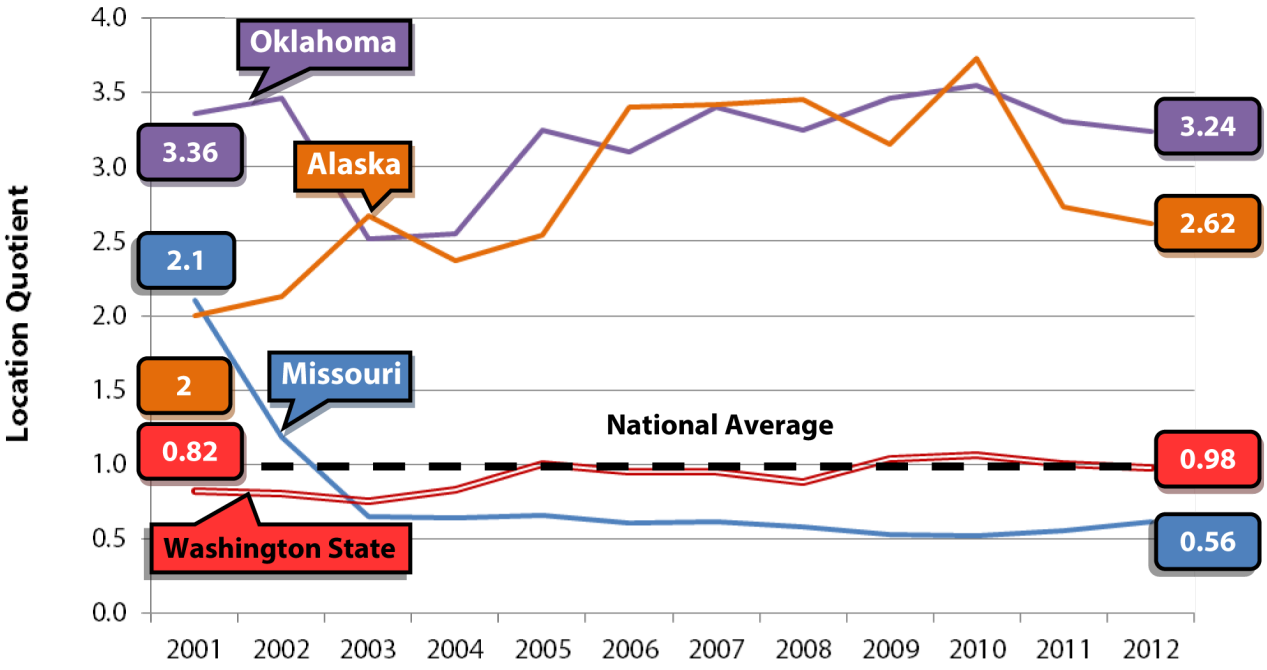
1) Continued presence of suppliers and vendors that support aerospace industry

Evidence on employment concentration shows that aviation maintenance and repair firms have maintained a continued presence in Washington. JLARC staff measured the employment concentration by using Bureau of Labor Statistics location quotients. Location quotients compare a state's share of employment in an industry to the total national share of employment in that industry. A location quotient of 1.0 means an industry is equally concentrated in the state as in the nation.

Location quotients are available for the aviation repair and other aviation support industries which is representative of aviation repair stations qualifying for the tax preference.

Exhibit 19 below shows location quotients for four states from 2001 through 2012. Washington's location quotient for aviation repair and support services employment has remained close to the national average and has remained stable since 2005. Oklahoma and Alaska are included in the exhibit because these two states rank the highest in the nation of aviation repair and support employment. Missouri is included in the Exhibit because it shows how a location quotient can change over time. Missouri had an above average concentration of industry employment in 2001, but it had a below average industry concentration by 2012.

Exhibit 19 – Stability of Washington's Aviation Repair and Support Employment Is Evidence of Its Continued Presence



Source: Bureau of Labor Statistics location quotient calculator.

2) Cost of doing business in Washington compared to locations in other states

The preferential B&O tax rate reduced the cost of doing business for aviation repair stations in Washington by reducing the industry's Washington tax liability. Before the 2003 preferential tax rate became effective, certified aviation repair stations paid the same B&O tax rate as other retailers of interstate transportation equipment of 0.484 percent. Currently, beneficiaries of the preferential rate pay a B&O tax rate of 0.2904 percent, a 40 percent reduction in tax.

Other states may be offering tax or cash incentives to the industry that may exceed taxpayer savings from Washington's preferential B&O rate, but this is difficult to quantify because of the differences in state tax systems and the types of incentives. Also, there are other factors that contribute to costs and that differ between states such as regulation, energy, transportation, infrastructure, and labor availability.

3) Jobs with good wages and benefits

Beneficiaries reported on the DOR annual report that the number of employees grew from 2,241 to 2,893 from 2009 through 2012, a 30 percent increase. Exhibit 20 below shows beneficiaries paid higher average wages than the transportation and warehousing industry as a whole during the same time period. The transportation and warehousing industry was chosen for this comparison because it is the industry classification that includes aviation repair stations.

Exhibit 20 – Beneficiaries Pay Higher Average Wages Than the Transportation & Warehousing Industry as a Whole, 2009–2012

Calendar Year	Average Wages Paid by:	
	Aviation Repair Station Beneficiaries	Transportation & Warehousing Industry as a Whole
2009	$57,479	$46,524
2010	$59,291	$47,742
2011	$60,868	$49,628
2012	$67,095	$50,877

Source: Employment Security Department quarterly employment. For the four-year period, JLARC staff found a 97 percent match between beneficiary employment reported to the Department of Revenue on the Annual Report and employment reported to ESD.

Exhibit 21 below shows that beneficiaries of the tax preference provided medical and retirement benefit coverage to a higher percentage of their employees than the transportation and warehousing industry as a whole in 2012.

Exhibit 21 – Beneficiaries Provide Benefits to a Higher Percentage of Employees Than the Transportation and Warehousing Industry, 2012

	Beneficiaries	Transportation & Warehousing
Medical Benefits		
Percent of ***Employees*** Offered Health Insurance	96%	80%
Percent of ***Firms*** Offering Health Insurance	81%	54%
Retirement Plans		
Percent of ***Employees*** Offered Retirement Plans	89%	81%
Percent of ***Firms*** Offering Retirement Plans	62%	37%

Source: JLARC staff analysis of Department of Revenue Annual Reports and Employment Security Department 2012 Employee Benefits Survey.

To what extent will continuation of the tax preference contribute to these public policy objectives?

While evidence is consistent with a finding that the 2008 public policy objectives are being achieved, JLARC staff do not assert whether there is a causal relationship between these outcomes and the tax preference.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

In 2013, Washington had 113 federally certified aviation repair stations. Of these, 35 benefited from the tax preference in Fiscal Year 2013. Not all certified aviation repair stations qualify for the preferential rate because some provide services for private airplanes not used in interstate or foreign commerce. Beneficiaries of the preference saved $480,000 in FY 2013 and paid $50 million in wages, or a savings equal to 1 percent of wages.

Revenue and Economic Impacts

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?

Beneficiaries of the preferential tax rate for federally certified aviation repair stations saved $480,000 in Fiscal Year 2013, the most recent year for which tax return data is available. They are estimated to save $1.3 million in the 2015-17 Biennium. (See Exhibit 22 below.)

Exhibit 22 – Estimated 2015–17 Beneficiary Savings from the Preferential Tax Rate for Aviation Repair Stations

Fiscal Year	Beneficiary Preferential B&O Tax Rate Savings
2013	$480,000
2014	$503,000
2015	$563,000
2016	$625,000
2017	$682,000
2015-17 Biennium	$1,307,000

Source: JLARC staff analysis of Department of Revenue Tax Returns. Fiscal Years 2014-2017 are estimates.

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?

If the tax preference were terminated, the B&O tax rate for certified aviation repair stations would revert to the previous rate of 0.484 percent. Beneficiaries would have a 40 percent increase in their tax liability. Costs would increase depending on the extent to which beneficiaries absorb the tax increase or pass it on to their customers.

Some firms may qualify for the preferential B&O tax rate for manufacturers, wholesalers, or retailers of commercial airplanes or component parts (a different preference).

Other States

Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

JLARC staff found four states other than Washington that provide tax benefits specifically directed at aviation repair stations:

- Colorado provides a $1,200 income tax credit for each new employee of an aviation repair firm that employs at least ten full-time workers located in an aviation development zone.
- Oklahoma provides a package of benefits to aviation repair firms that is similar to Washington's. These include a sales tax exemption for computers and a property tax exemption for new buildings and expansions. Oklahoma also provides an income tax credit for new jobs for up to ten years.
- Missouri recently offered cash awards to a Washington certified aviation repair station planning to create 500 jobs in Kansas City.
- New Mexico allows aircraft manufacturers or affiliates to deduct receipts from sales of services performed on aircraft or parts from its gross receipts tax.

Legislative Auditor Recommendation

There is evidence that the public policy objectives the Legislature established for this preference in 2008 are being achieved: a continued presence of the aerospace industry and suppliers and vendors that support the aerospace industry; a reduction in the cost of doing business in Washington for beneficiaries of the tax preference; and those beneficiaries providing jobs with good wages and benefits. However, JLARC staff do not assert whether there is a causal relationship between these outcomes and the tax preference.

In 2013, the Legislature specified a new public policy objective for this preference: to maintain **and grow** Washington's aerospace industry workforce. The Legislature also directed JLARC to review this and other aerospace tax preferences in 2019 and every five years thereafter.

The Legislature could facilitate these future reviews by providing additional detail within the tax preference performance statement for this preference. This additional detail would be consistent with the Legislative Auditor's January 2014 guidance for drafting performance statements in tax preference legislation. This additional detail would include:

- Identification of the tax preference logic chain and the specific target level the Legislature wants JLARC staff to use in future evaluations of the effectiveness of this preference, such as a specific number or percentage increase in aerospace and support industry jobs;
- Direction to JLARC staff whether to evaluate the preference's effectiveness based on achieving targets or determining causality. It is much more likely that an evaluation will have a conclusive answer to whether a target was achieved than an answer to whether there was a causal relationship between a tax preference and a target.

Legislative Auditor Recommendation: **The Legislature should review and clarify the preferential B&O tax rate for certified aviation repair stations because providing additional detail in the tax preference performance statement such as a measure of the desired number of jobs would facilitate future reviews of the preference.** The Legislative Auditor's guidance document for drafting performance statements provides information on what additional detail to include.

Legislation Required: Yes.

Fiscal Impact: Depends on legislative action.

COMMERCIAL AIRPLANE PART PLACE OF SALE (B&O TAX)

Report Summary			
What the Preference Does	**Public Policy Objectives**	**Estimated Beneficiary Savings**	**Auditor Recommendation**
Commercial Airplane Part Place of Sale (B&O Tax)			
Provides a B&O tax exemption for sales of certain airplane parts made by an out-of-state manufacturer if they are sold to a Washington manufacturer of a commercial airplane.	The Legislature stated the public policy objectives in a larger package of aerospace preferences containing this exemption: • To encourage the continued presence of suppliers and vendors that support the Washington aerospace industry; • To reduce the cost of doing business in Washington for aerospace suppliers and vendors; and • To provide jobs with good wages and benefits for aerospace suppliers and vendors	Unknown because beneficiaries are not required to report amount of exemption claimed.	**Review and clarify:** Because it seems to run counter to the Legislature's stated policy objective of reducing the cost of doing business in Washington compared to locations in other states. In addition, the Legislature may want to consider adding reporting or other accountability requirements that would provide better information on out-of-state manufacturers' use of this preference.

COMMERCIAL AIRPLANE PART PLACE OF SALE (B&O TAX)

Current Law

Sales of certain airplane parts made by out-of-state manufacturers are exempt from business and occupation (B&O) tax if they are sold to a Washington manufacturer of commercial airplanes. Statute accomplishes this by defining where the sale of these parts is considered to take place. Liability for B&O taxation of these airplane parts occurs at the place of final testing or inspection. If this final testing or inspection occurs outside Washington, the sale is exempt from B&O tax.

In order to qualify for the exemption, the airplane parts must be tested and inspected as part of a production or quality control system required and approved under Federal Aviation Administration (FAA) regulations. The exemption applies to parts such as propellers and engines where the FAA must approve the design and the manufacturing and quality control processes. The preferential tax treatment does not apply to standard parts such as nuts and bolts, to parts that are tested and inspected in Washington, and to parts for which FAA certification or approval is not required.

The buyer of the parts must be an in-state manufacturer of commercial airplanes. Statute defines a commercial airplane as an airplane certified by the FAA for transporting persons or property and any military derivative of such an airplane.

See Appendix 3 for the current statute, RCW 82.04.627.

Legal History

B&O tax liability for out-of-state manufacturers depends on whether the sale of their goods is considered to take place in-state or outside of Washington. If the sale is considered to take place in Washington, the out-of-state manufacturer owes B&O tax, unless some other preference applies. This section traces the legal history on the determination of "place of sale" for goods in general and for airplane parts in particular. Sales of airplane parts were treated the same as goods in general until 1999, when DOR began treating the sale of airplane parts differently.

Pre-1992 Prior to a rule change in 1992, the courts and the Department of Revenue (DOR) determined the "place of sale" of goods originating outside the state to be in Washington if:

- The goods are delivered to the buyer in Washington; ***and***
- The seller has nexus "essential to the completion of the sale."

Nexus exists when the seller carries on activities in Washington significantly associated with the seller's ability to establish or maintain a market for its products. A seller may establish nexus by means such as maintaining a place of business or soliciting orders in this state.

As with goods in general, this pre-1992 determination of place of sale meant that an airplane parts manufacturer located out of state and selling to a Washington commercial airplane manufacturer paid Washington's B&O tax if it met both of these conditions.

1992 DOR changed its interpretation of "place of sale" in a new rule (WAC 458-20-193). The change was to add consideration of where the buyer inspected the goods and where final acceptance of the goods took place. Under the new rule, delivery was considered to take place out of state and was not taxable in Washington if the ***buyer's employee or agent*** at the out-of-state site had "express written authority to accept or reject the goods for the purchaser with the right of inspection." This rule exempted sales originating from out of state if the buyer's agent or employee conducted the inspection at the site of the out-of-state manufacturer.

1999 Consistent with its 1992 rule, DOR determined that an out-of-state seller is taxable when the *seller's employee* inspects and accepts goods on behalf of a Washington buyer if the buyer reserves the right to final inspection in this state. The determination noted that it left undecided the situation where the seller's employee conducts a final inspection and accepts the goods at an out-of-state site on behalf of the buyer.

Following the 1999 decision, DOR began treating out-of-state sales of airplane parts differently than goods in general. For sales of airplane parts, DOR began exempting these parts in specific circumstances where the ***buyer designated the seller's employee to inspect and accept parts at the manufacturing site and the inspection followed FAA approved methods***.

2003 The Legislature enacted a package of tax preferences targeting manufacturers of commercial airplanes and their components. The tax package included a preferential B&O rate for wholesale sales of commercial airplane parts that applied to both in-state and out-of-state manufacturers. However, the preferential rate did not apply to out-of-state manufacturers if the sale took place at an out-of-state location because DOR treated these sales as exempt from B&O tax.

The preferential B&O tax rate for sales of airplane parts is reviewed separately in this 2014 report.

2008 The Legislature expanded the 2003 aerospace tax preferences in a bill that included this tax preference. The bill did not specifically require an agent or a designee to inspect and accept the parts on behalf of the buyer, but it did provide that the production and quality control system must be one that requires approval by the FAA.

According to DOR and the chair of the House Finance Committee, the provision clarified the Department's existing interpretation of "place of sale" tax law.

Other Relevant Background

This tax preference results in preferential tax treatment for out-of-state manufacturers of certain airplane parts when compared to in-state manufacturers of these parts. Exhibit 23 below illustrates the different tax treatment using the example of a $1 million sale of airplane parts.

Exhibit 23 – Example of Different Tax Treatment on Sale of Parts to Washington Commercial Airplane Manufacturer Depending on Place of Sale

Place of Sale	Value of Sale	B&O Tax Rate	B&O Tax Owed
In-state manufacturing site	$1 million	Tax = Preferential rate of 0.2904% X value of the sale	$2,904
Out-of-state manufacturing site	$1 million	Exempt	$0

Source: JLARC staff analysis of tax law.

Public Policy Objectives

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?

JLARC staff found two potential public policy objectives for this preferential tax treatment for sales of parts originating from an out-of-state manufacturer to a Washington manufacturer of a commercial airplane.

1) The Legislature stated broad public policy objectives that applied to the entire 2008 package of aerospace tax preferences. This package extended existing aerospace tax preferences to additional suppliers and vendors. The objectives are to ***encourage the continued presence of the aerospace industry*** for this new group of suppliers, to comprehensively ***address the cost of doing business in Washington compared to locations in other states***, and to ***provide well-paying jobs***.
2) JLARC staff infer from public testimony that the Legislature wanted to ***clarify DOR's existing interpretation of "place of sale"*** for sales of commercial airplane parts by out-of-state manufacturers.

What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives?

1) Broad Policy Objectives

The public policy objectives stated in 2008 applied to a number of tax preferences for aerospace suppliers excluded from previously enacted aerospace preferences:

> …the Legislature recognizes that key elements of Washington's aerospace industry cluster were afforded few, if any, of the aerospace tax incentives enacted in 2003 and 2006.

By making reference in its intent statement to the "Washington's aerospace industry cluster" and "well-paying jobs," the Legislature indicated its intention to benefit in-state suppliers. The Legislature also stated the objective of reducing the cost of doing business for Washington suppliers that support the state's aerospace industry compared to locations in other states.

As illustrated in Exhibit 23 above, the tax preference is not directly contributing to the stated public policy objectives because it provides greater tax advantages to out-of-state airplane part manufacturers than to in-state manufacturers.

A Washington commercial airplane manufacturer could benefit indirectly to the extent that the out-of-state parts manufacturer chooses to pass on its taxpayer savings to the buyer.

2) Clarifying Existing Interpretation of "Place of Sale" for Airplane Parts

JLARC staff infer from testimony that another public policy objective was to clarify DOR's existing interpretation of tax law.

This tax preference legislation followed 50 years of attempts by the courts and DOR to define "place of sale" for sales originating from out of state for purposes of state taxation. WAC 458-20-193 published in 1992 changed previous interpretations by exempting sales where the ***buyer's agent*** had inspected the goods at the seller's manufacturing site. Beginning in 1999, DOR began exempting sales of airplane parts sold into Washington where a buyer designated a ***seller's employee*** to conduct the inspection as long as the inspection followed FAA-approved methods.

In public testimony, the chair of the House Finance Committee and DOR called the 2008 legislation a clarification of existing DOR interpretation and practice. However, unlike the DOR interpretation, the statute is silent about who inspects and accepts the goods.

To what extent will continuation of the tax preference contribute to these public policy objectives?

Continuation of the preference will continue to provide greater tax advantages to out-of-state airplane part manufacturers than to in-state manufacturers.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

Beneficiaries of this preference are out-of-state manufacturers of certain airplane parts that sell these parts to a Washington manufacturer of commercial airplanes. It is not possible to identify the specific beneficiaries of the tax preference because beneficiaries are not required to report to DOR. Beneficiaries are located out of state and may not be registered with DOR. Unless the Legislature requires beneficiaries to register and report, they cannot be identified.

Revenue and Economic Impacts

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?

Taxpayer savings due to the preference cannot be estimated because beneficiaries are not required to report the amount of the exemption they are taking. Unless the Legislature requires beneficiaries to report the amount of exemption claimed, taxpayer savings cannot be determined.

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?

If the tax preference were terminated, "place of sale" for sales of airplane parts originating out of state to a commercial airplane manufacturer would be determined according to DOR's 1992 rule (WAC 458-20-193). The rule addresses "place of sale" for all sales originating from out of state and does not explicitly recognize different treatment for sales of parts to a commercial airplane manufacturer.

Other States

Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

Unlike Washington, no other state provides a tax exemption for the income from sales originating from out of state to a commercial airplane manufacturer.

Most states impose net income taxes that ensure at least a portion of sales into their state is taxed. Income tax states apportion out-of-state manufacturing income to their state according to one or more factors including payroll, property, and sales. States that conform to uniform standards of apportionment (under the Uniform Division of Income for Tax Purposes Act or UDITPA), apportion manufacturing income to the ultimate destination of the sale without regard to who pays shipping costs or other conditions of the sale. Currently, 23 states conform to UDITPA standards for sales factor apportionment.

Legislative Auditor Recommendations

When the Legislature expanded aerospace preferences to in-state suppliers in 2008, it explicitly stated its intent to more comprehensively address the cost of doing business ***in Washington*** compared to locations in other states. In contrast, with the preference under review here, the Legislature has provided out-of-state manufacturers of airplane parts with more advantageous tax treatment than the in-state manufacturers supplying these parts.

Legislative Auditor Recommendations:

The Legislature should review and clarify the preferential tax treatment provided to out-of-state manufacturers because it seems to run counter to the Legislature's stated policy objective of reducing the cost of doing business for Washington compared to locations in other states.

In addition, the Legislature may want to consider adding reporting or other accountability requirements that would provide better information on out-of-state manufacturers' use of this preference.

Legislation Required: Yes.

Fiscal Impact: Depends on the legislation.

AIRCRAFT PART PROTOTYPES (SALES AND USE TAX)

Report Summary			
What the Preference Does	**Public Policy Objectives**	**Estimated Beneficiary Savings**	**Auditor Recommendation**
Aircraft Part Prototypes (Sales and Use Tax)			
Provides sales and use tax exemptions for sales of materials incorporated into a prototype for aircraft parts, auxiliary equipment, or modifications.	The Legislature stated the public policy objectives: • To encourage, develop, and expand opportunities for family wage employment in manufacturing industries; • To solidify and enhance the state's competitive position.	$0 million in the 2015-17 Biennium No taxpayers are claiming the preference.	**Terminate:** Because the tax preferences are not being used and have not contributed to the stated public policy objectives.

AIRCRAFT PART PROTOTYPES (SALES AND USE TAX)

Current Law

Current law provides sales and use tax exemptions for sales of materials incorporated into a ***prototype*** for aircraft parts, auxiliary equipment, or modifications. The statutes also exempt sales of materials that are later destroyed in the testing or development of the prototype. ***Prototype*** is not defined in statute. According to a dictionary definition, a prototype is an original or first model of personal property from which the ultimate product is copied or developed.

Qualifying businesses must have annual taxable income of $20 million dollars or less, and the amount of tax exemption including state and local taxes is capped at $100,000 per taxpayer per calendar year. The businesses must first pay the tax and then apply for refunds from the Department of Revenue (DOR).

See Appendix 3 for the current statutes, RCWs 82.08.02566 and 82.12.02566.

Legal History

1996 As part of a larger bill expanding the 1995 exemptions for manufacturing machinery and equipment (M&E), the Legislature enacted sales and use tax exemptions for materials used in designing and developing aircraft parts, auxiliary equipment, or modifications. The exemptions could only be taken by businesses with gross income less than $20 million a year and for exemption amounts no more than $100,000 a year.

DOR interpreted the $100,000 cap to apply to the amount of ***sales*** exempted rather than the amount of ***sales or use tax*** exempted. Under this interpretation, the maximum sales tax exemption would be calculated as the state and local sales tax rate times the $100,000 in sales (for example, $100,000 sales **x** 8 percent state and local sales tax rates **=** $8,000 cap).

1997 The Legislature amended the language of the exemption to apply more specifically to materials incorporated into prototypes and specified that the $100,000 cap applied to the amount of the tax, not the amount of sales. This increased the maximum amount of exempted tax from $8,000 to $100,000 per year.

The limit on beneficiary earnings changed from less than $20 million to $20 million or less.

2003 As part of the multi-state Streamlined Sales and Use Tax Agreement (SSUTA), the Legislature amended the aircraft part prototype exemptions so that the businesses purchasing materials for prototypes were required to pay sales or use taxes on purchases, and then apply to DOR for a refund of the amount of tax paid.

Since the 2004 refund requirement became effective, DOR has had no applications for rebates for the aircraft prototype tax preferences.

Other Relevant Background

In the same 1996 bill, the Legislature adopted these sales and use tax exemptions, expanded other existing sales and use tax exemptions, and provided an intent statement for the legislation in its entirety. The Legislature intended the exemptions to benefit firms conducting research and development that could result in new products to be manufactured. However, the exemptions applied to different types of purchases, as follows:

1) The new sales and use tax exemptions applied to materials incorporated into prototypes for aircraft parts, auxiliary equipment, or modifications (the preferences in this review); and

2) The existing sales and use tax exemptions for manufacturing machinery and equipment (M&E) was expanded to apply to M&E for research and development and for testing operations conducted for a manufacturer (RCWs 82.08.02565 and 82.12.02565).

Unlike the aircraft prototype preferences, the manufacturing M&E exemptions are only available to manufacturers, processors for hire, and firms conducting testing operations for a manufacturer. The M&E must be used for research or for testing a product and cannot be a prototype (original or first model) of the ultimate product. The M&E must be used directly in a manufacturing process or must be integral to the research operation, and must have a useful life of a year or more. The exemption is administered by the seller who receives an exemption certificate from the buyer and does not charge the sales tax.

Exhibit 24 below explains the differences in criteria for qualifying for both types of exemptions. DOR has provided detailed written guidance to taxpayers on what types of machinery and equipment qualify for the manufacturing M&E exemption.

Exhibit 24 – Exemption Criteria Differ for Aircraft Part Prototypes and Manufacturing Machinery and Equipment (M&E)

Exemptions	Beneficiaries	Eligible Property	Eligible Use of Property	Administration of Exemption
Aircraft Part Prototype Exemption	Firms with $20 million or less in gross annual income	Materials incorporated into a prototype	Prototype for aircraft parts, auxiliary equipment, or modifications	Buyer pays sales tax and files for refund
Manufacturing M&E Exemption	Manufacturers, processors for hire, or a firm conducting tests for a manufacturer	Materials incorporated into M&E, or M&E itself; useful life of a year or more; cannot be a prototype of an ultimate product	M&E used directly in manufacturing or integral to a research operation; testing for a manufacturer	Buyer provides exemption certificate to seller; seller does not collect the sales tax

Source: JLARC staff analysis of tax law.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preferences? Is there any documentation on the purpose or intent of the tax preferences?

The Legislature stated public policy objectives when it enacted the tax preferences in 1996. The objectives applied to the entire legislation which included exemptions for manufacturing M&E used in research and development and testing operations. These objectives are to:

- Encourage, develop, and expand opportunities for family wage employment in manufacturing industries;
- Solidify and enhance the state's competitive position.

The Legislature stated it wanted to accomplish these objectives by extending the current manufacturing machinery and exemptions to include machinery and equipment used for research and development with potential manufacturing applications.

What evidence exists to show that the tax preferences have contributed to the achievement of any of these public policy objectives?

Since the change in law to conform to the SSUTA beginning July 1, 2004, DOR reports that no one has applied for a refund for taxes paid on prototypes, and there is no evidence of beneficiaries mistakenly taking the exemption directly from the seller rather than paying the tax and filing for a refund. Before July, 2004, there was no reporting, so it is not possible to track which taxpayers benefited from the tax preferences before this time.

Two Washington companies, the Soloy Corporation of Olympia and Rocket Engineering of Spokane, are on record as supporting the tax preference. These firms made prototypes of aircraft and aircraft parts, or modifications of aircraft that may not have qualified for the 1996 expanded M&E exemptions because they were models for the ultimate product for sale.

JLARC staff contacted both the Soloy Corporation and Rocket Engineering. Both firms indicated they have not been claiming the tax preferences.

To what extent will continuation of the tax preferences contribute to these public policy objectives?

Businesses that sought to receive the tax preferences are still in business and have not claimed the tax preferences. Because there is no evidence of beneficiaries claiming the tax preferences to date, continuation of the preferences may have no effect.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

No beneficiaries are using these tax preferences.

The fiscal note on the 1997 legislation assumed that the aircraft part prototype exemptions would apply to 103 firms, but that only two firms would take the maximum amount of exemption. Beginning July 1, 2004, the Legislature required beneficiaries to pay the sales or use tax and apply to DOR for a refund. This would allow DOR to track the number of firms actually qualifying for the tax exemptions. DOR indicated that there have been no beneficiaries.

Revenue and Economic Impacts

What are the past and future tax revenue and economic impacts of the tax preferences to the taxpayer and to the government if it is continued?

There is no revenue and economic impact because there are no current beneficiaries.

If the tax preferences were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preferences and the extent to which the resulting higher taxes would have an effect on employment and the economy?

There would be no negative effects of terminating the tax preferences.

Other States

Do other states have similar tax preferences and what potential public policy benefits might be gained by incorporating corresponding provisions in Washington?

No other state provides sales and use tax exemptions specifically targeted for materials incorporated in aircraft and aircraft part prototypes. However, Alabama, Florida, and Michigan provide broader sales and use tax exemptions for prototypes used in research and development.

Legislative Auditor Recommendation

The Legislature should terminate the sales and use tax exemptions for prototypes for aircraft parts, auxiliary equipment, and modifications because the tax preferences are not being used and have not contributed to the stated public policy objectives to:

- **Encourage, develop, and expand opportunities for family wage employment in manufacturing industries;**
- **Solidify and enhance the state's competitive position.**

Legislation Required: Yes.

Fiscal Impact: No impact.

DAIRY PRODUCT PROCESSORS - B&O TAX DEDUCTION AND PREFERENTIAL RATE

Report Summary			
What the Preference Does	**Public Policy Objectives**	**Estimated Beneficiary Savings**	**Auditor Recommendation**
Dairy Product Processors – Deduction (B&O Tax)			
Provides a B&O tax deduction to dairy product processors for: • Manufacturing activities for certain dairy products; • Sales of dairy products (wholesale or retail) by the processor to purchasers that receive the products in-state and transport them outside the state; and • Wholesale sales of dairy products by the processor for use as an ingredient to manufacture dairy products. Expires July 1, 2015.	The Legislature did not explicitly state a public policy objective for this preference in 2006 when it enacted the preference or when it extended it in 2012. JLARC staff infer the public policy objective was related to jobs. In 2013 when the preference was expanded to wholesale dairy product sales for use as an ingredient in manufacturing dairy products, the Legislature specifically stated it intended to provide incentives to create additional jobs in Washington's dairy industry and related dairy-based product manufacturing industry, and specifically to encourage infant formula producers to locate new facilities or expand existing ones in the state. Additionally, the Legislature noted that the actual fiscal impact of the expanded deduction should substantially conform with the fiscal note estimate.	$8.9 million in the 2013-15 Biennium.	**Review and clarify:** Because the Legislature indicated extension of the expiration date was directly related to jobs but has not yet identified job-related performance metrics, the Legislature should: 1) identify performance targets and metrics for the number and quality of jobs in the dairy processing industry; and 2) establish criteria for when to transition from the deduction to the preferential rate.

Report Summary			
What the Preference Does	**Public Policy Objectives**	**Estimated Beneficiary Savings**	**Auditor Recommendation**
Dairy Product Processors – Preferential Rate (B&O Tax)			
Effective July 1, 2015, provides a preferential B&O tax rate (0.138 percent) to dairy processors for: • Manufacturing activities for certain dairy products; • Sales of dairy products (wholesale or retail) by the processor to purchasers that receive the products in-state and transport them outside the state; or • Wholesale sales of dairy products by the processor for use as an ingredient to manufacture dairy products. The wholesale sales for use as an ingredient portion of the preference expires July 1, 2023.	When the Legislature first enacted a preferential B&O tax rate for dairy processors prior to establishing an exemption, the stated public policy objective was to provide a tax rate consistent with the rate provided to other fresh food processors. In 2013 when the preference was expanded to wholesale dairy product sales for use as an ingredient in manufacturing dairy products, the Legislature specifically stated it intended to provide incentives to create additional jobs in Washington's dairy industry and related dairy-based product manufacturing industry, and specifically to encourage infant formula producers to locate new facilities or expand existing ones in the state. Additionally, the Legislature noted that the actual fiscal impact of the expanded deduction should substantially conform with the fiscal note estimate.	$9.1 million in the 2015-17 Biennium.	**Review and clarify:** To clarify, before the preference takes effect, whether the Legislature intends there to be parity among all the different food processor manufacturing and sales activities.

DAIRY PRODUCT PROCESSORS - B&O TAX DEDUCTION AND PREFERENTIAL RATE

Current Law

This review includes the following tax preferences for dairy product processors:

1) A **business and occupation (B&O) tax deduction** for:

   - Manufacturing activities for certain dairy products, such as manufacturing yogurt or making cheese;
   - Sales of dairy products (wholesale or retail) by the processor to purchasers that receive the products in-state and transport them outside the state; or
   - Wholesale sales of dairy products by the processor for use as an ingredient or component to manufacture other dairy products.

   The B&O tax deduction is scheduled to expire on July 1, 2015.

2) A **preferential B&O tax rate of 0.138 percent** for the same dairy product manufacturing and sale activities noted above, which goes into effect when the B&O deduction expires on July 1, 2015.

   The part of the preferential tax rate that applies to sales for use as an ingredient or component in manufacturing other dairy products is scheduled to expire July 1, 2023. It is unclear if an expiration date applies to the parts of the preferential rates for manufacturing and for sales delivered in-state for transport out-of-state.

   A statute enacted in 2013 (ESSB 5882) directs the Department of Revenue (DOR) to notify the Code Reviser of the expiration date for the remainder of the preference. DOR has yet to do so as of July 2014. DOR states it is currently developing a framework for determining the impact that ESSB 5882 has on the expiration of this and other preferences.

Absent these tax preferences, dairy product processors would pay manufacturing B&O tax at a rate of 0.484 percent on their manufacturing activities. Income from sales of dairy products delivered in-state would be subject to the wholesaling B&O tax rate of 0.484 percent or the retailing B&O tax rate of 0.471 percent.

Qualifying "dairy products" are those that are:

- Listed in the Code of Federal Regulations under one of three broad categories (milk and cream, cheeses and related cheese products, and frozen desserts) and include by-products from manufacturing such items (such as whey and casein), or
- Comprised of 70 percent or more of the dairy products listed above when measured by weight or volume. This includes infant formula and dairy-based nutritional drinks.

In addition to their manufacturing activity, dairy product processors may also be involved in different kinds of sales activities. For instance, they may sell dairy products to other businesses that will in turn resell the product or use it to manufacture another product (subject to wholesaling B&O tax), or they may sell the product to the end user (subject to retailing B&O tax).

Exhibit 25, below, provides detail on the current and future tax treatment for dairy processors' various activities under these preferences.

Exhibit 25 – Dairy Product Processors' B&O Tax Rate Differs Depending on Customer and Place Delivered

Activity	B&O Tax Rate Through July 1, 2015	B&O Tax Rate Starting July 1, 2015
Processor or any other seller makes sale (wholesale or retail) delivered in-state	0.484% (wholesale) 0.471% (retail)	0.484% (wholesale) 0.471% (retail)
Processor makes sale (wholesale or retail) delivered in-state to take out-of-state	None *(This preference exempts this)*	0.138% *(This preference provides a reduced rate)*
Processor makes wholesale sale for use as ingredient to manufacture other dairy products	None *(This preference exempts this)*	0.138% *(Expires 7/01/2023)*
Processor makes sale (wholesale or retail) delivered out-of-state	None *(Exempt as an interstate sale)*	None *(Exempt as an interstate sale)*

Source: JLARC staff analysis of state statutes.

Beneficiaries of the B&O tax deduction must file an Annual Survey with DOR by April 30 each year based on the previous year's activity. The survey provides information on: the number of employees; wages by wage bands; and medical, dental, and retirement benefits. The names of beneficiaries and the amount of tax exemption taken are publicly disclosable. If a beneficiary fails to file a survey for a previous year, DOR may assess taxes and interest on the amount of exemption taken for that year. Beginning July 1, 2015, beneficiaries of the preferential B&O tax rate must also file an Annual Survey.

In addition to the preferences covered in this review, dairy product manufacturers may be eligible for several other tax preferences, including those noted in Exhibit 26, on the following page.

Exhibit 26 – Other Tax Preferences Are Available to Dairy Processors

	Manufacturers' Machinery and Equipment Sales & Use Tax Exemption	Rural County & Community Empowerment Zone (CEZ) New Jobs B&O Tax Credit	High Unemployment County Sales & Use Tax Deferral/ Waiver for Manufacturing Facilities
Began in:	1995	1986	1985
Type:	Sales & use tax exemption	B&O tax credit for manufacturers and other businesses that hire workers in rural counties or CEZs	Sales & use tax deferral and eventual exemption for construction and equipment purchased by new or expanding businesses in certain counties and all CEZs
Restrictions on Use:	Available to any manufacturer. Not available for hand-powered tools, items with useful life less than one year, or buildings	Business must be located in rural county or CEZ. Business must increase its employment by at least 15% within one year of first hiring to take the credit	Businesses must be located in a county with a high unemployment rate. Facility must stay operational seven years to receive full exemption
Items Impacted:	Purchases of machinery and equipment used in manufacturing process, repair and maintenance work	Provides up to a $4,000 B&O tax credit for each new position created by manufacturing and other businesses that hire workers in rural counties or CEZs	Construction of new structures and expansion of existing structures; industrial fixtures, equipment, and support facilities integral to the manufacturing operation
JLARC Staff Review	None, per RCW 43.136.045	Completed in 2013	Scheduled for 2018

Source: JLARC staff analysis of statutes; Department of Revenue Tax Incentives web site.

See Appendix 3 for the current statutes, RCW 82.04.4268 and 82.04.260(1)(c).

Legal History

Over the years, the Legislature has provided preferential B&O tax rates to processors of several fresh food products. Flour processors received the first preferential B&O rate in 1949, followed by seafood processors in 1959, fresh fruit and vegetable products processors in 1965, processors of dried peas and perishable meat products in 1967, and dairy product processors in 2001.

JLARC staff previously reviewed the preference for processors of flour in 2009, the preferences for dairy product, seafood, and fruit and vegetable processors in 2010, and the preference for meat processors in 2011.

Pre-2001 Dairy product processors and wholesalers paid the general manufacturing and wholesaling B&O tax rate of 0.484 percent. Dairy product retailers paid the general retailing rate of 0.471 percent.

2001 The Legislature enacted a preferential B&O tax rate of 0.138 percent for dairy product manufacturing activities or for selling activities (either retail or wholesale) of dairy products in-state to purchasers that transported the products out-of-state.

The Legislature stated it intended to provide dairy product processors a B&O tax rate on par with rates provided to other fresh food processors. The Legislature further stated the rate was intended for processors of dairy products from raw materials, such as fluid or dehydrated milk or milk byproducts like cream, buttermilk, whey, butter, or casein, and *not intended* for processors that used dairy products as an ingredient or component of their product, such as milk-based soups or pizza. The legislation did not set an expiration date for the new lower rate for dairy product processing and sales.

2005 The Legislature changed the preferential B&O tax rate for fresh fruit and vegetable processors and certain wholesale sales by processors to an exemption, effective July 1, 2005. The B&O tax rate for dairy processors remained at 0.138 percent.

2006 The Legislature replaced the preferential B&O tax rate for dairy product processors and sellers with a B&O tax exemption. Unlike the fruit and vegetable preference passed in 2005, the exemption was not limited to sales by the processor. The exemption took effect July 1, 2006, and was set to expire July 1, 2012. Beneficiaries of the exemption were required to file an Annual Survey with DOR.

The legislation provided that, after the exemption expired, dairy product processors and sellers would pay the same preferential B&O tax rate (0.138 percent) provided to other fresh food processors.

In the same bill, the Legislature set the same July 1, 2012, expiration date for the B&O tax exemption provided in 2005 to fruit and vegetable processors, and to the newly created B&O exemption for seafood processors and sellers.

2010 JLARC staff issued a performance audit review of the dairy product processors B&O tax exemption and preferential rate to the Legislature. In the report, the Legislative Auditor recommendation was to allow the B&O tax exemption to expire as scheduled in 2012 and the preferential rate to begin. This would have resulted in consistent tax treatment for processing fresh food products.

2012 The Legislature extended the expiration date for the dairy, fruit and vegetable, and seafood product processor B&O exemption to July 1, 2015, and adjusted the preferential rate to begin after the exemption ended.

2013 Effective October 1, 2013, the Legislature made the following changes to the dairy processer preferences:

- Changed the existing B&O tax *exemption* for dairy processors to a *deduction*;

- Narrowed the preference for *all* wholesale sales made in-state for delivery outside the state to apply *only to sales by dairy processors* delivered in-state for delivery outside the state; and
- Expanded the preference by providing a deduction and subsequent preferential rate to wholesale sales by dairy processors for use as an ingredient or component to manufacture other dairy products. By law, this preferential rate should expire July 1, 2023.

Other Relevant Information

Farmer-owned dairy cooperatives conduct numerous activities for member dairy farmers, including negotiating prices and assembling, hauling, manufacturing, processing, or marketing milk and dairy products to wholesalers, retailers, or in their own facilities. Washington's first dairy cooperatives began operations in 1898.

Darigold, the state's largest dairy product processor, began as a cooperative in 1918. It currently operates six plants in Washington and has over 550 member farms, 350 of which are in Washington. In 2012, it was the fourth largest dairy cooperative in the U.S. and is a major beneficiary of this preference.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preferences? Is the purpose or intent of the tax preferences clear?

B&O Tax Deduction

Related to jobs

The Legislature did not explicitly state the public policy objective for the tax preference when it was first enacted in 2006 or in 2012 when it extended the expiration date for B&O tax exemptions for dairy, seafood, and fruit and vegetable processors to July 1, 2015. JLARC staff infer the public policy objective was related to jobs based on member comments during a 2012 Senate floor debate stating the exemptions were directly related to jobs.

When the Legislature enacted the preference in 2006, it required beneficiaries to file an Annual Survey with DOR detailing:

- The number of full-time, part-time, and temporary employees;
- The number of employees by wage bands; and
- The extent to which beneficiaries offered medical, dental, and retirement benefits to employees.

Encouraging infant formula producers to locate new or expand existing facilities in Washington

In 2013 when the preference was expanded to wholesale dairy product sales for use as an ingredient in manufacturing other dairy products, the Legislature specifically stated it intended to provide

incentives to create additional jobs in Washington's dairy industry and related dairy-based product manufacturing industry. The Legislature elaborated that its particular objective was to encourage infant formula producers to locate new facilities or expand existing ones in the state.

A July 2013 Department of Commerce news release stated the expansion was expected to create 25 additional jobs and maintain the 137 current positions at the Sunnyside Darigold processing facility.

B&O Tax Preferential Rate

Provide tax treatment consistent with other food processors

When a preferential B&O tax rate for dairy processors was first enacted in 2001 (prior to establishment of the exemption), the Legislature stated its public policy objective was to provide a tax rate for dairy product processors commensurate to the rate imposed on certain other processors of agricultural commodities.

In 2012, the Legislature extended the B&O exemption expiration date for dairy, seafood, and fruit and vegetable processors to July 2015. After that time, all three of these types of food processors are scheduled to pay the same preferential tax rate of 0.138 percent, the tax rate currently paid by several other food processors.

Legislature Established Measurement of Effectiveness

Provide incentive in a fiscally responsible manner

When the Legislature expanded the preferences to include sales for use as ingredients in manufacturing other dairy products, the Legislature stated it intended to provide the incentive in a fiscally responsible manner, where the actual revenue impact of the 2013 expansion "substantially conforms" with the fiscal note estimate.

What evidence exists to show that the tax preferences have contributed to the achievement of any of these public policy objectives?

B&O Tax Deduction

Related to jobs

While the 2012 Senate floor speeches indicated the exemption was directly related to jobs, the Legislature has not established specific job number or job quality targets to use in assessing achievement of the jobs-related objective.

There is, however, descriptive information available for the Legislature's review on jobs in the dairy product processing industry and job-related information reported by the businesses using the dairy product processor B&O exemption. This section of the report provides historical trend data on employment in the dairy product processing industry as a whole (beneficiaries and non-beneficiaries). It then answers the following four questions using data from self-reported 2009-2012 Annual Surveys filed by the beneficiaries of the preference:

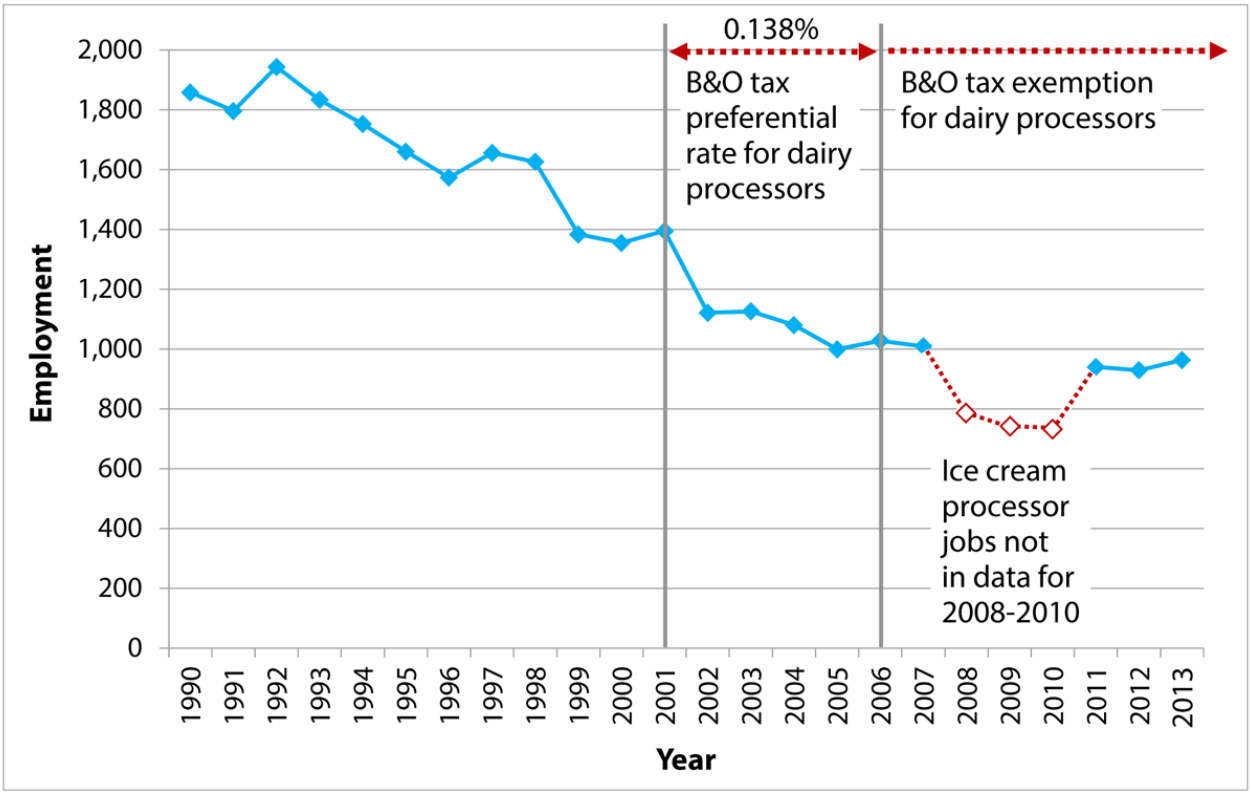
1. What percentage of beneficiaries reported creating new jobs each year?
2. How many jobs are beneficiaries reporting?

3. What wages do beneficiaries pay their employees?
4. How many beneficiary employees receive health and retirement benefits?

JLARC staff do not assert whether there is a causal relationship between the outcomes shown in this section and the tax preference.

For Washington's dairy processing industry as a whole, from 1990 to 2013, there has been a 193 percent reduction in jobs. These figures include businesses that did not or could not use the preference. See Exhibit 27, below.

Exhibit 27 – Washington Dairy Processing Jobs



NOTE: Employment for creamery butter and dehydrated or dried dairy products as well as ice cream manufacturing jobs for 2008 through 2010 not reported in Employment Security data due to confidentiality requirements.

Source: Quarterly Census of Employment of Employment and Wages data, 1990 through June 2013, NAICS 31151 and 31152.

1. What percentage of beneficiaries reported creating new jobs in each year?

Annual Survey data indicates that the number of beneficiaries using the exemption increased from 7 firms in 2009 to 17 firms in 2012. Of these, up to three firms reported creating jobs in any given year. See Exhibit 28, on the following page.

Exhibit 28 – Annual Survey Data Reflects While Dairy Industry Beneficiaries Increased, Few Created Jobs

Calendar Year	Number of Firms Filing Survey	Number of Firms Creating Jobs	Percent of Firms Creating Jobs
2009	7	1	14%
2010	11	0	0%
2011	16	3	19%
2012	17	3	18%

Source: Department of Revenue Annual Survey data 2009 -2012.

2. How many jobs are beneficiaries reporting?

Annual Survey data for Calendar Years 2009 through 2012 indicates that 93 to 96 percent of dairy beneficiaries' employment positions are full-time jobs. See Exhibit 29, below.

Exhibit 29 – Dairy Processing Beneficiaries Provide Predominately Full-Time Jobs

Calendar Year	Full-Time	Part-Time	Temporary	Total Employees Reported	Percent Full-Time
2009	1,094	86	0	1,180	93%
2010	1,172	64	2	1,239	95%
2011	1,309	71	20	1,400	94%
2012	1,315	57	2	1,374	96%

Source: Department of Revenue Annual Surveys, 2009 – 2012.

3. What wages do beneficiaries pay their employees?

The Legislature requires beneficiaries to report the number of Washington employment positions into one of three wage bands on the Annual Survey. For Calendar Years 2009 through 2012, Annual Survey data reflects that 56 to 57 percent of dairy processor beneficiary employee wages are in the $30,000 to $59,999 band, and 27 to 31 percent receive wages of $60,000 or more annually. See Exhibit 30, below.

Exhibit 30 – Dairy Product Processor Beneficiary Wages

	Percent Positions Within Annual Wage Bands *(Per Beneficiary Annual Surveys)*		
Calendar Year	Under $30,000	$30,000 to $59,999	$60,000 or More
2009	17%	56%	27%
2010	14%	57%	29%
2011	13%	56%	31%
2012	13%	56%	31%

Note: Positions include full-time, part-time, and temporary positions.

Source: Department of Revenue Annual Survey data, 2009 – 2012.

In addition to looking at wages reported by beneficiaries on Annual Surveys, JLARC staff analyzed state average annual wages for specific manufacturing industry categories as reported by the Employment Security Department. The industry-wide data (including beneficiaries and non-beneficiaries) shows that wages paid by dairy product processors are higher than other Washington food processors, but less than the average wages paid to other manufacturing employees. See Exhibit 31, below.

Exhibit 31 – Dairy Processing Industry Annual Wages Are Above Food Product Manufacturing Industry Wages

Average Annual Wages for Selected Industries *(Per State Employment Security Data)*				
Calendar Year	**Dairy Processing**	**Food Product Manufacturing**	**Manufacturing** *(Excluding Aerospace)*	**Manufacturing** *(Including Aerospace)*
2009	$49,464	$40,531	$51,699	$62,931
2010	$49,524	$40,911	$52,991	$64,925
2011	$53,963	$41,682	$54,677	$68,065
2012	$45,178	$42,969	$55,709	$69,306

Note: Positions include full-time, part-time, and temporary positions.

Source: Employment Security Quarterly Census Employment and Wages annual data, 2009-2012.

4. How many beneficiary employees receive health and retirement benefits?

Beneficiaries must also report on the Annual Survey the number of employees receiving medical, dental, and retirement benefits. See Exhibit 32, below.

Exhibit 32 – Medical, Dental, and Retirement Benefits

Calendar Year	Medical	Dental	Retirement
2009	91%	78%	87%
2010	92%	80%	89%
2011	83%	75%	81%
2012	89%	78%	81%

Source: Department of Revenue Annual Surveys, 2009 – 2012.

Encouraging infant formula producers to locate new or expand existing facilities in Washington

Information on the expanded use of the preference for sales of dairy products used as ingredients in manufacturing other dairy products is not yet available. DOR staff stated they will add a deduction line to the tax return specifically for this activity, beginning with the April 2014 tax return. This will ensure that future qualifying sales are deducted and that data will be available for future analysis. According to fiscal note estimates for the expanded exemption, no activity was expected before July 2015.

Darigold stated it is expanding its production facility in Sunnyside to allow for production of dairy products for use in producing infant formula. As of May 2014, the facility was in phase one of a two-phase process, with completion expected by late 2015.

B&O Tax Preferential Rate

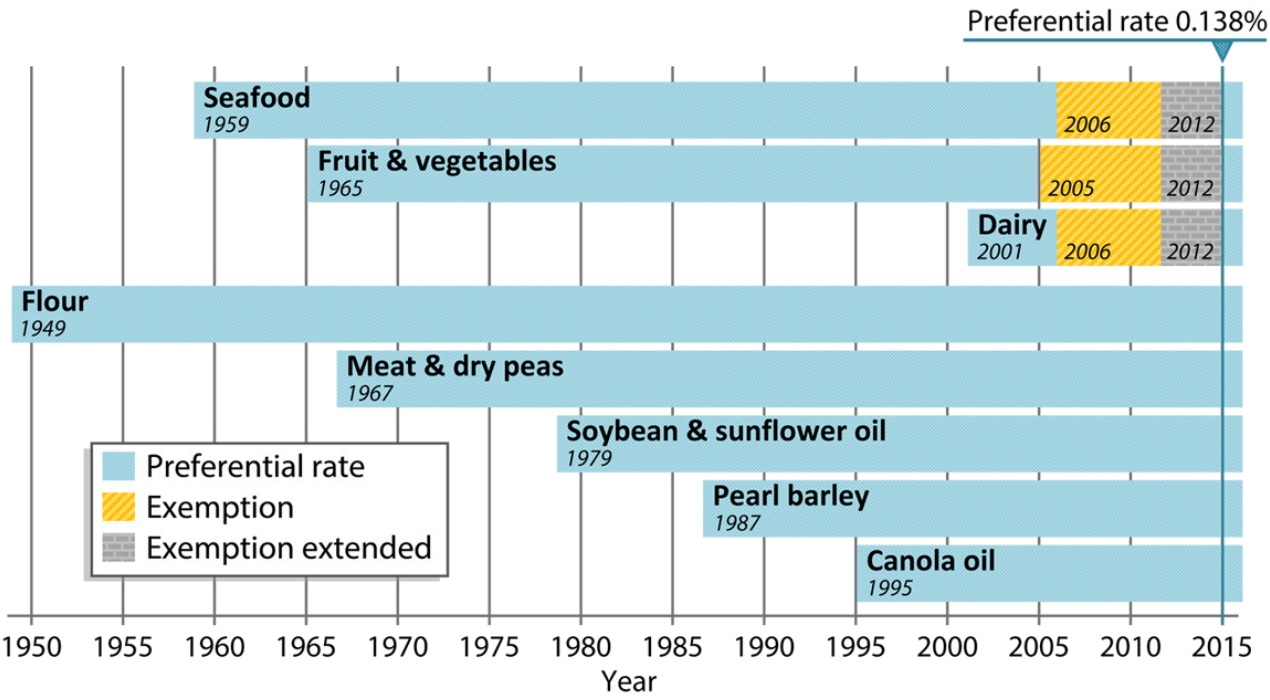
Provide tax treatment consistent with other food processors

While the future preferential B&O tax rate will provide parity in tax treatment for food product *processing activities* (manufacturing), it will not provide parity for various wholesale or retail *sale activities*. If tax parity is what the Legislature intended, it will only partly be achieved.

Food tax parity for manufacturing

For the most part, the same preferential rate will apply to food *manufacturing* activities. The Legislature granted preferential tax rates to food processors one sector at a time over a period of years beginning in 1949, and then provided full exemptions to fruit and vegetable, dairy, and seafood product processors in 2005 and 2006. On July 1, 2015, dairy, fruit and vegetable, and seafood processors will pay the same preferential B&O tax rate of 0.138 percent that many other food processors now do. See Exhibit 33 below. It is unclear why the Legislature selected the rate of 0.138 percent to apply to these food processors.

Exhibit 33 – History of Tax Preference for Food Processors



Source: JLARC staff analysis of various food processor statutes.

Food tax parity for selling

While the Legislature's actions will result eventually in B&O tax parity among food processors for their *manufacturing* activity, the same is not true for their *selling* activities. Examples of differences in the application of the preferential rate to sales activities include the following:

- Some food processors receive no preferential rate on any of their sales activities (flour, dried peas, soybean and sunflower oil, pearl barley, and canola oil processors);
- Some food processors receive the preferential rate on their wholesale sales delivered in-state but transported outside the state (fruit and vegetable, seafood, and dairy processors);
- Some food processors receive the preferential rate on an additional portion of their sales activities (seafood and dairy processors for retail sales delivered in-state for transport out-of-state; and dairy processors for wholesale sales for use as a component in making other dairy products); and
- Some businesses that are *not food processors* receive the preferential rate (businesses making retail or wholesale sales of seafood products delivered in-state for delivery out-of-state, businesses making wholesale sales of meat products)

The inconsistencies are illustrated in Exhibit 34, below.

Exhibit 34 – Future Preferential B&O Tax Rate Will Provide Tax Parity for Food Processing Activities but not for Sales Activities

☑ Will pay preferential B&O rate (0.138%) effective July 1, 2015

Industry	Processing (manufacturing)	Sales delivered in-state for delivery out-of-state				Other wholesale sales
		Sales by Processor		Sales by Others		
		Wholesale	*Retail*	*Wholesale*	*Retail*	
Seafood	☑	☑	☑	☑	☑	
Dairy	☑	☑	☑			☑*
Fruit & Vegetables	☑	☑				
Meat	☑					☑**
Flour	☑					
Dried Peas	☑					
Soybean & Sunflower Oil	☑					
Pearl Barley	☑					
Canola Oil	☑					

* Wholesale sales by processor for use as an ingredient in making other dairy product.

** Wholesale sales by any business.

Source: JLARC staff analysis of RCW 82.04.260.

Legislature Established Measurement of Effectiveness

Provide incentive in a fiscally responsible manner

There is currently no information available to determine actual use of the deduction for sales of dairy products for use as an ingredient in manufacturing other dairy products. The fiscal note for the expanded preference assumed that eligible activities would not begin until mid-2015. It is unknown whether eligible sales might be occurring prior to those anticipated in the fiscal note.

To what extent will continuation of the tax preferences contribute to these public policy objectives?

It is unclear whether continuing the B&O tax deduction scheduled to expire July 1, 2015, would contribute to the public policy objective related to jobs. Allowing the deduction to expire and replacing it with the 0.138 percent preferential B&O tax rate would provide tax parity for several types of fresh food *manufacturing activities*. However, the tax treatment provided for various *selling activities* of fresh food products would remain inconsistent.

Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preferences?

From 2006 through 2012, the number of beneficiaries increased from four to 17 businesses, according to Annual Survey data.

Darigold, Inc., consistently tops the list of dairy product processor beneficiaries. Four beneficiaries have accounted for between 95 to 98 percent of the tax preference received from 2009 through 2012. See Exhibit 35, below.

Exhibit 35 – One Firm Accounts for Close to 90 Percent of the Preference Claimed

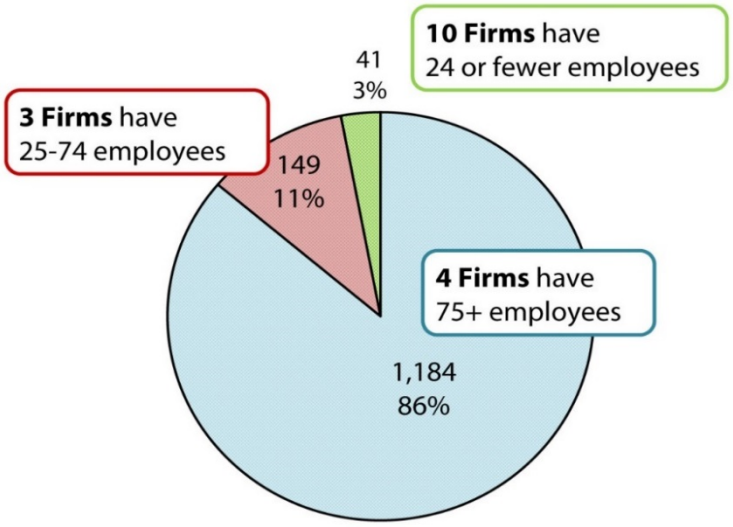
	Percentage of Total Tax Preference Claimed			
Business	**2009**	**2010**	**2011**	**2012**
Darigold, Inc.	89%	89%	90%	87%
Safeway, Inc. (dairy processing plant)	3%	3%	3%	3%
Safeway, Inc. (ice cream plant)	4%	3%	3%	3%
Anderson Dairy, Inc.	2%	2%	2%	2%
All Remaining Beneficiaries	2% (3 firms)	3% (7 firms)	2% (12 firms)	5% (13 firms)

Source: Department of Revenue Annual Survey data, 2009 – 2012.

Beginning October 1, 2013, the changes to the preference may impact the number of future beneficiaries. First, the definition of qualifying dairy products was expanded to include items such as infant formula and dairy-based nutritional drinks. Second, eligible sales were restricted to only those made by the manufacturer of the dairy product (previously, qualifying sales could be made by any business). Finally, qualifying sales were expanded to include sales by the manufacturer for use in manufacturing other dairy products.

The four largest dairy product beneficiary businesses employed 86 percent of the total employees reported by beneficiaries in 2012. See Exhibit 36 below.

Exhibit 36 – In 2012, Most Dairy Product Beneficiary Employees Work for Larger Businesses



Source: Department of Revenue 2012 Annual Survey data.

Revenue and Economic Impacts

What are the past and future tax revenue impacts of the tax preferences to the taxpayer and to the government if it is continued?

Beneficiaries are estimated to have saved $4.5 million in Fiscal Year 2013 due to the preference. The estimated 2013-15 Biennial savings (prior to the preference's expiration on July 1, 2015) is nearly $9 million. These estimates are based on the fact that without the preference, these businesses would likely pay B&O tax at a rate of 0.484 percent. See Exhibit 37, below.

Exhibit 37 – Estimated 2013-15 Beneficiary Savings from B&O Tax Exemption/Deduction for Dairy Product Processors

Fiscal Year	Taxable Gross Income	Beneficiary Savings
2012	$875,820,000	$4,239,000
2013	$926,618,000	$4,485,000
2014	$907,159,000	$4,391,000
2015	$946,167,000	$4,579,000
2013-15 Biennium	**$1,853,326,000**	**$8,970,000**
Exemption scheduled to expire effective July 1, 2015		

Source: Department of Revenue Annual Report data for Calendar Year 2012 used for 2012 calculation. Growth estimated using Economic and Revenue Forecast Council's actual B&O tax growth for Fiscal Year 2013 and estimated growth for Fiscal Years 2014 – forward (November 2013 forecast).

After the deduction expires, it will be replaced by the preferential 0.138 percent tax rate. Beneficiaries are estimated to save $9.1 million in the 2015-17 Biennium due to the preferential rate. These estimates are calculated using the difference between the general manufacturing/ wholesaling B&O tax rate (0.484 percent) and the preferential rate (0.138 percent). See Exhibit 38, below.

Exhibit 38 – Estimated 2015-17 Beneficiary Savings from Preferential B&O Tax Rate for Dairy Product Processors

Fiscal Year	Taxable Gross Income	B&O Tax Under General Rate (0.484%)	B&O Tax Under Preferential Rate (0.138%)	Beneficiary Savings
2012	Preferential rate does not take effect until July 1, 2015.			
2013				
2014				
2015				
2016	$1,192,529,000	$5,772,000	$1,646,000	$4,126,000
2017	$1,453,348,000	$7,034,000	$2,006,000	$5,029,000
2015-17 Biennium	**$2,645,877,000**	**$12,806,000**	**$3,651,000**	**$9,155,000**

Source: Department of Revenue Annual Report data for Calendar Year 2012 used as basis for Fiscal Year calculations. Includes Department of Revenue 2013 fiscal note estimate for ingredients used to manufacture dairy products. Growth estimated using Economic and Revenue Forecast Council's estimated B&O tax growth for Fiscal Years 2016 and 2017 (November 2013 forecast).

If the tax preferences were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preferences and the extent to which the resulting higher taxes would have an effect on employment and the economy?

If the B&O tax deduction (currently scheduled to expire July 1, 2015) and the preferential B&O tax rate scheduled to begin July 1, 2015, were terminated, dairy processors that now pay no B&O tax would pay B&O tax and those scheduled to pay a preferential B&O tax rate will pay a higher rate. The effect of these terminations on employment and the economy would depend on the extent to which the industry could absorb the increased costs or pass them along to their customers.

Other States

Do other states have similar tax preferences and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

JLARC staff reviewed taxation for dairy processors and sellers in states with dairy operations that were geographically proximate (Oregon, Idaho, and California) and also with major dairy producing states (Wisconsin, New York, and Pennsylvania). Washington produced 3.3 percent of the U.S. milk supply in 2012, the last year of data available.

Since none of these competitor states impose a B&O or similar tax, JLARC staff looked to other tax preferences provided to dairy product processors or sellers. See Exhibit 39 on the following page.

Exhibit 39 – Tax Preferences Provided in Competing Dairy Production States

State	2012 Percentage of U.S. Milk Production	Tax Preferences Provided by State
California	20.87%	• Sales tax exemption for diesel fuel used in food processing • State income tax deduction for cooperatives for income from business for or with members
Wisconsin	13.59%	• Franchise tax credit for modernization or expansion of dairy manufacturing facilities • Cooperatives exempt from income tax
Idaho	6.77%	• Income tax deduction for cooperatives on patronage income
New York	6.59%	• No comparable tax preferences found
Pennsylvania	5.24%	• No comparable tax preferences found
Washington	3.3%	• B&O tax deduction, followed by preferential rate for processors for manufacturing, sales for delivery outside the state, and sales for ingredients in manufacturing other dairy products
Oregon	1.25%	• Income tax exemption for cooperatives on patronage dividends and transactions with members

Source: USDA Economic Research Service data for 2012 for U.S. milk production.

Legislative Auditor Recommendations

B&O Tax Deduction for Dairy Product Processors

Prior to the scheduled expiration of the dairy product processor and seller B&O exemption in July 2012, JLARC staff reviewed this pair of preferences. The Legislative Auditor's recommendation at that time was to allow the B&O exemption to expire as scheduled in 2012 and the B&O preferential rate to begin. This would have resulted in consistent tax treatment for processing food products.

The Legislature chose a different course of action. In the 2012 session, the Legislature extended the expiration date for the dairy product processor exemption (and the seafood and fruit and vegetable exemptions) to July 2015, and delayed the effective date of the preferential rate to begin when the exemption expires. While the legislation did not include a specific statement of intent, floor speeches indicated extension of the expiration date for the exemptions was directly related to jobs.

In 2013, the Legislature changed the exemption to a deduction and expanded the preference to include additional dairy products and wholesale sale transactions, and also narrowed it to apply only to sales by the processor, while maintaining the July 2015 expiration date. Additionally, the Legislature stated a public policy objective for the expanded deduction and noted that the actual fiscal impact of the expanded deduction should substantially conform with the fiscal note estimate.

In light of the Legislature's actions in 2012 and 2013, the Legislative Auditor is modifying his recommendations in this 2014 review.

Because the Legislature indicated that the extension of the expiration date for this deduction was directly related to jobs but has not yet identified job-related performance metrics, the Legislature should review and clarify this preference to:

- **Identify performance targets and metrics for the number and quality of jobs in the dairy product processing industry; and**
- **Establish criteria for when to transition from the deduction to the preferential rate.**

Legislation Required: Yes.

Fiscal Impact: Depends on Legislation.

Preferential B&O Rate for Dairy Product Processors

The preferential B&O rate for dairy product processors has not yet taken effect, so its performance cannot be evaluated. However, we note that the Legislature has not made a clear statement on the public policy objective of the preferential rate beyond the policy objective provided for dairy products used as ingredients in manufacturing other dairy products. When it originally established the preferential rate for dairy product processors before replacing it with the exemption, the Legislature indicated an objective of providing a tax rate commensurate to the rate paid by other processors of agricultural commodities. The Legislature may intend eventual consistent tax treatment for all food processors, but there is not a clear statement of this objective, and the Legislature's action in 2012 delayed this from happening.

Also, while the preferential rate will make the tax rate of several food processing manufacturing activities conform, there will not be tax parity among various sales activities of food products.

Because it has an opportunity to do so before the preference takes effect, the Legislature should review and clarify this preference to clarify whether the Legislature intends there to be parity among all the different food processor manufacturing and sales activities.

Legislation Required: Yes.

Fiscal Impact: Depends on Legislation.

FRESH FRUIT AND VEGETABLE PROCESSORS - B&O TAX EXEMPTION AND PREFERENTIAL RATE

Report Summary			
What the Preference Does	**Public Policy Objectives**	**Estimated Beneficiary Savings**	**Auditor Recommendation**
Fruit and Vegetable Processors – Exemption (B&O Tax)			
Provides a B&O tax exemption to fruit and vegetable processors for: • Manufacturing activities for fresh fruit and vegetable products, or • Wholesale sales of fruit or vegetable products by the processor to purchasers that receive the products in-state and transport them outside the state.	The Legislature did not explicitly state a public policy objective for this preference in 2005 when it first enacted the preference or when it extended it in 2012. JLARC staff infer the public policy objective was related to jobs.	$39.3 million in the 2013-15 Biennium	**Review and clarify:** Because the Legislature indicated extension of the expiration date was directly related to jobs but has not yet identified job-related performance metrics, the Legislature should: 1) identify performance targets and metrics for the number and quality of jobs in the fruit and vegetable processing industry; and 2) establish criteria for when to transition from the deduction to the preferential rate.
Fruit and Vegetable Processors – Preferential Rate (B&O Tax)			
Effective July 1, 2015, provides a preferential B&O tax rate (0.138 percent) to fruit and vegetable processors for: • Manufacturing activities for fresh fruit and vegetable products, or • Wholesale sales of fruit or vegetable products by the processor to purchasers that receive the products in-state and transport them outside the state.	The Legislature did not explicitly state a public policy objective for this preference. JLARC staff infer the policy objective is to treat fruit and vegetable processors consistently with other fresh food processors.	$30.8 million in the 2015-17 Biennium.	**Review and clarify:** To clarify, before the preference takes effect, whether the Legislature intends there to be parity among all the different food processor manufacturing and sales activities.

FRESH FRUIT AND VEGETABLE PROCESSORS - B&O TAX EXEMPTION AND PREFERENTIAL RATE

Current Law

This review includes two tax preferences for fresh fruit and vegetable product processors:

1) A **business and occupation (B&O) tax exemption** for:

    - Manufacturing activities for fresh fruit and vegetable products, such as canning asparagus or producing apple juice, or
    - Wholesale sales of fruits or vegetables by the processor to purchasers that receive the products in-state and transport them outside the state.

    The B&O tax exemption is scheduled to expire July 1, 2015.

2) A **preferential B&O tax rate of 0.138 percent** for the same fruit and vegetable manufacturing and wholesaling activities, which goes into effect when the B&O exemption expires on July 1, 2015.

    The preferential tax rate does not have an expiration date.

Absent these tax preferences, fresh fruit and vegetable processors would pay manufacturing B&O tax at a rate of 0.484 percent on their manufacturing activities. The selling activity would be taxed at the wholesaling B&O tax rate, which is also 0.484 percent.

Processors are eligible for the tax preferences if they manufacture fresh fruits and vegetables by canning, preserving, freezing, processing, or dehydrating. In addition to their manufacturing activity, fruit and vegetable processors may also be involved in different kinds of sale activities. For instance, they may sell fruit and vegetable products to other businesses that will in turn resell the product or use it to manufacture another product (subject to wholesaling B&O tax), or they may sell the product to the end user (subject to retailing B&O tax). Fruit and vegetable processor wholesale sales qualify for the preferences if the products are delivered in-state to purchasers that then transport them outside the state.

Exhibit 40 on the following page provides detail on the current and future tax treatment for fruit and vegetable processors' various sales activities under these preferences.

Exhibit 40 – Fruit and Vegetable Product Processor B&O Tax Rate Differs Depending on Customer and Place Delivered

Activity	B&O Tax Rate	
	Through July 1, 2015	Starting July 1, 2015
Wholesale sale by processor delivered in-state	0.484%	0.484%
Wholesale sale by processor delivered in-state to take out-of-state	None *(This preference exempts this)*	0.138% *(This preference provides a reduced rate)*
Wholesale sale by processor delivered out-of-state	None *(Exempt as an interstate sale)*	None *(Exempt as an interstate sale)*

Source: JLARC staff analysis of state statutes.

Beneficiaries of the B&O tax exemption must file an Annual Survey with the Department of Revenue (DOR) by April 30 each year based on the previous year's activity. The survey provides information on: the number of employees; wages by wage bands; and medical, dental, and retirement benefits. The names of beneficiaries and the amount of tax exemption taken are publicly disclosable. If a beneficiary fails to file a survey for a previous year, DOR may assess taxes and interest on the amount of exemption taken for the year. The survey will not be required for beneficiaries of the preferential rate when it takes effect in July 2015.

In addition to the preferences covered in this review, fruit and vegetable processors may be eligible for several other tax preferences, including those noted in Exhibit 41, on the following page.

Exhibit 41 – Other Tax Preferences Are Available to Fruit and Vegetable Processors

	Manufacturers' Machinery and Equipment Sales & Use Tax Exemption	Rural County & Community Empowerment Zone (CEZ) New Jobs B&O Tax Credit	High Unemployment County Sales & Use Tax Deferral/ Waiver for Manufacturing Facilities
Began in:	1995	1986	1985
Type:	Sales & use tax exemption	B&O tax credit for manufacturers and other businesses that hire workers in rural counties or CEZs	Sales & use tax deferral and eventual exemption for construction and equipment purchased by new or expanding businesses in certain counties and all CEZs
Restrictions on Use:	Available to any manufacturer. Not available for hand-powered tools, items with useful life less than one year, or buildings	Business must be located in rural county or CEZ. Business must increase its employment by at least 15% within one year of first hiring to take the credit	Business must be located in a county with a high unemployment rate. Facility must stay operational seven years to receive full exemption
Items Impacted:	Purchases of machinery and equipment used in manufacturing process, repair, and maintenance work	Provides up to a $4,000 B&O tax credit for each new position created by manufacturing and other businesses that hire workers in rural counties or CEZs	Construction of new structures and expansion of existing structures; industrial fixtures, equipment, and support facilities integral to the manufacturing operation
JLARC Staff Review	None, per RCW 43.136.045	Completed in 2013	Scheduled for 2018

Source: JLARC staff analysis of statutes; Department of Revenue Tax Incentives web site.

See Appendix 3 for the current statutes, RCWs 82.04.4266 and 82.04.260(1)(d).

Legal History

Over the years, the Legislature has provided preferential B&O tax rates to processors of several fresh food products. Flour processors received the first preferential B&O rate in 1949, followed by seafood processors in 1959, fresh fruit and vegetable product processors in 1965, processors of dried peas and perishable meat products in 1967, and dairy product processors in 2001.

JLARC staff previously reviewed the preference for flour processors in 2009, and the preferences for fruit and vegetable, seafood, and dairy product processors in 2010, and the preference for meat processors in 2011.

Pre-1954 B&O tax law classified canning and packing fresh fruits and vegetables as a manufacturing activity. Processors that prepared and froze fresh fruits and vegetables owed tax as wholesalers. The tax rates for wholesaling and manufacturing were both 0.3 percent in the early 1950s.

1954 The Tax Commission amended a rule to define canning, preparing, and freezing fresh fruits and vegetables as a manufacturing process.

1957 The State Supreme Court confirmed that the Tax Commission had the authority to change the manufacturing definition by rule and that the change did not require legislation.[4]

1959 The general manufacturing B&O tax rate was increased to 0.44 percent.

1965 The Legislature provided fresh fruit and vegetable processors a preferential B&O tax rate of 0.3 percent. To qualify, a business had to process fresh fruits and vegetables by "canning, preserving, freezing, or dehydrating."

1990s All B&O tax rates increased and gradually decreased due to surtax impositions and expirations.

1996 The Legislature expanded the preferential rate for fruit and vegetable processors to include in-state wholesale sales by the processor to purchasers that transported the goods out-of-state. The Legislature also added "processing" fresh fruits and vegetables to the list of eligible activities of "canning, preserving, freezing, or dehydrating."

1997 When the last B&O surtax expired on July 1, 1997, the fruit and vegetable processing rate became 0.33 percent while the general manufacturing rate became 0.484 percent.

1998 The Legislature reduced the fruit and vegetable processing B&O tax rate to 0.138 percent. The general manufacturing rate remained at 0.484 percent.

2005 The Legislature replaced the preferential B&O tax rate with an exemption effective July 1, 2005.

Additionally, in *Agrilink Foods v. DOR*, the State Supreme Court granted a preferential B&O tax rate for processing perishable meat to a chili manufacturer.[5] DOR interpreted the decision to also expand this preference so that fresh fruit and vegetable processors might be granted the preference even though the end product contained only a small portion of fruit and vegetables.

2006 The Legislature added a July 1, 2012, expiration date for the B&O tax exemption for fruit and vegetable processors. The legislation provided that after the exemption expired, the industry would pay a preferential B&O tax rate of 0.138 percent. In the same bill, the Legislature provided the B&O tax exemption to processors of dairy and seafood products, with the same expiration date and the same future preferential B&O tax rate.

2007 DOR determined that wineries qualified for the fresh fruit and vegetable processing tax preference. Wineries that filed claims were entitled to refunds of previously paid B&O taxes going back to 2003.

2010 Responding to the 2005 *Agrilink* case, the Legislature approved DOR-request legislation narrowing the B&O tax exemption for fruit and vegetable processors (and subsequent preferential B&O tax rate) to apply **only if** fruit, vegetable, and water comprised at least 50

[4] *Stokely-Van Camp, Inc. v. Washington*, 50 Wn.2d 492 (1957)

[5] *Agrilink Foods, Inc. v. Department of Revenue,* 153 Wn.2d 392 (2005)

percent of the ingredients in the end product. The Legislature noted its intent was to avoid providing the tax preference to processors that only included a small amount of fruit and vegetables in their end product. The same bill also narrowed the preferential B&O rate for processors of perishable meat to only apply to specific activities and products.

In November, state voters approved Initiative 1107, which repealed (effective December 2, 2010) several tax measures passed earlier that year by the Legislature, including the changes made to the B&O tax preferences for fruit and vegetable processors and processors of perishable meat. Thus the 2010 legislative changes to the fruit and vegetable processor exemption were in effect only from June 1 through December 1, 2010.

Also in 2010, JLARC staff issued a performance audit review of the fresh fruit and vegetable processors B&O tax exemption and preferential rate to the Legislature. In the report, the Legislative Auditor's recommendation was to allow the B&O tax exemption to expire as scheduled in 2012 and the preferential rate to begin. This would have resulted in consistent tax treatment for processing fresh food products.

2012 The Legislature extended the expiration date for the fruit and vegetable, dairy, and seafood processor B&O tax exemption to July 1, 2015, and adjusted the preferential rate to begin after the exemption ended.

2014 The Legislature clarified that marijuana, usable marijuana, and marijuana-infused products are not considered "fruits" or "vegetables" for the purpose of these tax preferences.

Other Relevant Background

Washington is the leading U.S. producer of apple juice, a leader in grape and berry juice production, and is the second-largest premium wine producer in the U.S. with more than 750 licensed wineries. Washington was responsible for 4.6 percent of the value of U.S. manufactured fruit and vegetable products in both 2010 and 2011. There were a number of processing plant closures in the years leading up to the 2005 enactment of the tax exemption.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preferences? Is there any documentation on the purpose or intent of the tax preferences?

B&O Tax Exemption

Related to jobs

The Legislature did not explicitly state a public policy objective for the tax preference when it was first enacted in 2005, or in 2012 when the Legislature extended the expiration date for B&O tax exemptions for fruit and vegetable, dairy, and seafood processors to July 1, 2015. JLARC staff infer the public policy objective was related to jobs based on member comments during a 2012 Senate floor debate, where senators stated the exemptions were directly related to jobs.

A year after the preference was first enacted, the Legislature required beneficiaries to file an Annual Survey with DOR detailing:

- The number of full-time, part-time, and temporary employees;
- The number of employees by wage bands; and
- The extent to which beneficiaries provided medical, dental, and retirement benefits to employees.

B&O Tax Preferential Rate

Provide tax treatment consistent with other food processors

The Legislature has not explicitly stated a public policy objective for the preferential B&O tax rate. JLARC staff infer the public policy objective is to treat fruit and vegetable processors consistently with other food processors, as reflected in parallel legislative actions for fruit and vegetable, dairy, and seafood processors.

In its actions in 2005 and 2006, the Legislature established that these food processors would all eventually pay the preferential B&O tax rate of 0.138 percent, the same rate as many other food processors. In 2012, the Legislature extended the B&O tax exemption for fruit and vegetable, dairy, and seafood processors to July 2015. After that time, all three of these types of food processors currently exempt from the tax are scheduled to pay the same preferential B&O tax rate paid by several other food processors.

What evidence exists to show that the tax preferences have contributed to the achievement of any of these public policy objectives?

B&O Tax Exemption

Related to jobs

While the 2012 Senate floor speeches indicated the exemption was directly related to jobs, the Legislature has not established specific job number or job quality targets to use in assessing achievement of the jobs-related objective.

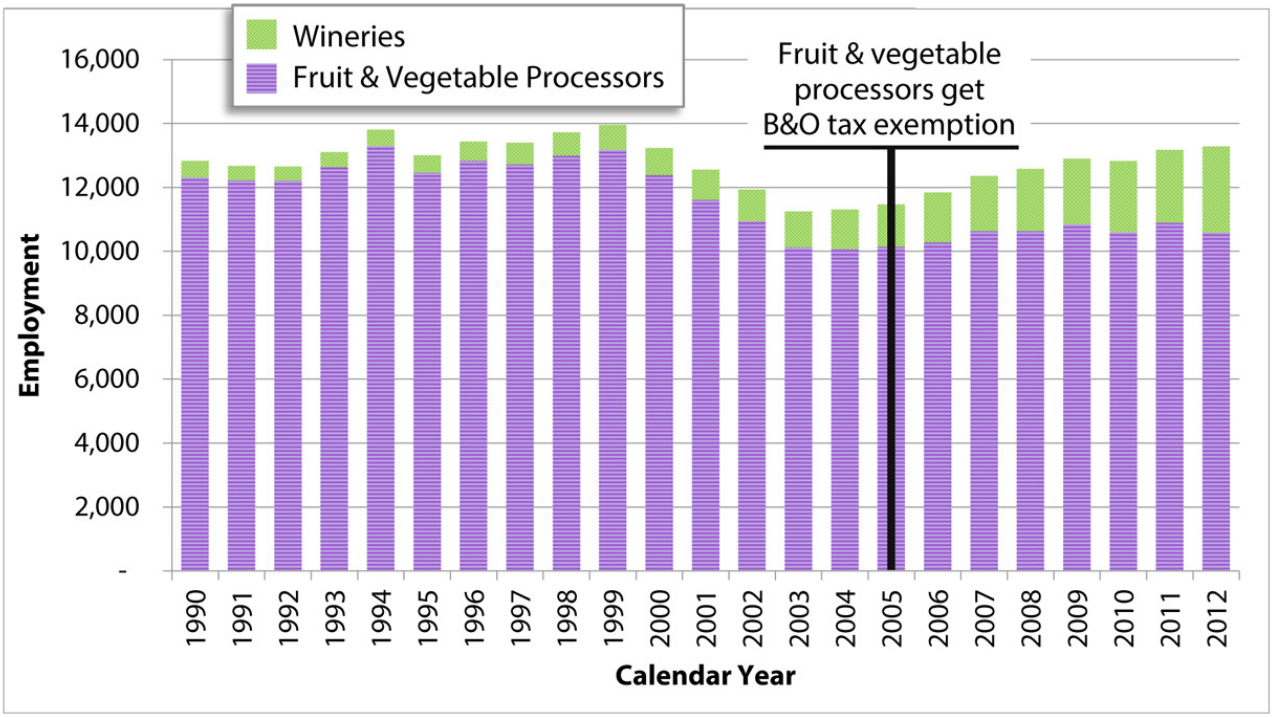
There is, however, descriptive information available for the Legislature's review on jobs in the fruit and vegetable processing industry and job-related information reported by the businesses using the fruit and vegetable processor B&O exemption. This section of the report provides historical trend data on employment in the fruit and vegetable processing industry as a whole (beneficiaries and non-beneficiaries). It then answers the following four questions using data from self-reported 2009-2012 Annual Survey filed by the beneficiaries of the preference:

1. What percentage of beneficiaries reported creating new jobs each year?
2. How many jobs are beneficiaries reporting?
3. What wages do beneficiaries pay their employees?
4. How many beneficiary employees receive health and retirement benefits?

JLARC staff do not assert whether there is a causal relationship between the outcomes shown in this section and the tax preference.

For Washington's fruit and vegetable processing industry as a whole, employment dropped between 1999 and 2003, but has grown since, largely due to increased employment by wineries. These figures include businesses that did not or could not use the preference. See Exhibit 42, below.

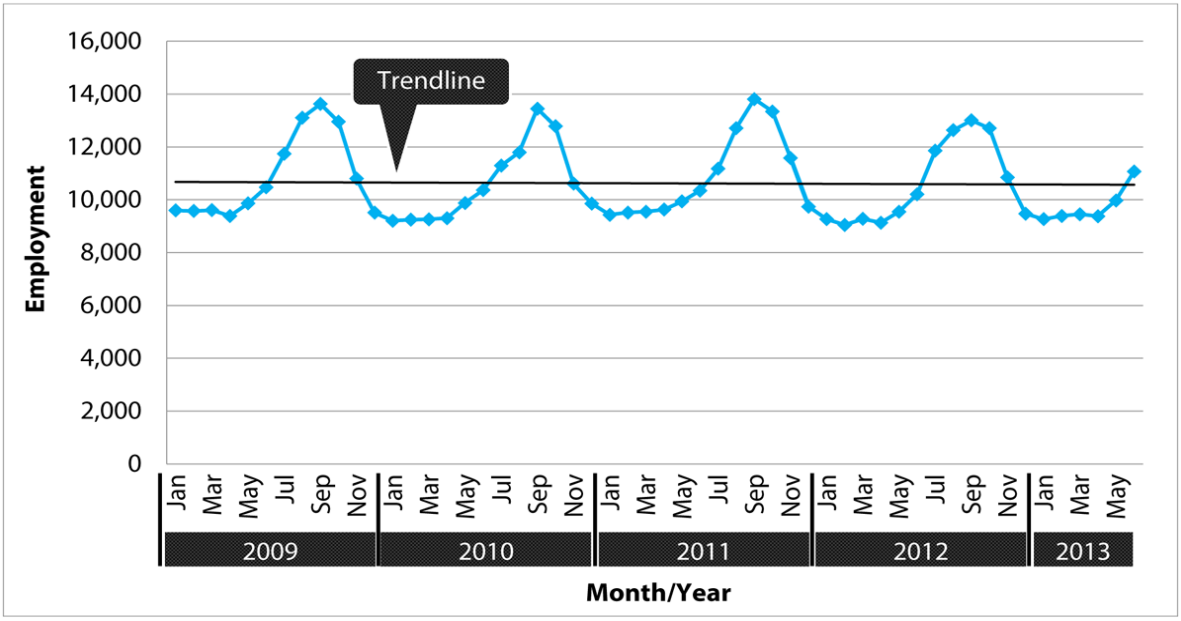
Exhibit 42 – Fruit and Vegetable Processing Employment Recovery Helped by Winery Employment Growth



Source: Quarterly Census of Employment and Wages data, 1990 through 2012.

Monthly state employment data reflects the highly seasonal nature of fruit and vegetable processing employment, with employment peaking during the summer and fall. Data from January 2009 through June 2013 reflects that job levels are fairly constant during that period. See Exhibit 43, on the following page.

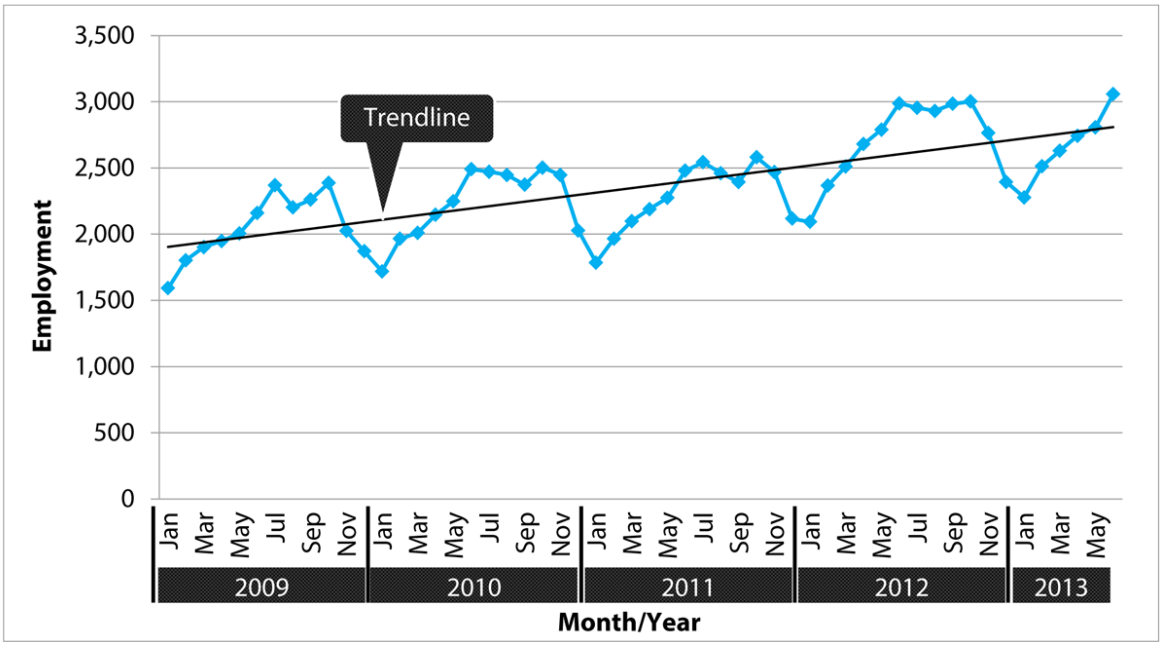
Exhibit 43 – Fruit and Vegetable Processing Industry Employment Continues To Be Highly Seasonal



Note: Data does not include winery or distillery employment. Source: Employment Security Quarterly Census of Employment and Wages, Jan. 2009- June 2013 monthly data.

The seasonal employment pattern is mirrored when looking specifically at winery employment. However, the jobs data reflects an upward trend in winery employment that is not seen in general fruit and vegetable processing. See Exhibit 44, below.

Exhibit 44 – Winery Industry Employment Follows Cyclical Pattern but Is Trending Upward



Note: Distillery data included beginning January 2013. Source: Employment Security Quarterly Census of Employment and Wages, Jan. 2009- June 2013 data.

1. What percentage of beneficiaries reported creating new jobs in each year?

Annual Survey data indicates that the number of beneficiaries using the exemption increased from 95 firms in 2009 to 185 firms in 2012. The number of firms that reported creating jobs increased from 21 firms in 2009 to 57 firms in 2012. See Exhibit 45, below.

Exhibit 45 – Number of Fruit & Vegetable Processor Beneficiaries Has Increased; 22 Percent to 36 Percent of Firms Reported Creating Jobs

Calendar Year	Number of Firms Filing Survey	Number of Firms Creating Jobs	Percent of Firms Creating Jobs
2009	95	21	22%
2010	122	28	23%
2011	165	59	36%
2012	185	57	31%

Source: Department of Revenue Annual Surveys, 2009 – 2012.

2. How many jobs are beneficiaries reporting?

While this industry is seasonal, Annual Survey data for Calendar Years 2009 through 2012 indicates that beneficiaries employed at least 75 to 86 percent of their employees on a full-time basis since 2009. Employment numbers of temporary and part-time workers have varied. See Exhibit 46, below.

Exhibit 46 – 75 to 86 Percent of Fruit and Vegetable Processor Beneficiary Employees Work Full-Time

Calendar Year	Full-Time	Part-Time	Temporary	Total Employees Reported	Percent Full-Time
2009	9,027	1,471	1,482	12,020	75%
2010	10,668	1,160	602	12,429	86%
2011	10,409	1,549	1,874	13,832	75%
2012	10,722	878	950	12,550	85%

Source: Department of Revenue Annual Surveys, 2009 – 2012.

3. What wages do beneficiaries pay their employees?

The Legislature requires beneficiaries to report the number of Washington employment positions into one of three wage bands on the Annual Survey. For Calendar Years 2009 through 2012, Annual Survey data reflects a movement in beneficiary employee wages, with the percentage of jobs in the "under $30,000" category decreasing as those in the "$30,000 - $59,999" category increased. See Exhibit 47, on the following page.

Exhibit 47 – Fruit and Vegetable Processor Beneficiary Wages

	Percent Positions within Annual Wage Bands *(Per Beneficiary Annual Surveys)*		
Calendar Year	**Under $30,000**	**$30,000 to $59,999**	**$60,000 or More**
2009	57%	34%	9%
2010	50%	38%	12%
2011	53%	37%	10%
2012	45%	43%	13%

Note: Positions include full-time, part-time, and temporary positions.

Source: Department of Revenue Annual Survey data, 2009 – 2012.

In addition to looking at wages reported by beneficiaries on Annual Surveys (in Exhibit 3, above), JLARC staff analyzed state average annual wages for specific manufacturing industry categories as reported by the Employment Security Department. The industry-wide data shows that wages paid by the fruit and vegetable processing industry (including beneficiaries and non-beneficiaries) are lower than other manufacturing industry categories. See Exhibit 48, below.

Exhibit 48 –Fruit & Vegetable Processor Industry Annual Wages Are Below Other Food Processing and Manufacturing Categories

Average Annual Wages for Selected Industries *(Per State Employment Security Data)*					
Calendar Year	**Fruit & Vegetable Processing** *(Including Wineries)*	**Wineries**	**Food Product Manufacturing**	**Manufacturing** *(Excluding Aerospace)*	**Manufacturing** *(Including Aerospace)*
2009	$37,892	$28,534	$40,531	$51,699	$62,931
2010	$36,744	$27,981	$40,911	$52,991	$64,925
2011	$37,202	$29,070	$41,682	$54,677	$68,065
2012	$38,884	$28,136	$42,969	$55,709	$69,306

Note: Positions include full-time, part-time, and temporary positions.

Source: Employment Security Quarterly Census Employment and Wages annual data, 2009-2012.

A factor reducing the industry's average wages are the lower wages paid to winery employees. From 2009 to 2012, winery beneficiary employees comprised 17 to 20 percent of the employees included in the broader "fruit and vegetable processing" category.

4. How many beneficiary employees receive health and retirement benefits?

Beneficiaries must also report on the Annual Survey the number of employees receiving medical, dental, and retirement benefits. See Exhibit 49, below.

Exhibit 49 – Medical, Dental, and Retirement Benefits

Calendar Year	Medical	Dental	Retirement
2009	60%	58%	55%
2010	58%	56%	67%
2011	61%	53%	62%
2012	63%	60%	49%

Source: Department of Revenue Annual Surveys, 2009 – 2012.

B&O Tax Preferential Rate

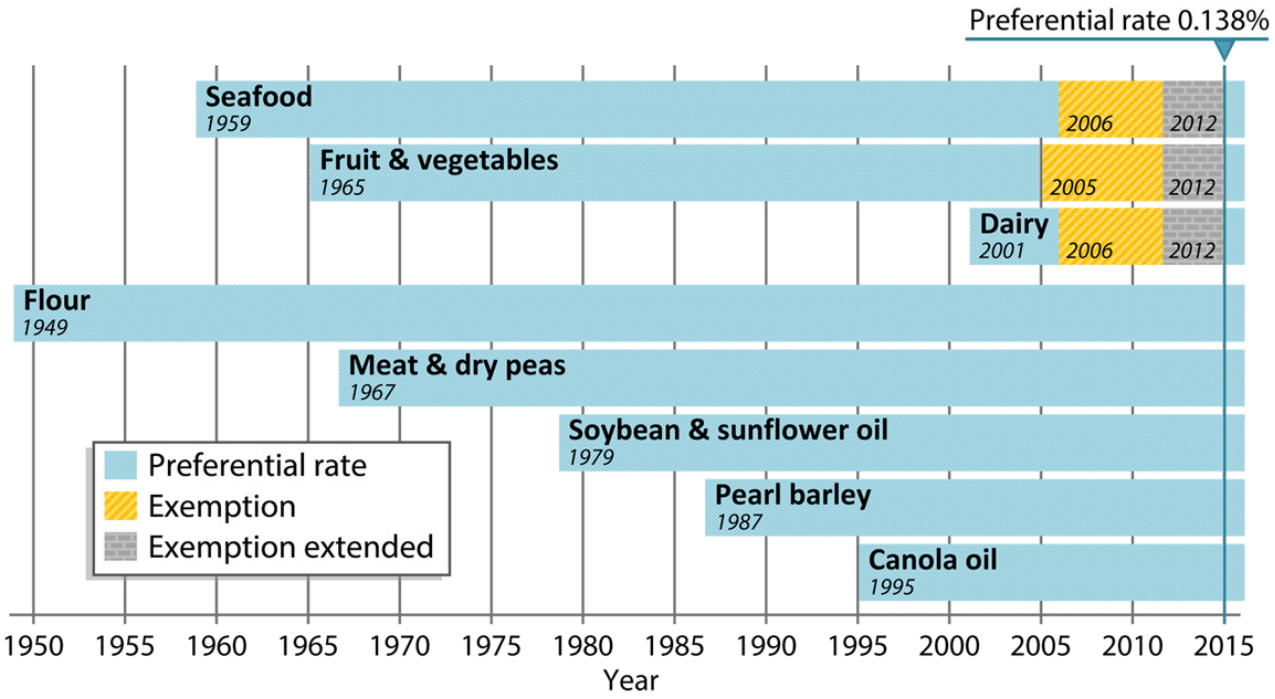
Provide tax treatment consistent with other food processors

While the future preferential B&O tax rate will provide parity in tax treatment for food product *processing activities* (manufacturing), it will not provide parity for various wholesale or retail *sale activities.* If tax parity is what the Legislature intended, it will only partly be achieved.

Food tax parity for manufacturing

For the most part, the same preferential rate will apply to fresh food *manufacturing* activities. The Legislature granted preferential tax rates to food processors one sector at a time over a period of years beginning in 1949, and then provided full exemptions to fruit and vegetable, dairy, and seafood product processors in 2005 and 2006. On July 1, 2015, fruit and vegetable, dairy, and seafood processors will pay the same preferential B&O tax rate of 0.138 percent that many other food processors now do. See Exhibit 50, on the following page. It is unclear why the Legislature selected the particular rate of 0.138 percent to apply to the food processors.

Exhibit 50 – History of Tax Preference for Food Processors



Source: JLARC staff analysis of various food processor statutes.

Food tax parity for selling

While the Legislature's actions will result eventually in B&O tax parity among food processors for their *manufacturing* activity, the same is not true for their *selling* activities. Examples of differences in the application of the preferential rate to sales activities include the following:

- Some food processors receive no preferential rate on any of their sales activities (flour, dried peas, soybean and sunflower oil, pearl barley, and canola oil processors);
- Some food processors receive the preferential rate on their wholesale sales delivered in-state but transported outside the state (fruit and vegetable, seafood, and dairy processors);
- Some food processors receive the preferential rate on an additional portion of their sales activities(seafood and dairy processors for retail sales delivered in-state for transport out-of-state; and dairy processors for wholesale sales for use as a component in making other dairy products); and
- Some businesses that are *not food processors* receive the preferential rate (businesses making retail or wholesale sales of seafood products delivered in-state for delivery out-of-state, businesses making wholesale sales of meat products).

The inconsistencies are illustrated in Exhibit 51, on the following page.

Exhibit 51 – Future Preferential B&O Tax Rate Will Provide Tax Parity for Food Processing Activities but not for Sales Activities

☑ Will pay preferential B&O rate (0.138%) effective July 1, 2015

Industry	Processing (manufacturing)	Sales delivered in-state for delivery out-of-state				Other wholesale sales
		Sales by Processor		Sales by Others		
		Wholesale	*Retail*	*Wholesale*	*Retail*	
Seafood	☑	☑	☑	☑	☑	
Dairy	☑	☑	☑			☑*
Fruit & Vegetables	☑	☑				
Meat	☑					☑**
Flour	☑					
Dried Peas	☑					
Soybean & Sunflower Oil	☑					
Pearl Barley	☑					
Canola Oil	☑					

* Wholesale sales by processor for use as an ingredient in making other dairy product.

** Wholesale sales by any business.

Source: JLARC staff analysis of RCW 82.04.260.

To what extent will continuation of the tax preferences contribute to these public policy objectives?

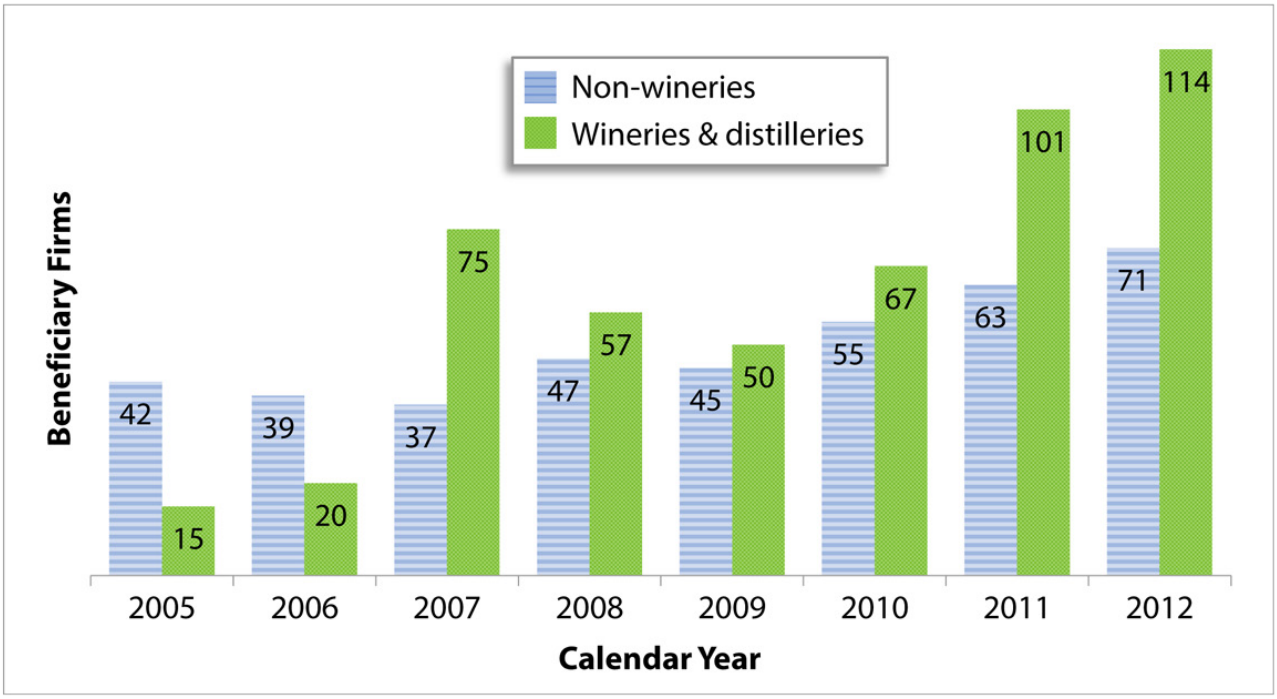
It is unclear whether continuing the B&O tax exemption scheduled to expire July 1, 2015, would contribute to the inferred public policy objective related to jobs. Allowing the exemption to expire and replacing it with the 0.138 percent preferential B&O tax rate would provide tax parity for several types of food *manufacturing activities.* However, the tax treatment provided for various *selling activities* of food products would remain inconsistent.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preferences?

The beneficiaries of the tax preferences are fresh fruit and vegetable manufacturers, including wineries and distilleries. From 2005 to 2012, the number of beneficiaries increased from 57 to 185. As shown in Exhibit 52, on the following page, wineries and distilleries have grown faster than other fruit and vegetable processor beneficiaries.

Exhibit 52 – Fruit and Vegetable Processor Beneficiary Numbers Have Increased Over Time



Source: JLARC staff analysis of Department of Revenue Annual Survey data, 2005 – 2012.

Of the 185 beneficiaries in 2012, 50 percent of the tax preference was used by eight businesses. Conagra Foods Lamb Weston, Inc. has been the top user of the preference every year from 2009 to 2012. See Exhibit 53, below.

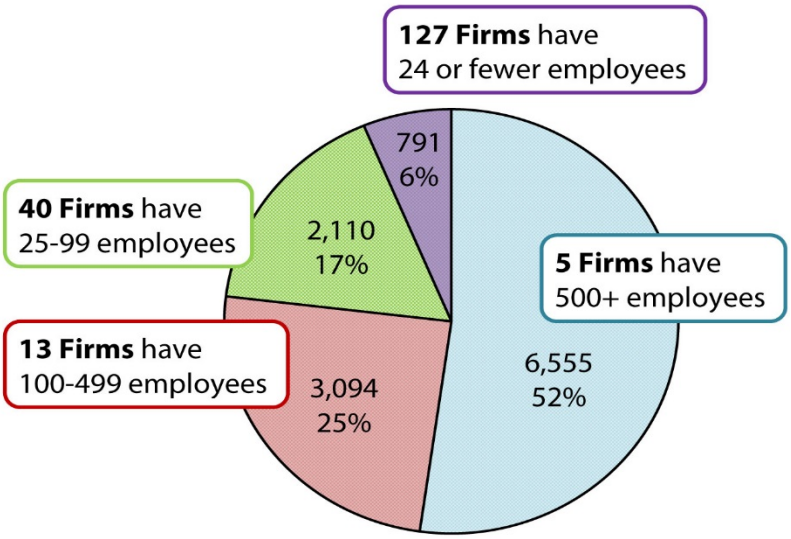
Exhibit 53 – Eight Beneficiaries Receive Half of the Tax Preference Taken in 2012

	Percentage of Total Tax Preference Claimed			
Business	**2012**	**2011**	**2010**	**2009**
Conagra Foods Lamb Weston, Inc.	17%	16%	17%	22%
J R Simplot Company	11%	1%	Less than 1%	1%
Crunch Pak LLC	6%	Less than 1%	Less than 1%	Less than 1%
Tree Top, Inc.	5%	7%	7%	9%
St. Michelle Wine Estates LTD	4%	12%	10%	13%
Stockpot, Inc.	3%	3%	13%	*
Bybee Foods LLC	2%	6%	4%	6%
Del Monte Corp.	2%	5%	5%	8%
All Remaining Beneficiaries	50% (177 Firms)	50% (157 Firms)	44% (114 firms)	41% (87 Firms)

* Did not file Annual Survey for this year. Note: Sorted by top five beneficiaries for each year, 2009 through 2012.
Source: Department of Revenue Annual Survey data, 2009 to 2012.

Five out of the 185 beneficiaries employed 500 or more people in Calendar Year 2012, but most beneficiary businesses employ 25 or fewer employees. However, the five beneficiaries with employment over 500 persons in 2012 employed 52 percent of the total employees reported. See Exhibit 54, below.

Exhibit 54 – 52% of 2012 Beneficiary Employees Work for Businesses with 500 or More Employees



Source: Department of Revenue 2012 Annual Survey Data.

Revenue and Economic Impacts

What are the past and future tax revenue and economic impacts of the tax preferences to the taxpayer and to the government if they are continued?

Beneficiaries are estimated to have saved $19.6 million in Fiscal Year 2013 due to the preference. The estimated 2013-15 Biennial savings (prior to the exemption's expiration on July 1, 2015) is $39.3 million. These estimates are based on the fact that without the exemption, these businesses would pay B&O tax at a rate of 0.484 percent. See Exhibit 55, below.

Exhibit 55 – Estimated 2013-15 Beneficiary Savings from B&O Tax Exemption for Fresh Fruit and Vegetable Processors

Fiscal Year	Taxable Gross Income	Beneficiary Savings
2012	$3,833,654,000	$18,556,000
2013	$4,056,006,000	$19,631,000
2014	$3,970,830,000	$19,219,000
2015	$4,141,576,000	$20,045,000
2013-15 Biennium	**$8,112,406,000**	**$39,264,000**
Exemption scheduled to expire effective July 1, 2015		

Source: Department of Revenue Annual Survey data for Calendar Year 2012 used for 2012 calculation. Growth estimated using Economic and Revenue Forecast Council's actual B&O tax growth for Fiscal Year 2013 and estimated growth for Fiscal Years 2014 – forward (November 2013 forecast).

After the exemption expires, it will be replaced by the preferential 0.138 percent B&O tax rate. Beneficiaries are estimated to save $30.8 million in the 2015-17 Biennium due to the preferential rate. These estimates are calculated using the difference between the general manufacturing/ wholesaling B&O tax rate (0.484 percent) and the preferential rate (0.138 percent). See Exhibit 56, below.

Exhibit 56 – Estimated 2015-17 Beneficiary Savings from Preferential B&O Tax Rate for Fresh Fruit and Vegetable Processors

Fiscal Year	Taxable Gross Income	B&O Tax Under General Rate (0.484%)	B&O Tax Under Preferential Rate (0.138%)	Beneficiary Savings
2012	Preferential Rate does not take effect until July 1, 2015.			
2013				
2014				
2015				
2016	$4,344,513,000	$21,027,000	$5,996,000	$15,032,000
2017	$4,566,083,000	$22,100,000	$6,301,000	$15,799,000
2015-17 Biennium	**$8,910,596,000**	**$43,127,000**	**$12,297,000**	**$30,831,000**

Source: Department of Revenue Annual Survey data for Calendar Year 2012 used as basis for Fiscal Year calculations. Growth estimated using Economic and Revenue Forecast Council's estimated B&O tax growth for Fiscal Years 2016 and 2017 (November 2013 forecast).

If the tax preferences were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preferences and the extent to which the resulting higher taxes would have an effect on employment and the economy?

If the B&O tax exemption (currently scheduled to expire July 1, 2015) and the preferential B&O tax rate scheduled to begin July 1, 2015, were terminated, fresh fruit and vegetable processors that now pay no B&O tax would pay B&O tax at the general manufacturing/wholesaling rate of 0.484 percent. The effect of these terminations on employment and the economy would depend on the extent to which the industry could absorb the increased costs or pass them along to their customers.

Other States

Do other states have similar tax preferences and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

JLARC staff reviewed states that rank highest in production for some of the same fruit and vegetable crops as grown and processed in Washington. These include: California, Oregon, Idaho, New York, Pennsylvania, Michigan, Wisconsin, and Minnesota.

Since none of these competitor states impose a B&O or similar tax, JLARC staff looked to other tax preferences provided to fresh fruit and vegetable processors. Preferences provided by other states to food processors include:

- California provides a sales tax exemption for diesel fuel used in food processing.
- Idaho, Michigan, Oregon, Pennsylvania, and Wisconsin provide income tax exemptions, deductions, or preferential rates for certain agricultural cooperative organizations.
- Oregon also provides a property tax exemption for equipment used in food processing.
- Wisconsin allows a franchise tax credit for modernizing or expanding food processing facilities.

Legislative Auditor Recommendations

B&O Tax Exemption for Fruit and Vegetable Processors

Prior to the scheduled expiration of the fruit and vegetable processor B&O exemption in July 2012, JLARC staff reviewed this pair of preferences. The Legislative Auditor's recommendation at that time was to allow the B&O exemption to expire as scheduled in 2012 and the B&O preferential rate to begin. This would have resulted in consistent tax treatment for processing food products.

The Legislature chose a different course of action. In the 2012 session, the Legislature extended the expiration date for the fruit and vegetable processor exemption (and the dairy and seafood exemptions) to July 2015, and delayed the effective date of the preferential rate to begin when the exemption expires. While the legislation did not include a specific statement of intent, floor speeches indicated extension of the expiration date for the exemptions was directly related to jobs.

In light of the Legislature's actions in 2012, the Legislative Auditor is modifying his recommendations in this 2014 review.

Because the Legislature indicated that the extension of the expiration date for this exemption was directly related to jobs but has not yet identified job-related performance metrics, the Legislature should review and clarify this preference to:

- **Identify performance targets and metrics for the number and quality of jobs in the fruit and vegetable processing industry; and**
- **Establish criteria for when to transition from the exemption to the preferential rate.**

Legislation Required: Yes.

Fiscal Impact: Depends on Legislation.

Preferential B&O Rate for Fruit and Vegetable Processors

The preferential B&O rate for fruit and vegetable processors has not yet taken effect, so its performance cannot be evaluated. However, we note that the Legislature has not made a clear statement on the public policy objective of the preferential rate. The Legislature may intend eventual consistent tax treatment for all food processors, but there is not a clear statement of this objective, and the Legislature's action in 2012 delayed this from happening.

Also, while the preferential rate will make the tax rate of several food processing activities conform, there will not be tax parity among various sales activities of food products.

Because it has an opportunity to do so before the preference takes effect, the Legislature should review and clarify this preference to clarify whether the Legislature intends there to be parity among all the different food processor manufacturing and sales activities.

Legislation Required: Yes.

Fiscal Impact: Depends on Legislation.

SEAFOOD PRODUCT PROCESSORS AND CERTAIN SELLERS - B&O TAX EXEMPTION AND PREFERENTIAL RATE

Report Summary			
What the Preference Does	**Public Policy Objectives**	**Estimated Beneficiary Savings**	**Auditor Recommendation**
Seafood Product Processors and Certain Sellers – Exemption (B&O Tax)			
Provides a B&O tax exemption to the seafood industry for: • Manufacturing activities for certain seafood products; or • Sales of certain seafood products (retail or wholesale) to purchasers that receive the products in-state and transport them outside the state.	The Legislature did not explicitly state a public policy objective for this preference. JLARC staff infer that the policy objective was related to jobs.	$4.4 million in the 2013-15 Biennium.	**Review and clarify:** Because the Legislature indicated extension of the expiration date was directly related to jobs but has not yet identified job-related performance metrics, the Legislature should: 1) identify performance targets and metrics for the number and quality of jobs in the seafood processing industry; and 2) establish criteria for when to transition from the deduction to the preferential rate.
Seafood Product Processors and Certain Sellers – Preferential Rate (B&O Tax)			
Effective July 1, 2015, provides a preferential B&O tax rate (0.138 percent) to the seafood industry for: • Manufacturing activities for certain seafood products; or • Sales of certain seafood products (retail or wholesale) to purchasers that receive the products in-state and transport them outside the state.	The Legislature did not explicitly state a public policy objective for this preference. JLARC staff infer the policy objective is to treat seafood processors consistently with other fresh food processors.	$3.5 million in the 2015-17 Biennium	**Review and clarify:** To clarify, before the preference takes effect, whether the Legislature intends there to be parity among all the different food processor manufacturing and sales activities.

SEAFOOD PRODUCT PROCESSORS AND CERTAIN SELLERS - B&O TAX EXEMPTION AND PREFERENTIAL RATE

Current Law

This review includes two tax preferences for the seafood industry:

1) A **business and occupation (B&O) tax exemption** for:
    - Manufacturing activities for certain seafood products, such as freezing raw salmon fillets; or
    - Sales of certain seafood products (retail or wholesale) to purchasers that receive the products in-state and transport them outside the state.

    The B&O tax exemption is scheduled to expire on July 1, 2015.

2) A **preferential B&O tax rate of 0.138 percent** for the same seafood product manufacturing and selling activities noted above, which goes into effect when the B&O exemption expires on July 1, 2015.

    The preferential tax rate does not have an expiration date.

Absent these tax preferences, seafood product manufacturers would pay manufacturing B&O tax at a rate of 0.484 percent. Sales of seafood products delivered in-state would be subject to the wholesaling B&O tax at a rate of 0.484 percent or the retailing B&O tax at a rate of 0.471 percent.

To qualify for the preferences, the seafood must remain in a raw, raw frozen, or raw salted state at the end of the manufacturing process. Seafood product sales, both wholesale and retail, qualify for the tax preferences if the sale is of qualifying seafood products that are delivered in-state to purchasers that then transport the products outside the state.

Neither of the preferences applies to:

- Cutting, grading, or ice glazing seafood which has been cooked, frozen, or canned outside of Washington; or
- Inspecting, testing, labeling, and storing canned salmon owned by another business.

In addition to their manufacturing activity, seafood processors may also conduct different kinds of sales activities. For instance, they may sell seafood products to other businesses that in turn resell the product or use it to manufacture another product (subject to wholesaling B&O tax), or they may sell the product to the end user (subject to retailing B&O tax).

Exhibit 57, on the following page provides detail on the current and future tax treatment for seafood processors and sellers' various activities under these preferences.

Exhibit 57 – Seafood Product Sales B&O Tax Rate Differs Depending on Customer and Place Delivered

Activity	B&O Tax Rate Through July 1, 2015	B&O Tax Rate Starting July 1, 2015
Processor or any other seller makes sale (wholesale or retail) delivered in-state	0.484% (wholesale) 0.471% (retail)	0.484% (wholesale) 0.471% (retail)
Processor or any other seller makes sale (wholesale or retail) delivered in-state to take out-of-state	None *(This preference exempts this)*	0.138% *(This preference provides reduced rate)*
Processor or any other seller makes sale (wholesale or retail) delivered out-of-state	None *(Exempt as an interstate sale)*	None *(Exempt as an interstate sale)*

Source: JLARC staff analysis of state statutes.

Beneficiaries of the B&O tax exemption must file an Annual Survey with the Department of Revenue (DOR) by April 30 each year based on the previous year's activity. The survey provides information on: the number of employees; wages by wage bands; and medical, dental, and retirement benefits. The names of beneficiaries and the amount of tax exemption taken are publicly disclosable. If a beneficiary fails to file a survey for a previous year, DOR may assess taxes and interest on the amount of exemption taken for that year. The survey will not be required for beneficiaries of the preferential rate when it takes effect in July 2015.

In addition to the preferences covered in this review, seafood processors may be eligible for several other tax preferences, including those noted in Exhibit 58, below:

Exhibit 58 – Other Tax Preferences Are Available to Seafood Processors

	Manufacturers' Machinery and Equipment Sales & Use Tax Exemption	Rural County & Community Empowerment Zone (CEZ) New Jobs B&O Tax Credit	High Unemployment County Sales & Use Tax Deferral/ Waiver for Manufacturing Facilities
Began in:	1995	1986	1985
Type:	Sales & use tax exemption	B&O tax credit for manufacturing and other businesses that hire workers in rural counties or CEZs	Sales & use tax deferral and eventual exemption for construction and equipment purchased by new or expanding businesses in certain counties and all CEZs
Restrictions on Use:	Available to any manufacturer. Not available for hand-powered tools, items with useful life less than one year, or buildings	Business must be located in rural county or CEZ. Business must increase its employment by at least 15% within one year of first hiring to take the credit	Business must be located in a county with high unemployment rate. Facility must stay operational 7 years to receive full exemption
Items Impacted:	Purchases of machinery and equipment used in manufacturing process, repair, and maintenance work	Provides up to a $4,000 B&O tax credit for each new position created by manufacturing and other businesses that hire workers in rural counties or CEZs	Construction of new structures and expansion of existing structures; industrial fixtures, equipment, and support facilities integral to the manufacturing operation
JLARC Staff Review	None, per RCW 43.136.045	Completed in 2013	Scheduled for 2018

Source: JLARC staff analysis of statutes; Department of Revenue Tax Incentives web site.

See Appendix 3 for the current statutes, RCW 82.04.4269 and 82.04.260(1)(b).

Legal History

Over the years, the Legislature has provided preferential B&O tax rates to manufacturers of several fresh food products. Flour processors received the first preferential B&O rate in 1949, followed by seafood processors in 1959, fresh fruit and vegetable products processors in 1965, processors of dried peas and perishable meat products in 1967, and dairy product processors in 2001.

JLARC staff previously reviewed the preference for processors of flour in 2009, the preferences for seafood, dairy product, and fruit and vegetable processors in 2010, and the preference for meat processors in 2011.

Pre-1959 Seafood processing was classified as a manufacturing activity; processors paid the general manufacturing B&O tax rate.

1959 The Legislature enacted a preferential B&O tax rate of 0.125 percent for manufacturing seafood products when the product remained in a raw, raw frozen, or raw salted state at the end of the manufacturing process. In the same year, the Legislature increased the general manufacturing B&O tax rate from 0.40 percent to 0.44 percent.

1990s All B&O tax rates increased and gradually decreased due to surtax impositions and expirations. When the last surtax expired on July 1, 1997, the seafood processor B&O tax rate became 0.138 percent while the general manufacturing rate became 0.484 percent.

2005 The Legislature changed the preferential B&O tax rate for fresh fruit and vegetable processors and certain wholesale sales by processors to an exemption, effective July 1, 2005. The preferential B&O tax rate for seafood processors remained at 0.138 percent.

2006 The Legislature made a number of changes for fresh food processors:

- Replaced the preferential B&O tax rate for seafood and dairy processors with a B&O tax exemption, which was set to expire July 1, 2012;
- Extended the exemption to apply to wholesale or retail seafood or dairy product sales to purchasers that transported the goods out-of-state, which was set to expire July 1, 2012. Unlike the fruit and vegetable preference passed in 2005, the exemption was not limited to sales by the processor;
- Provided a July 1, 2012, expiration date for the fruit and vegetable processor B&O tax exemption;
- Provided a preferential B&O tax rate of 0.138 percent for seafood, dairy, and fruit and vegetable processors when the exemption expired, the same rate that was provided to other fresh food processors;
- Did not provide a preferential B&O tax rate for seafood product wholesalers and retailers after the exemption expired, making their sales subject to the wholesaling (0.484 percent) or retailing (0.471 percent) B&O tax rates after July 1, 2012.
- Required all beneficiaries of the exemption to file an Annual Survey with DOR.

2007 The Legislature expanded the 0.138 percent preferential B&O tax rate to sales (retail and wholesale) of seafood products to purchasers that transported the goods out-of-state. The preferential rate was scheduled to begin after the B&O exemption expired on July 1, 2012. The Legislature had provided the same preferential tax rate to dairy sales (retail and wholesale), and certain wholesale sales by fruit and vegetable processors previously.

2010 JLARC staff issued a performance audit review of the seafood product processing B&O tax exemption and preferential rate to the Legislature. In the report, the Legislative Auditor recommendation was to allow the B&O tax exemption to expire as scheduled in 2012 and the preferential rate to begin. This would have resulted in consistent tax treatment of processing fresh food products.

2012 The Legislature extended the expiration date for the seafood, fruit and vegetable, and dairy product processor B&O tax exemption to July 1, 2015, and adjusted the preferential tax rate to begin after the exemption ended.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

B&O Tax Exemption

Related to jobs

The Legislature did not explicitly state a public policy objective for the tax preference when it was first enacted in 2006 or in 2012 when it extended the expiration date for B&O tax exemptions for dairy, seafood, and fruit and vegetable processors to July 1, 2015. JLARC staff infer the public policy objective was related to jobs based on member comments during 2012 Senate floor debate where senators stated the exemptions were directly related to jobs.

When the Legislature enacted the preference in 2006, it required beneficiaries to file an Annual Survey with DOR detailing:

- The number of full-time, part-time, and temporary employees;
- The number of employees by wage bands; and
- The extent to which beneficiaries offered medical, dental, and retirement benefits to employees.

B&O Tax Preferential Rate

Provide tax treatment consistent with other food processors

JLARC staff infer the public policy objective was to treat seafood processors consistently with other food processors and is reflected in parallel legislative actions for seafood, fruit and vegetable, and dairy processors.

In its actions in 2005 and 2006, the Legislature established that these food processors would all eventually pay the preferential B&O tax rate of 0.138 percent, the same rate as many other food processors. In 2012, the Legislature extended the B&O tax expiration date for seafood, diary, and fruit and vegetable processors to July 2015. After that time, all fresh food processors are scheduled to pay the same preferential tax rate of 0.138 percent, the rate currently paid by several other fresh food processors.

What evidence exists to show that the tax preferences have contributed to the achievement of any of these public policy objectives?

B&O Tax Exemption

Related to jobs

While the 2012 Senate floor speeches indicated the exemption was directly related to jobs, the Legislature has not established specific job number or job quality targets to use in assessing achievement of the jobs-related objective.

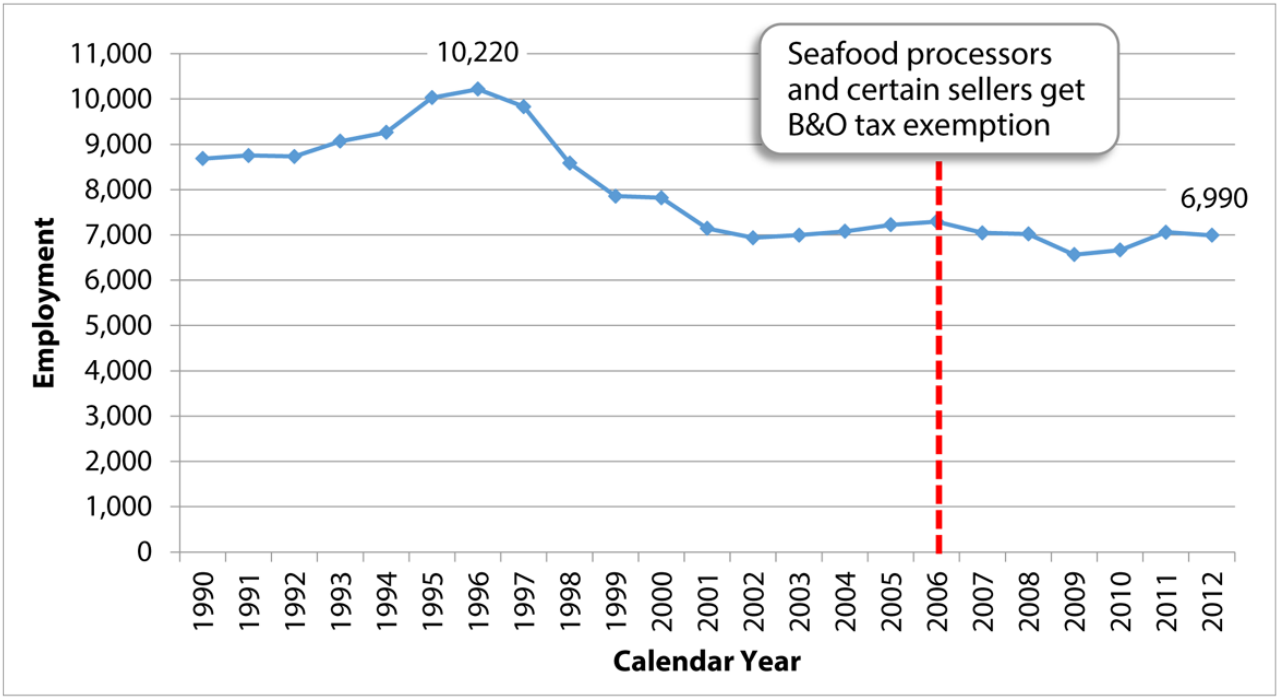
There is, however, descriptive information available for the Legislature's review on jobs in the seafood processing industry and job-related information reported by the businesses using the seafood processor B&O exemption. This section of the report provides historical trend data on employment in the seafood processing industry as a whole (beneficiaries and non-beneficiaries). It then answers the following four questions using data from self-reported 2009-2012 Annual Surveys filed by the beneficiaries of the preference:

1. What percentage of beneficiaries reported creating new jobs each year?
2. How many jobs are beneficiaries reporting?
3. What wages do beneficiaries pay their employees?
4. How many beneficiary employees receive health and retirement benefits?

JLARC staff do not assert whether there is a causal relationship between the outcomes shown in this section and the tax preference.

For Washington's seafood industry as a whole, Washington employment peaked in the mid-1990s at 10,220 and then declined to 6,990 in 2012. These figures include businesses that did not or could not use the preference. See Exhibit 59, on the following page.

Exhibit 59 – Over the Past 22 Years, Washington Seafood Processing Employment Peaked in 1996



Source: Quarterly Census of Employment and Wages, 1990 – June 2013.

1. What percentage of beneficiaries reported creating new jobs in each year?

Annual Survey data indicates that the percentage of beneficiary firms creating new jobs ranged from 8 percent to 25 percent between 2009 and 2012. See Exhibit 60, below.

Exhibit 60 – 8% to 25% of Seafood Processor Beneficiaries Report Creating Jobs

Calendar Year	Number of Firms Filing Survey	Number of Firms Creating Jobs	Percent of Firms Creating Jobs
2009	19	3	16%
2010	28	7	25%
2011	36	3	8%
2012	46	8	17%

Source: Department of Revenue Annual Survey data, 2009 -2012.

2. How many jobs are beneficiaries reporting?

Annual Survey data for Calendar Years 2009 through 2012 shows a range between 62 and 85 percent full time employees. See Exhibit 61, below.

Exhibit 61 – Seafood Processor Beneficiary Employment

Calendar Year	Full-Time	Part-Time	Temporary	Total Employees Reported	Percent Full-Time
2009	1,543	401	526	2,470	62%
2010	1,617	245	276	2,138	76%
2011	2,466	245	189	2,900	85%
2012	2,348	336	150	2,834	83%

Source: Department of Revenue Annual Surveys, 2009 – 2012.

3. What wages do beneficiaries pay their employees?

The Legislature requires beneficiaries to report the number of Washington employment positions into one of three wage bands on the Annual Survey. Between 47 percent and 53 percent of beneficiary employees are paid wages of less than $30,000 annually, 31 percent to 35 percent receive wages in the $30,000 to $59,999 band, and 14 percent to 19 percent earn $60,000 or more. See Exhibit 62, below.

Exhibit 62 – Seafood Processor Beneficiary Employee Wages

	Percent Positions within Annual Wage Bands *(Per Beneficiary Annual Surveys)*		
Calendar Year	**Under $30,000**	**$30,000 to $59,999**	**$60,000 or More**
2009	48%	33%	19%
2010	53%	33%	14%
2011	51%	31%	18%
2012	47%	35%	18%

Note: Data includes full-time, part-time, and temporary positions. Source: Department of Revenue Annual Survey data, 2009–2012.

In addition to looking at wages reported by beneficiaries on Annual Surveys (in Exhibit 62, above), JLARC staff analyzed state average annual wages for specific manufacturing industry categories as reported by the Employment Security Department. The industry-wide data (including beneficiaries and non-beneficiaries) shows that wages paid by seafood processors are higher than other Washington food processors and manufacturers, when aerospace wages are not included. See Exhibit 63, on the following page.

Exhibit 63 –Seafood Processor Industry Annual Wages In Upper Range of Manufacturing Industry Wages

Average Annual Wages for Selected Industries *(Per State Employment Security Data)*				
Calendar Year	**Seafood Processing**	**Food Product Manufacturing**	**Manufacturing** *(Excluding Aerospace)*	**Manufacturing** *(Including Aerospace)*
2009	$52,698	$40,531	$51,699	$62,931
2010	$51,201	$40,911	$52,991	$64,925
2011	$54,992	$41,682	$54,677	$68,065
2012	$57,955	$42,969	$55,709	$69,306

Note: Data includes full-time, part-time, and temporary positions. Source: Employment Security Quarterly Census Employment and Wages annual data, 2009-2012.

4. How many beneficiary employees receive health and retirement benefits?

Beneficiaries must also report on the Annual Survey the number of employees receiving medical, dental, and retirement benefits. See Exhibit 64, below.

Exhibit 64 – Medical, Dental, and Retirement Benefits

Calendar Year	Medical	Dental	Retirement
2009	54%	50%	38%
2010	63%	61%	39%
2011	51%	51%	39%
2012	65%	63%	38%

Source: Department of Revenue Annual Surveys, 2009 – 2012.

B&O Tax Preferential Rate

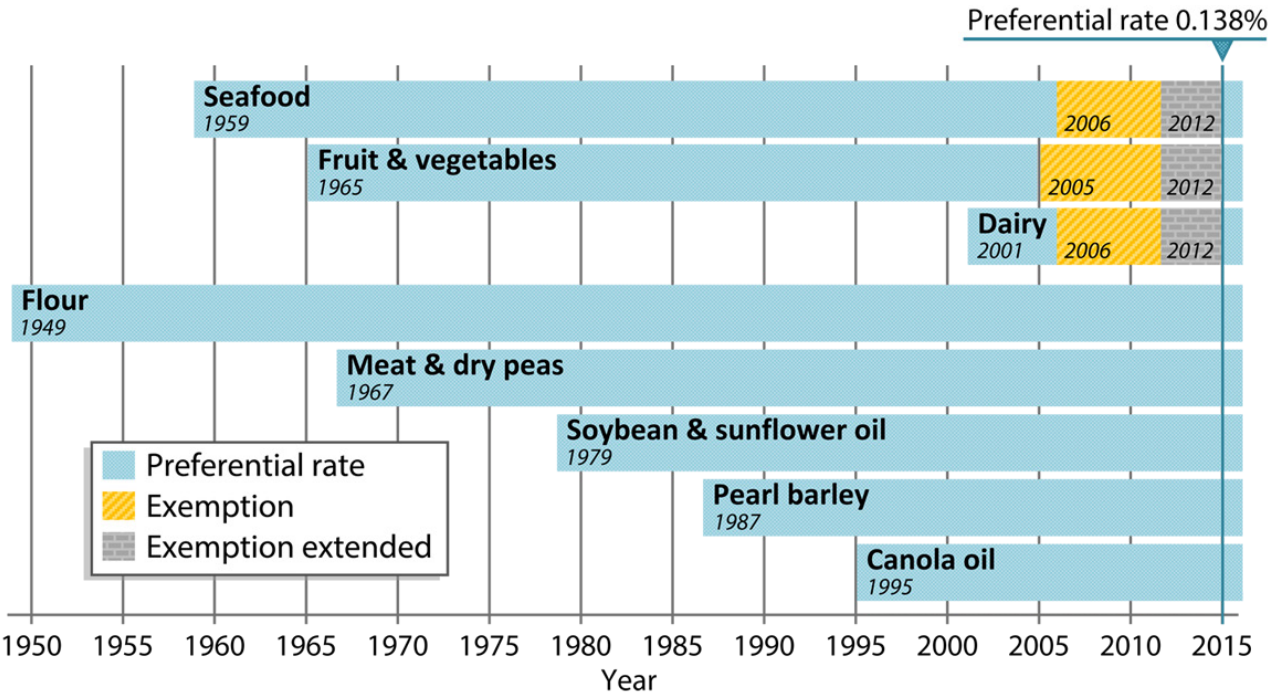
Provide tax treatment consistent with other food processors

While the future preferential B&O tax rate will provide parity in tax treatment for food product *processing* (manufacturing), it will not provide parity for various wholesale or retail *sale activities*. If tax parity is what the Legislature intended, it will only partly be achieved.

Food tax parity for manufacturing

For the most part, the same preferential rate will apply to food *manufacturing* activities. The Legislature granted preferential tax rates to food processors one sector at a time over a period of years beginning in 1949, and then provided full exemptions to fruit and vegetable, dairy, and seafood product processors in 2005 and 2006. On July 1, 2015, seafood, dairy, and fruit and vegetable processors will pay the same preferential B&O tax rate of 0.138 percent that many other food processors now do. See Exhibit 65, below. It is unclear why the Legislature selected the particular rate of 0.138 percent to apply to food processors.

Exhibit 65 – History of Tax Preference for Food Processors



Source: JLARC staff analysis of various food processor statutes.

Food tax parity for selling

While the Legislature's actions will result eventually in B&O tax parity among food processors for their *manufacturing* activity, the same is not true for their *selling* activities. Examples of differences in the application of the preferential rate to sales activities include the following:

- Some food processors receive no preferential rate on any of their sales activities (flour, dried peas, soybean and sunflower oil, pearl barley, and canola oil processors);

- Some food processors receive the preferential rate on their wholesale sales delivered in-state but transported outside the state (fruit and vegetable, seafood, and dairy processors);
- Some food processors receive the preferential rate on an additional portion of their sales activities (seafood and dairy processors for retail sales delivered in-state for transport out-of-state; and dairy processors for wholesale sales for use as an ingredient in making other dairy products); and
- Some businesses that are *not food processors* receive the preferential rate (businesses making retail or wholesale sales of seafood products delivered in-state for delivery out-of-state, businesses making wholesale sales of meat products).

The inconsistencies are illustrated below in Exhibit 66.

Exhibit 66 – Future Preferential B&O Tax Rate Will Provide Tax Parity for Food Processing Activities but not for Sales Activities

☑ Will pay preferential B&O rate (0.138%) effective July 1, 2015

Industry	Processing (manufacturing)	Sales delivered in-state for delivery out-of-state				Other wholesale sales
		Sales by Processor		Sales by Others		
		Wholesale	*Retail*	*Wholesale*	*Retail*	
Seafood	☑	☑	☑	☑	☑	
Dairy	☑	☑	☑			☑*
Fruit & Vegetables	☑	☑				
Meat	☑					☑**
Flour	☑					
Dried Peas	☑					
Soybean & Sunflower Oil	☑					
Pearl Barley	☑					
Canola Oil	☑					

* Wholesale sales by processor for use as an ingredient in making other dairy product.

** Wholesale sales by any business.

Source: JLARC staff analysis of RCW 82.04.260.

To what extent will continuation of the tax preferences contribute to these public policy objectives?

It is unclear whether continuing the B&O tax exemption scheduled to expire July 1, 2015, would contribute to the inferred public policy objective related to jobs. Allowing the deduction to expire and replacing it with the preferential B&O tax rate of 0.138 percent would provide tax parity for several types of food *manufacturing activities.* However, the tax treatment provided for various *selling activities* of food products would remain inconsistent.

Beneficiaries

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

From 2006 to 2012, the number of beneficiaries increased from four to 46 businesses, according to Annual Survey data.

Of the 46 businesses that used the preference in 2012, the top two beneficiaries combined for a total of 66 percent of the total tax preference claimed. Three beneficiaries have dominated use of the preference since 2009. See Exhibit 67, below.

Exhibit 67 – Seafood Processor Preference Use

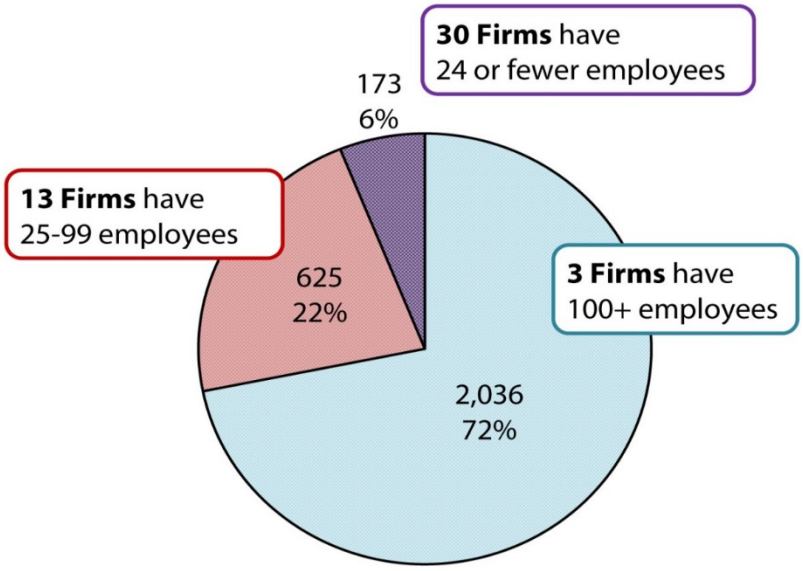
	Percentage of Total Tax Preference Claimed			
Business	**2009**	**2010**	**2011**	**2012**
Orca Bay Seafoods, Inc.	55%	56%	29%	34%
Trident Seafoods Corp	18%	20%	32%	32%
Alyeska Seafoods, Inc.	11%	12%	14%	Did not file Annual Survey
All Remaining Beneficiaries	16% (16 firms)	12% (25 firms)	25% (36 firms)	34% (43 firms)

Source: Department of Revenue Survey data, 2009 – 2012.

Three businesses with 100 or more employees in 2012 employed 72 percent of the total employees reported. See Exhibit 68, below.

Exhibit 68 – 72% of 2012 Beneficiary Employees Work for Businesses with 100 or More Employees

(Percent of Employees Reported by Beneficiary Size)



Source: Department of Revenue 2012 Annual Survey data.

Revenue and Economic Impacts

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

Beneficiaries are estimated to have saved $2.2 million in Fiscal Year 2013 due to the preference. The estimated 2013-15 Biennial savings (prior to the exemption's expiration on July 1, 2015) is $4.4 million. Without the exemption, these businesses would likely pay B&O tax at a rate of 0.484 percent. See Exhibit 69, on the following page.

Exhibit 69 – Estimated 2013-15 Beneficiary Savings from B&O Tax Exemption for Seafood Processors and Certain Sellers

Fiscal Year	Taxable Gross Income	Beneficiary Savings
2012	$435,828,000	$2,109,000
2013	$461,106,000	$2,232,000
2014	$451,423,000	$2,185,000
2015	$470,834,000	$2,279,000
2013-15 Biennium	$922,257,000	**$4,464,000**
Exemption scheduled to expire effective July 1, 2015.		

Source: Department of Revenue Annual Report data for Calendar Year 2012 used for 2012 calculation. Growth estimated using Economic and Revenue Forecast Council's actual B&O tax growth for Fiscal Year 2013 and estimated growth for Fiscal Years 2014 – forward (November 2013 forecast).

After the exemption expires, it will be replaced by the preferential 0.138 percent B&O tax rate. Beneficiaries are estimated to save $3.5 million in the 2015-17 Biennium due to the preferential rate. These estimates are calculated using the difference between the general manufacturing/ wholesaling B&O tax rate (0.484 percent) and the preferential rate (0.138 percent). See Exhibit 70, below.

Exhibit 70 – Estimated 2015-17 Beneficiary Savings from Preferential B&O Tax Rate for Seafood Processors and Certain Sellers

Fiscal Year	Taxable Gross Income	B&O Tax Under General Rate (0.484%)	B&O Tax Under Preferential Rate (0.138%)	Beneficiary Savings
2012	Preferential rate does not take effect until July 1, 2015.			
2013				
2014				
2015				
2016	$493,905,000	$2,391,000	$682,000	$1,709,000
2017	$519,094,000	$2,512,000	$716,000	$1,796,000
2015-17 Biennium	$1,012,999,000	$4,903,000	$1,398,000	**$3,505,000**

Source: Department of Revenue Annual Report data for Calendar Year 2012 used as basis for Fiscal Year calculations. Growth estimated using Economic and Revenue Forecast Council's estimated B&O tax growth for Fiscal Years 2016 and 2017 (November 2013 forecast).

If the tax preferences were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preferences and the extent to which the resulting higher taxes would have an effect on employment and the economy?

If the B&O tax exemption (currently scheduled to expire July 1, 2015) and the preferential B&O tax rate scheduled to begin July 1, 2015, were terminated, seafood processors and certain sellers of qualifying products that now pay no B&O tax would pay B&O tax and those scheduled to pay a preferential B&O tax rate will pay a higher rate. The effect of these terminations on employment

and the economy would depend on the extent to which the industry could absorb the increased costs or pass them along to their customers.

Other States

Do other states have similar tax preferences and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

JLARC staff reviewed other West Coast states with the potential to process foods from Pacific Coast fisheries (Alaska, Oregon, and California). Since none of these competitor states impose a B&O or similar tax, JLARC staff looked to other tax preferences provided to seafood product processors and sellers.

- California provides a sales tax exemption for diesel fuel used in food processing activities.
- Oregon provides a property tax exemption for equipment used in seafood processing.

Alaska does not provide a preference, but instead imposes a specific fisheries tax on seafood processors that process Alaskan resources.

Legislative Auditor Recommendations

B&O Tax Exemption for Seafood Processors and Certain Sellers

Prior to the scheduled expiration of the seafood processor B&O exemption in July 2012, JLARC staff reviewed this pair of preferences. The Legislative Auditor's recommendation at that time was to allow the B&O exemption to expire as scheduled in 2012 and the B&O preferential rate to begin. This would have resulted in consistent tax treatment for processing food products.

The Legislature chose a different course of action. In the 2012 session, the Legislature extended the expiration date for the seafood processor exemption (and the dairy and fruit & vegetable exemptions) to July 2015, and delayed the effective date of the preferential rate to begin when the exemption expires. While the legislation did not include a specific statement of intent, floor speeches indicated extension of the expiration date for the exemptions was directly related to jobs.

In light of the Legislature's actions in 2012, the Legislative Auditor is modifying his recommendations in this 2014 review.

Because the Legislature indicated that the extension of the expiration date for this exemption was directly related to jobs but has not yet identified job-related performance metrics, the Legislature should review and clarify this preference to:

- **Identify performance targets and metrics for the number and quality of jobs in the seafood product processing and sales industries; and**
- **Establish criteria for when to transition from the exemption to the preferential rate.**

Legislation Required: Yes.
Fiscal Impact: Depends on Legislation.

Preferential B&O Rate for Seafood Processors and Certain Sellers

The preferential B&O rate for seafood processors and certain sellers has not yet taken effect, so its performance cannot be evaluated. However, we can note that the Legislature has not made a clear statement on the public policy objective of the preferential rate. The Legislature may intend eventual consistent tax treatment for all food processors, but there is not a clear statement of this objective, and the Legislature's action in 2012 delayed this from happening.

Also, while the preferential rate will make the tax rate of several food processing manufacturing activities conform, there will not be tax parity among various sales activities of food products.

Because it has an opportunity to do so before the preference takes effect, the Legislature should review and clarify this preference to clarify whether the Legislature intends there to be parity among all the different fresh food processor manufacturing and sales activities.

Legislation Required:	Yes.
Fiscal Impact:	Depends on Legislation.

ELECTRIC POWER EXPORTED OR RESOLD (PUBLIC UTILITY TAX, B&O TAX)

Report Summary			
What the Preference Does	**Public Policy Objectives**	**Estimated Beneficiary Savings**	**Auditor Recommendation**
Electric Power Exported or Resold (Public Utility Tax, B&O Tax)			
These two preferences provide: **Public utility tax deductions** for four types of electricity sales made by light and power (L&P) businesses: • Direct (to end user) sales delivered out-of-state; • Wholesale sales between L&P businesses delivered in-state; • Wholesale sales to non-L&P businesses delivered in-state; and • Wholesale sales delivered out-of-state. **B&O tax exemptions** for non-L&P businesses for wholesale electricity sales delivered in-state and out-of-state.	The Legislature did not state the public policy objectives for the public utility tax (PUT) deductions to L&P businesses for four types of electricity sales or the B&O tax exemptions for non-L&P businesses for two types of electricity sales. JLARC staff infer the public policy objectives were **PUT deductions:** • Direct sales delivered out-of-state – to ensure the state complied with federal limitations on taxing goods in interstate commerce. • In-state wholesale sales between L&P businesses – to ensure the PUT did not pyramid, while facilitating transfers of electricity between L&P companies to help meet customer demand. • In-state wholesale sales to non-L&P companies – to provide consistent PUT treatment for wholesale sales by L&P companies regardless of the purchaser. • Out-of-state wholesale sales – to provide consistent tax treatment with wholesale sales delivered in-state to comply with federal requirements. **B&O tax exemptions:** • In-state sales – to provide similar tax treatment to wholesale electricity sales by non-L&P businesses as to L&P businesses, and to keep electricity marketers from moving outside the state; and • Out-of-state wholesale sales – to provide consistent tax treatment for wholesale electricity delivered in-state and out-of-state to comply with federal requirements.	**PUT deductions:** $111.9 million in the 2015-17 Biennium **B&O tax exemptions:** Cannot be reliably estimated	**PUT deductions:** **Continue:** Because the preference is achieving the inferred public policy objectives. **B&O tax exemptions:** **Review and clarify:** Because: 1) the Legislature may want to consider adding reporting or other accountability requirements to provide better information on use of the preference; 2) it is unclear whether the preference is still needed to keep electricity marketers from moving out-of-state due to 2010 changes in how service businesses calculate their taxable income; and 3) it is unclear whether the Legislature intended the preference to apply to commission or fee income from electricity brokering.

ELECTRIC POWER EXPORTED OR RESOLD (PUBLIC UTILITY TAX, B&O TAX)

Current Law

This review covers two tax preferences for businesses making sales of electricity. The first preference provides a deduction from public utility tax (PUT) for four types of electricity sales made by light and power (L&P) businesses:

- Direct (to end user) sales of electricity delivered out-of-state;
- Wholesale sales of electricity between L&P businesses delivered in-state;
- Wholesale sales of electricity to non-L&P businesses delivered in-state; and
- Wholesale sales of electricity delivered out-of-state.

The second preference provides an exemption from business and occupation (B&O) tax for non-light and power (non-L&P) businesses for two kinds of electricity sales:

- Wholesale sales of electricity delivered in-state; and
- Wholesale sales of electricity delivered out-of-state.

Wholesale sales are also referred to as "sales for resale." These sales refer to intermediary transactions between any two businesses but do not include sales to the end user.

What businesses are involved?

L&P businesses generally operate a plant or system to generate, produce, or distribute electrical energy for hire or sale and/or that transmit or distribute electricity for others. L&P businesses include municipally owned utilities, investor-owned (private, for-profit) utilities, mutual or cooperative utilities, and public utility districts.

Non-L&P businesses include electricity marketers that buy and sell electricity or the future right to deliver electricity. They also include electricity brokers that receive a commission for arranging sales between third party buyers and sellers; however, it is unclear whether this preference applies to these businesses.

What taxes are involved?

Public utility tax applies to the gross income of businesses or entities that provide certain public services or utilities, including electrical energy. Sales of electricity in Washington are subject to state PUT only when sold and delivered to the end consumer in Washington.

B&O tax applies to the gross income of other, non-light and power businesses or entities making sales of electricity, performing activities, or providing services in Washington. Businesses must have established nexus (either physically or economically) in Washington to be subject to B&O tax.

Exhibit 71 below summarizes how the preferences apply to various types of electricity sales by L&P and non-L&P entities. See Appendix 3 for the current statutes:

- RCW 82.16.050(11) (Note: Legislation in the 2014 Session modified this section. See SB 6505, *sec. 25);* and
- RCW 82.04.310(2) (Note: Legislation in the 2014 Session modified this section. See ESSB 6440, sec. 302).

Exhibit 71 – How the PUT and B&O Preferences Apply to Sales of Electricity

Type of Sale	Applicable Tax	Not Taxed Due to:
Light & Power Business Electricity Sales		
Direct sales delivered out-of-state	PUT	Deduction
In-state wholesale sales to other L&P businesses	PUT	Deduction
In-state wholesale sales to non-L&P businesses	PUT	Deduction
Wholesale sales delivered out-of- state	PUT	Deduction
Non-Light & Power Business Electricity Sales		
In-state wholesale sales	B&O Tax	Exemption
Wholesale sales delivered out-of-state	B&O Tax	Exemption

Source: JLARC staff summary of current law.

Legal History

1935 The Legislature enacted the PUT and the B&O tax. The Tax Commission interpreted a clause exempting activities that the state cannot tax under the federal Constitution or laws to exempt from taxation electricity sold and delivered outside the state. No exemption was provided for sales of electricity for resale. However, the Legislature did provide a PUT deduction for wholesale sales of other non-electric public services within the state.

1937 The Legislature extended a PUT deduction created in 1935 for wholesale sales within the state by other public service entities to also apply to electricity sales and trades between L&P businesses.

1965 The Legislature **changed how it taxed sales of electricity delivered outside the state**, switching from the PUT to the B&O tax. This change was facilitated by taxing sales of electricity for consumption or resale out-of-state at *the point of production*, in the same manner that manufacturing activities were taxed under the B&O tax, rather than at the point of sale. The Legislature redefined "manufacturing activity" to include "generation or production of electrical energy for resale or consumption outside the state," making it taxable under B&O tax. Wholesale electricity sales between L&P businesses in-state remained deductible from PUT.

1982 In a second extraordinary session, the Legislature again changed how it taxed electricity sales for subsequent delivery out-of-state, taxing them **under the PUT rather than the B&O tax** effective August 1, 1982.

The Legislature was aware that recent federal legislation prohibited states from imposing or assessing a tax on electricity generation or transmission that discriminated against out-of-state producers, sellers, or consumers of the electricity. According to the federal law, a tax was discriminatory if it resulted in a greater tax burden on electricity generated and transmitted in *interstate* commerce than on electricity generated and transmitted *in-state*.

The Legislature did not explicitly state its intent in the 1982 legislation. In response to questions on the legislative intent, the Speaker of the House and the Senate majority leader sent a letter to the Governor dated 12 days after the second extraordinary session adjourned, stating the legislation was

> . . . intended to apply the same tax rate to electricity which is exported as is currently applied to electricity consumed within Washington. . . the legislature (recognized) the need to identify the 'last distribution" of power within the state as the legally taxable event and not the delivery of the electricity across state boundaries. To that end, the increased tax rate would only apply to the last transfer of power into a delivery system or grid in Washington for export delivery.
>
> The effect is that the tax is imposed on all electricity generated in Washington only at the time of its final distribution within this State and therefore would not apply to exchanges, wholesale sales, and sales for later resale within the state.

Legislation passed in 1989 retroactively stated the Legislature's intent in 1982 was to extend state public utility taxation to electricity generated in-state for eventual distribution outside the state.

1983 In June, the Department of Revenue (DOR) issued an assessment against a Washington L&P company for PUT owed on out-of-state electricity sales for periods beginning August 1, 1982. The utility paid the assessment and subsequently filed an appeal.

1986 Ruling on the 1983 appeal, the Thurston County Superior Court held the 1982 law was "unconstitutionally vague."[6] The court invalidated the 1982 legislation, which had the effect of reinstating the prior tax structure enacted in 1965. Under that tax structure, L&P businesses paid manufacturing B&O tax at the point of production, and sales for resale and interstate sales were deducted. The Court did not address whether the statute interfered with interstate commerce.

DOR subsequently appealed the decision. Another impact of reinstating the 1965 tax structure was that taxpayers that had paid the PUT since 1982 on exported sales were now eligible for a refund of the invalidated PUT. While the appeal was pending, DOR entered into negotiations and settled with most of the major L&P taxpayers. Most utilities agreed to forgo a portion of the refunds they were entitled to and agreed to work with DOR on future proposed legislation.

1989 The Legislature passed a DOR-request bill drafted with input from L&P companies that slightly increased the PUT rate on in-state electricity consumption, while exempting electricity generation, distribution, and sales for delivery outside the state from both PUT

[6] *Washington Water Power v. State of Washington (*memorandum opinion No. 83-2-00977-1)

and B&O tax. The stated purpose of the legislation was: 1) to recognize the effect of the 1986 Superior Court decision and correct the relevant statues as if the 1982 legislation had never been enacted; and 2) to provide a constitutional means of replacing the revenue lost due to the 1986 decision. Although the bill was touted as being revenue neutral (replacing revenue lost when the 1982 law was struck down), it resulted in shifting the tax burden to tax in-state consumption at a higher rate, since electricity delivered out-of-state was no longer taxed.

1990s Federal deregulation of the electricity industry resulted in emergence of an active wholesale electricity market that bought, sold, or traded rights to electricity, future rights to electricity, or the electricity itself. This market started in Washington around 1995.

Previously, only L&P companies bought or sold electricity. After deregulation, non-L&P businesses (such as electricity marketers or brokers) could purchase and sell electricity for resale inside and outside of Washington. The same electricity could change hands several times before being consumed in-state or sold out-of-state. Non-L&P businesses were taxable under the B&O tax, not the PUT.

1999 In December, DOR issued a study at the request of the Legislature on taxation of the electricity industry. The report provided information on current state and local taxation of the industry, and offered taxation options to avoid revenue loss, promote competitive neutrality, and encourage economic development within the industry.

DOR's report noted the Attorney General's office had interpreted that the statute providing a PUT deduction for wholesale sales of electricity between L&P companies **did not apply** to wholesale electricity transactions between L&P and non-L&P entities or sales by non-L&P entities. This meant that, if an L&P business sold electricity for resale to a non-L&P business (like an energy marketer), the L&P business owed PUT; if the energy marketer then sold the electricity to a L&P utility, the energy marketer owed B&O tax. The study noted that non-L&P electricity marketers and brokers had not existed prior to deregulation and were not contemplated at the time the deduction was initially enacted.

2000 The Legislature expanded the **deduction for PUT sales for resale** to include all wholesale sales by L&P companies within and outside the state, including sales to non-L&P companies. In the same bill, the Legislature established **a new B&O tax exemption for income received for wholesale electricity sales by any entity**. In combination, this meant that L&P businesses did not owe PUT on wholesale electricity sales to non-L&P marketers, and non-L&P businesses did not owe B&O tax when they made wholesale electricity sales.

2010 Effective June 1, the Legislature revised the rules businesses use to apportion their taxes when they have business activity in multiple states. These rules address economic nexus and apportionment standards.

Previously, an electricity marketer or broker doing business with customers in multiple states determined its taxable Washington income based on where the marketer or broker performed the service, that is, at the broker's desk in Washington. Thus, for Washington-based businesses, a large part of their gross income was subject to B&O tax, even if their customers were located out-of-state.

After this change, electricity marketer and broker taxable income would be determined by the location of their customer. This would reduce the portion of income subject to B&O tax for Washington non-L&P businesses that make electricity sales for resale outside the state. Conversely, the change would increase or establish a B&O tax obligation for non-L&P businesses located outside the state making electricity sales for resale or providing services into Washington.

Exhibit 72, below, displays the historic taxability of electricity sales since 1935.

Exhibit 72 – Historical Taxation of Sales of Electrical Energy

Year	Sales for consumption In-state	Sales for consumption or resale out-of-state	Sales for resale in-state		
			Between L&P	L&P seller to other	Non-L&P seller
1935	PUT	Assumed constitutionally nontaxable	PUT	N/A	N/A
1937 SB 256			Deducted from PUT	PUT	Electricity only sold by L&P businesses per federal regulation until early 1990s. Non-L&P wholesale marketers and brokers appeared in WA around 1995 In 1999, DOR determined such sales were subject to service B&O tax
1965 SB 608		Manufacturing B&O tax *(taxed at point of production)*			
1982 SB 5014		PUT *(value or amounts accruing from last taxable distribution in state)*	PUT *(value or amounts from last taxable distribution in-state)*		
1986 Thurston Co Sup Crt		Manufacturing B&O tax *(back to 1965 after 1982 court ruling)*	Deducted from PUT *(back to 1937 law)*		
1989 HB 1305		Deducted from PUT & B&O tax			
2000 EHB 2755				Deducted from PUT	Exempt from B&O tax

Source: JLARC staff analysis of statutory law, court decisions, and supporting documentation.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preferences? Is there any documentation on the purpose or intent of the tax preferences?

PUT Deductions

The Legislature did not state the public policy objectives for the preference that provides PUT deductions to light and power businesses for four types of electricity sales:

1. Direct sales of electricity delivered out-of-state;
2. Wholesale sales of electricity between L&P companies delivered in-state;
3. Wholesale sales of electricity to non-L&P businesses delivered in-state; and
4. Wholesale sales of electricity delivered out-of-state.

1. JLARC staff infer the public policy objective for the PUT deduction for direct sales of electricity delivered outside the state was **to ensure the state was in compliance with federal limitations on taxing goods in interstate commerce**.

   The Legislature appears to have enacted this preference to ensure Washington law clearly complied with federal limitations in the 1930s on taxing sales delivered outside the state.

2. JLARC staff infer the public policy objective for the PUT deduction for in-state wholesale sales of electricity between L&P companies was **to ensure the PUT tax did not pyramid, while facilitating transfers of electricity between L&P companies to help meet customer demand**.

   When the Legislature originally enacted a PUT deduction for electricity sales between L&P businesses in 1937, electricity was heavily regulated and only L&P businesses bought, sold, and traded electricity. Although not specifically stated, the theory for this deduction appeared to be facilitating transfers of electricity between L&P companies with surpluses and those without, in order to help to meet the state's power demands. Allowing a deduction for such sales/trades ensured that PUT did not pyramid and was owed only at the final point of consumption. The deduction was enacted in 1937, removed in 1982, and then reestablished in 1986 due to a Thurston County court case that invalidated the 1982 law.

3. JLARC staff infer the public policy objective for the PUT deduction for in-state wholesale sales of electricity to non-L&P companies was **to provide consistent PUT treatment for wholesale sales by L&P companies regardless of who purchased the electricity**.

   After federal deregulation of the electrical industry, many new, non-L&P entities began purchasing electricity or the rights to such power at wholesale from L&P companies. Extending the PUT deduction for in-state wholesale sales between L&P companies to non-L&P purchasers provided the same tax treatment for in-state wholesale sales by L&P companies, regardless of who purchased the power. Industry lobbyists claimed in committee hearings in 2000 that the Legislature did not intend electricity sales to be subject to PUT except at the point of consumption, and that the possibility of wholesale sales to non-L&P businesses was not contemplated when the PUT deduction was initially enacted in 1937 or re-established in 1986.

4. JLARC staff infer the public policy objective for the PUT deduction for out-of-state wholesale sales of electricity was **to provide consistent tax treatment of such sales with the tax treatment for wholesale sales delivered in-state in order to comply with federal requirements.**

   Federal statutes and the Constitution prohibit states from imposing a greater tax burden on transactions involving interstate commerce than in-state transactions. The PUT deduction for wholesale electricity sales by L&P businesses delivered outside the state ensures that these transactions are taxed consistently with wholesale electricity sales by L&P businesses delivered in the state, thus complying with federal law and the Constitution.

B&O Tax Exemptions

The Legislature did not state the public policy objective for the preference that provides B&O tax exemptions to non-light and power businesses for two kinds of electricity sales:

5. Wholesale sales of electricity delivered in-state; and
6. Wholesale sales of electricity delivered out-of-state.

5. JLARC staff infer the public policy objective for the in-state sales B&O tax exemption was two-fold: **to give in-state wholesale sales of electricity by non-L&P businesses similar tax treatment to similar sales by L&P businesses, and to keep electricity marketers from moving outside the state**.

   Federal deregulation of the electricity industry altered how and by whom electricity is sold or traded. Beginning in the mid-1990s, non-L&P businesses could buy, sell, and trade electricity on a wholesale basis in Washington. DOR and utility industry representatives testifying before the Legislature in 2000 described the emergence of new types of entities – electricity marketers – that buy and sell electricity but lack the ability to take physical delivery of the product, meaning they must resell it. In addition, DOR's 1999 report on electricity taxation noted another activity – electricity brokering – had emerged after federal deregulation.

   In 1999, DOR's assistant attorney general determined that in-state wholesale sales of electricity by non-L&P businesses, including the new electricity marketers, were subject to B&O tax. This meant that if a L&P business made an in-state electricity sale to another L&P business, the seller could deduct the PUT tax. However, if a non-L&P business made an in-state sale to that same L&P business, the seller would owe B&O tax.

   Utility industry representatives appearing before legislative committees in 2000 claimed that it was never the Legislature's intention to put a tax on wholesale electricity transactions, regardless of the originating party. They also testified that Washington-based electricity marketing businesses were at a competitive disadvantage due to the B&O tax and might move outside the state to avoid B&O taxation.

6. JLARC staff infer the public policy objective for the B&O tax exemption for wholesale out-of-state electricity sales by non-L&P businesses was to **provide consistent tax treatment for wholesale electricity delivered in-state and out-of-state to comply with federal requirements**.

   Federal statutes and the Constitution prohibit states from imposing a greater tax burden on transactions involving interstate commerce than in-state transactions. The B&O tax exemption for wholesale electricity sales by non-L&P businesses delivered out-of-state ensures that these

transactions are taxed consistently with wholesale electricity sales by non-L&P businesses delivered in-state, thus complying with federal law and the Constitution.

What evidence exists to show that the tax preferences have contributed to the achievement of any of these public policy objectives?

As summarized in Exhibit 73 below, evidence suggests that the preferences are achieving the public policy objectives for five out of the six areas. A lack of reporting prevents a determination on whether electricity marketers have moved out-of-state.

Exhibit 73 – Evidence Suggests the Preferences Are Achieving Five of the Six Areas

Type of Electricity Sale	Inferred Public Policy Objective	Meeting Objective?
PUT Deductions for Light & Power Businesses		
1. Direct sales delivered out-of-state	To ensure the state was in compliance with federal limitations on taxing goods in interstate commerce	☑
2. In-state wholesale sales to other L&P businesses	To ensure the PUT tax did not pyramid while facilitating trades among L&P businesses to help meet customer demand	☑
3. In-state wholesale sales to non-L&P businesses	To provide consistent PUT treatment for wholesales sales from L&P businesses	☑
4. Wholesale sales delivered out-of-state	To provide consistent tax treatment of such sales with in-state wholesale sales to comply with federal law	☑
B&O Exemptions for Non-Light & Power Businesses		
5. In-state wholesale sales	• To give in-state wholesale sales of electricity by non-L&P businesses similar tax treatment to similar sales by L&P business	☑
	• To keep electricity marketers from moving out of state	Cannot determine – No reporting
6. Wholesale sales delivered out-of-state	To provide consistent tax treatment of such sales with in-state wholesale sales to comply with federal law	☑

Source: JLARC staff analysis of evidence.

PUT Deductions

1. PUT deduction for direct sales of electricity delivered out-of-state

The preference is achieving the inferred public policy objective of ensuring the state complies with federal limitations on taxing goods in interstate commerce.

2. PUT deduction for wholesale sales of electricity between L&P companies delivered in-state

The preference is achieving the inferred public policy objective of ensuring PUT does not pyramid. Electricity sales and trades between L&P companies have been deducted from the measure of PUT since 1937, ensuring that the intermediate trades do not pyramid and that PUT is collected only at the point of consumption.

3. PUT deduction for wholesale sales of electricity to non-L&P businesses delivered in-state

The preference is achieving the inferred public policy objective of providing consistent PUT treatment of wholesale sales by L&P businesses, regardless of who purchases the power. This preference allows L&P businesses to deduct *any sales for resale* they make, whether the sales are to other L&Ps or to non-L&P entities, in the same manner as wholesale sales between L&P companies have been treated since 1937.

4. PUT deduction for wholesale sales of electricity delivered out-of-state

The preference is achieving the inferred public policy objective of providing consistent tax treatment of such sales with the treatment of wholesale sales delivered in-state. Wholesale electricity sales by L&P businesses delivered outside the state are deducted from the measure of PUT in the same manner as in-state wholesale electricity sales, ensuring equal treatment for in-state and out-of-state wholesale sales, and complying with federal requirements.

B&O Tax Exemptions

5. B&O tax exemption for wholesale in-state sales of electricity by non-L&P businesses

The preference is achieving the first inferred public policy objective of giving in-state wholesale sales of electricity by non-L&P businesses similar tax treatment to similar sales by L&P businesses. An L&P business making such a sale receives a PUT deduction, while a non-L&P business making a similar sale receives a B&O tax exemption.

The second inferred public policy objective is to keep electricity marketers from moving outside the state. It is unclear whether the preference is meeting this objective because there is no business reporting on the use of this preference.

6. B&O tax exemption for wholesale out-of-state electricity sales by non-L&P businesses

The preference is achieving the inferred public policy objective of providing consistent tax treatment of such sales with the treatment of wholesale sales delivered in-state in order to comply with federal requirements. Wholesale electricity sales by non-L&P businesses delivered outside the state are exempt from the B&O tax in the same manner as in-state wholesale electricity sales, ensuring equal treatment for in-state and out-of-state wholesale sales.

Other Factors for the Legislature's Consideration

Changes in Economic Nexus and Apportionment Rules May Affect Where Electricity Marketers Locate

In 2010, the Legislature changed the rules service businesses like electricity marketers use to determine their taxes when they have business activity in multiple states.

Prior to the change, electricity sales were considered to take place and be taxable according to where the electricity marketer made the arrangement (i.e., at the desk of the marketer's Washington office). The energy marketer would owe Washington B&O tax (absent the preference) even if the marketer's customers were located out-of-state. An energy marketer based in another state was not required to pay Washington B&O tax on sales into Washington if they performed no work in the state. Under the old rules and without the preference, there could be an incentive for an energy marketer to move out-of-state in order to avoid Washington B&O tax.

Under the new rules, the marketer services are considered to be located where the electricity is delivered. This factors into an apportionment formula that generally reduces the portion of income subject to B&O tax for service businesses located in Washington operating in multiple states. The incentive to move outside the state was therefore reduced.

With the change in economic nexus rules and without the exemption, an energy marketer located outside of Washington would owe B&O tax on electricity sales made into Washington, depending on whether the business had "substantial nexus" with Washington. This would mean that B&O tax liability may no longer be an incentive for an energy marketer to move out-of-state.

If the Preference Applies to Electricity Brokers, They Would Be Taxed Differently Than Other Brokers

When the Legislature was considering the preference in 2000, testimony at committee meetings focused exclusively on *wholesale sales* of electricity. However, the 1999 DOR study on electricity taxation, discussions with utility industry representatives, and a review of industry information indicates that *electricity brokering* may be taking place. Different than wholesaling, electricity brokering is where a broker or agent arranges an electricity sale on behalf of two parties in exchange for a commission or fee. Because there is no reporting, it is unclear if electricity brokering is taking place in Washington.

Without the preference, electricity marketer and broker income subject to Washington B&O tax would now be determined by the location of their customer. This would reduce the portion of income subject to B&O tax for Washington brokers making electricity sales for resale outside the state. Conversely, the change would increase or establish a B&O tax obligation for electricity brokers located outside the state making electricity sales for resale into Washington.

Under Washington statutes, brokers are generally not taxed on the dollar value of a sale, but rather on the commission or fee they earn. While DOR indicates the preference would not apply to electricity brokers and that commission income is subject to B&O tax under the service classification, the statutory language does not clearly address taxation of brokered electricity sales.

It is unclear whether the Legislature intended or even anticipated the exemption's application to commissions or fees earned from brokering electricity.

To what extent will continuation of the tax preferences contribute to these public policy objectives?

PUT Deductions

Continuing the PUT deductions would continue to achieve the inferred public policy objectives.

B&O Tax Exemptions

Continuing the preference providing a B&O tax exemption would continue to achieve the first inferred public policy objective of giving in-state wholesale sales of electricity by non-L&P businesses similar tax treatment to similar sales by L&P businesses.

It is unclear if continuing the preference would contribute to the second inferred public policy objective of keeping electricity marketers from moving outside the state because:

- The 2010 changes in how businesses determine their taxable Washington income may have reduced the competitive disadvantage for businesses located in Washington that provide services in multiple states; and
- There is no business reporting on use of this preference, so there is not documentation of whether marketers have moved out-of-state.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

PUT Deductions

Beneficiaries of PUT deductions for interstate sales and wholesale sales of electricity include investor-owned utilities, municipally owned service providers, mutuals, or cooperatives that generally supply power to rural or once-rural areas, and public utility districts. As of 2012, there were 60 electric utilities in the state that are potential beneficiaries of the preference. Beneficiaries may also include ports, water districts, and irrigation districts that do not necessarily produce power, but that sometimes fall under the definition of a L&P business.

The number of L&P businesses that sell and deliver electricity outside the state is unknown because federal report data does not detail this, and the PUT deductions are not consistently reported.

For the wholesale sale deductions, the most recent federal data (from 2012) shows 21 of the 46 Washington electricity producers that filed detailed federal forms reported making wholesale electricity sales. The remaining smaller utilities may have also made wholesale sales, but detailed information on their sales was not available. L&P businesses located outside of Washington may also make wholesale electricity sales in Washington, but sales data is not available.

B&O Tax Exemptions

Because there is no tax reporting requirement or mechanism for beneficiaries to report, there is little data available to determine use of this preference. These businesses are not regulated on a state level. Federal filing information notes 87 businesses that do not own transmission lines that are currently authorized to make wholesale electricity sales in the Northwest region (Washington, Oregon, Idaho, Colorado, and parts of Nevada, Wyoming, Montana, and California). Data is not available, however, to determine which of these businesses conduct business in Washington or with Washington customers.

Revenue and Economic Impacts

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?

PUT Deductions

Because of the lack of consistent reporting, beneficiary savings could not be estimated using DOR data. JLARC staff estimated the beneficiary savings based on federal U.S. Energy Information Administration and state Department of Commerce utility data from 2012, the most recent data available. This reporting covers 46 Washington electricity producers.

JLARC staff estimate the beneficiary savings for the PUT deductions for direct sales outside the state, sales for resale between L&P companies and to non-L&P companies, and wholesale sales of electricity delivered outside the state at $56 million in Fiscal Year 2013 and $111.9 million in the 2015-17 Biennium. See Exhibit 74, below.

Exhibit 74 – Estimated 2015-17 Beneficiary Savings for the Public Utility Tax Deduction for Electric Power Exported or Resold

FY	Interstate/ Exported Sales	Beneficiary Savings for PUT- Interstate or Exported Sales	Utility Sales for Resale	Beneficiary Savings for PUT - Sales for Resale	Total Beneficiary Savings for PUT
2012	$78,237,000	$3,030,000	$1,367,078,000	$52,947,000	$55,977,000
2013	$78,237,000	$3,030,000	$1,367,078,000	$52,947,000	$55,977,000
2014	$78,237,000	$3,030,000	$1,367,078,000	$52,947,000	$55,977,000
2015	$78,237,000	$3,030,000	$1,367,078,000	$52,947,000	$55,977,000
2016	$78,237,000	$3,030,000	$1,367,078,000	$52,947,000	$55,977,000
2017	$78,237,000	$3,030,000	$1,367,078,000	$52,947,000	$55,977,000
2015-17 Biennium	**$156,474,000**	**$6,060,000**	**$2,734,156,000**	**$105,894,000**	**$111,954,000**

Source: U.S. Energy Information Administration CY 2012 data on retail and wholesale electricity sales for 46 Washington electricity producers; Department of Commerce information on electricity consumed in Washington. Due to fluctuations in energy demand and prices, JLARC staff did not estimate any growth.

B&O Tax Exemptions

Due to a lack of information regarding use of this preference, the beneficiary savings for the B&O tax exemption for wholesale and brokered sales of electricity by non-L&P businesses in-state and outside the state cannot be reliably estimated. Reasons for this include:

- The preference is a B&O tax exemption with no accountability reporting requirements or mechanisms to collect information on usage;
- While anecdotal information from industry and Federal Energy Regulatory Commission representatives noted such sales are occurring in Washington, JLARC staff could only identify a few such businesses that appear to conduct these transactions. This limited information amounted to about $17 million in beneficiary savings in the 2011-2013 Biennium. However, the limited data was not sufficient for JLARC staff to confidently estimate usage of the preference.

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?

PUT Deductions

For direct and wholesale electricity sales delivered out-of-state, there are federal limitations on states taxing such sales. If this preference were terminated, a different PUT statute that prohibits taxing amounts from business activities that are prohibited by the federal Constitution would remain.

For in-state sales for resale to other L&P businesses, if the deduction were terminated, PUT would apply to each level of sale in the state (pyramid). Although the PUT is a tax on the power distributor/provider, the tax may generally be itemized on billings to utility customers. If the deduction were terminated, PUT would apply to L&P wholesale sales to non-L&P businesses, as well (pyramid).

B&O Tax Exemptions

If the B&O tax exemptions for wholesale sales by non-L&P entities were terminated, income from wholesale electricity sales by such businesses would be subject to B&O tax under the service activities classification. Due to the 2010 changes, businesses located inside and outside of Washington that conducted such transactions would be subject to B&O tax if they have certain levels of activity in the state. B&O tax would apply at each transaction level (pyramid).

Other States

Do other states have similar tax preferences and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

States implement a wide variety of systems to tax utilities. JLARC staff looked for tax preferences in other states imposing a gross receipts tax similar to the public utility tax, or with a particular tax treatment for electricity sales. Listed below are examples of what we found:

Preferences in States that Tax Based on Gross Receipts

- Alabama excludes both wholesale sales of electricity and services the state is prohibited from taxing under the federal constitution or laws or under Alabama's constitution.
- Louisiana taxes only transactions from "Louisiana intrastate business." Electric cooperatives receive a limited deduction for the cost paid for wholesale power. This deduction applies only to power on which fees have been or will be paid, ensuring all power used within the state is taxed at least once.
- Texas exempts electricity purchased for resale. Interstate sales are not explicitly exempt, but this could be because the Texas electrical grid is not connected to other states.

Preferences in States that Tax Based on Units of Electricity Produced, Consumed, or Transmitted

- Illinois imposes an electricity excise tax based on kilowatt-hours delivered to the purchaser, rather than gross receipts. It provides an exemption for sales for resale or interstate commerce.
- Montana, in addition to its property tax, imposes a wholesale energy transaction tax on each kilowatt-hour transmitted. For electricity produced in-state for delivery elsewhere, the tax is paid by the producer. For electricity produced for delivery in Montana, the tax is paid by the distribution services provider. Electricity transmitted through Montana but not produced or delivered in-state is exempt. In this way, Montana avoids pyramiding and taxes each transmission of electricity.

Legislative Auditor Recommendations

Public Utility Tax Deductions

The Legislature should continue the PUT deductions for light and power businesses because the preference is achieving the following inferred public policy objectives:

1) For direct sales of electricity delivered out-of-state, it ensures the state is in compliance with federal limitations on taxing sales delivered outside the state;

2) For wholesale, in-state sales of electricity between light and power businesses, it ensures that the public utility tax does not pyramid;

3) For in-state wholesale sales of electricity to non-light and power companies, it provides consistent public utility tax treatment for wholesale sales by light and power companies regardless of who purchases the electricity; and

4) For out-of-state wholesale sales, it provides consistent tax treatment between wholesale sales of electricity delivered out-of-state and wholesale sales delivered in-state in order to comply with federal requirements.

Legislation Required: No.

Fiscal Impact: None.

B&O Tax Exemptions

The Legislature should review and clarify the B&O tax exemption for sales for resale of electricity by non L&P businesses:

- The Legislature may want to consider adding reporting or other accountability requirements that would provide better information on the use of this preference and the presence of electricity marketers and brokers in the state.
- It is unclear whether the preference is still needed to keep electricity marketers from moving out-of-state due to 2010 changes in how service businesses calculate their taxable income; and
- It is unclear whether the Legislature intended the tax preference to apply to commission or fee income from electricity brokering.

Legislation Required: Yes.

Fiscal Impact: Depends on legislative action.

INTERNATIONAL INVESTMENT MANAGEMENT SERVICES (B&O TAX)

Report Summary			
What the Preference Does	**Public Policy Objectives**	**Estimated Beneficiary Savings**	**Auditor Recommendation**
International Investment Management (B&O Tax)			
Provides a preferential B&O tax rate (0.275 percent) to businesses conducting international investment management services.	The Legislature did not state the public policy objective for this preference. JLARC staff infer the preferential B&O tax rate has two public policy objectives: 1) To reduce a perceived competitive disadvantage for IIMS businesses located in Washington; and 2) To attract new international trade and finance business to the state.	$26.6 million in the 2015-17 Biennium.	**Review and clarify:** To determine if the preference is still necessary, since Washington's 2010 adoption of an economic nexus and apportionment standard has reduced the competitive disadvantage for international investment management businesses located in-state as compared to those located out-of-state. If the Legislature determines it wants to maintain this tax preference, then the Legislature should consider clarifying the law to identify which businesses qualify for the preference and what income is subject to the preferential rate.

INTERNATIONAL INVESTMENT MANAGEMENT SERVICES (B&O TAX)

Current Law

This preference provides a preferential business and occupation (B&O) tax rate of 0.275 percent to businesses conducting international investment management services (IIMS) on income from investment management services. Without this preference, businesses would pay the general service activities B&O tax rate of 1.5 percent.

A business provides IIMS if it meets two requirements:

1. It primarily provides investment management services; and
2. At least 10 percent of its gross income is derived from providing these services to either:
    - Persons or collective investment funds residing outside the United States; or
    - Persons or collective investment funds with at least 10 percent of their investments located outside the United States.

In February 2014, the Department of Revenue (DOR) published an Excise Tax Advisory (ETA) that addresses a number of questions regarding use of the preference. ETAs are interpretive statements issued by DOR under statutory authority that explain the Department's policy regarding how tax law applies to a specific issue or specific set of facts.

DOR determined that a business is "primarily" engaged in providing investment management services when more than 50 percent of its activities are investment management services. If a business's activities are not primarily investment management services, then it cannot qualify for the preferential rate. Statute defines "investment management services" as investment research, investment consulting, portfolio management, fund administration, fund distribution, investment transactions, or related investment services.

The ETA also provides clarification and guidance on determining whether businesses conduct IIMS and whether they qualify to use the preferential B&O tax rate.

In addition to this preference, certain qualifying IIMS businesses are also exempt from sales and use tax on their purchases or use of "standard financial information." This preference is scheduled for review by JLARC staff at a later date.

See Appendix 3 for the current statutes, RCWs 82.04.290(1) and 82.04.293.

Legal History

1993 The Legislature divided the service activities B&O tax classification into three classifications. The applicable tax rates (which included a surtax) were increased from 1.5 percent to:

- 2.5 percent for businesses conducting business services;
- 1.7 percent for businesses conducting financial services (including banking, loan, security, investment management or advisory, or other financial businesses), and

- 2.09 percent for all other activities falling under the service classification.

1995 The Legislature enacted this preference providing a preferential B&O tax rate of 0.287 percent (including a temporary surtax) for **international** investment management services. The fiscal note for the bill noted "only a very limited taxpayer group would benefit from the reduced rate." The preference has not been substantively altered since enacted.

1997 The B&O surtax expired, reducing the tax rate for IIMS to 0.275 percent. Additionally, the Legislature repealed the special service B&O tax classifications established in 1993 and set the tax rate for the remaining general service activities B&O tax classification at 1.5 percent.

2010 Effective June 1, the Legislature revised the rules businesses use to apportion their taxes when they have business activity in multiple states. These rules address economic nexus and apportionment standards.

Previously, a Washington-based IIMS provider doing business in multiple states determined its taxable Washington income based on where the service was performed, that is, at the investment manager's desk in Washington. Thus, for Washington-based IIMS providers, a large part of their gross income was subject to B&O tax, even if their customers were located out-of-state.

After this change, an IIMS provider's Washington taxable income was determined by its customers' locations. This would reduce the portion of income subject to B&O tax for Washington-based IIMS businesses providing services to customers located out-of-state. Conversely, the change would increase or establish a B&O tax obligation for IIMS businesses located outside the state providing services to Washington clients if the out-of-state firms met minimum nexus requirements. So the change generally *reduced* the amount of tax an IIMS provider based in Washington would pay and *increased* the amount of tax an IIMS based outside of Washington would owe.

2014 DOR published an Excise Tax Advisory clarifying which businesses qualify for the IIMS preferential rate.

Public Policy Objective

What is the public policy objective that provides a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference?

The Legislature did not state the public policy objective for this tax preference.

JLARC staff infer from testimony at 1995 committee hearings that the preferential B&O tax rate has two public policy objectives:

1) To reduce a perceived competitive disadvantage for IIMS businesses located in Washington; and

2) To attract new international trade and finance business to the state.

The prime sponsor of the bill testified in a committee hearing that it was:

> . . . evident that this state is not a really hospitable state to the folks that are engaged in international trade or international finance and we . . . can help resolve that problem and do two things. One is to make sure we retain the people in this state and the business in this state. . . But perhaps even more important, we have the opportunity to attract businesses to this state.

An industry proponent testified that IIMS businesses operate on very narrow margins and that more than 95 percent of their revenues were derived from outside the state. The proponent claimed "the high rate of tax we pay in the state of Washington is a burden our competitors in other states and countries do not bear and one which renders the state of Washington non-competitive."

Those testifying in support of the bill stated that most of their revenue was received from outside the state, and the preference was to create tax parity with out-of-state firms.

Evidence suggests that the Legislature anticipated a limited beneficiary group. Testimony in 1995 by the prime sponsor and industry proponents noted that the Frank Russell Company was the primary business providing IIMS in Washington. Also, the fiscal note stated that only a "very limited" taxpayer group would benefit from the preference.

What evidence exists to show that the tax preference has contributed to the achievement of the public policy objective?

The evidence indicates that:

- After this preference was enacted, the Legislature revised the rules that impact the relative tax treatment of IIMS businesses located in the state versus those located outside the state, raising the question of whether an in-state business currently suffers a competitive disadvantage in relation to out-of-state firms;
- The number of businesses using the preference has grown, but the increase may include firms that do not qualify for the preference and does include businesses located outside the state; and
- Challenges remain in determining which businesses qualify for the preferential rate and what income the preferential rate applies to.

Changes in Economic Nexus and Apportionment Rules Address Competitive Disadvantage in a Different Way

The inferred objective of reducing a perceived competitive disadvantage for IIMS providers located in Washington was initially achieved. Without the preference, Washington-based IIMS businesses would have paid B&O tax on their gross income from services performed in Washington under the financial services classification (through June 1997) at a rate of 1.7 percent and after that rate expired, under the general service activities B&O tax classification, currently at 1.5 percent. By comparison, IIMS businesses located outside the state but with clients in Washington paid no B&O tax if the services were not performed in Washington. So the preference did initially reduce the B&O tax for Washington IIMS firms relative to that for out-of-state businesses.

However, the relative taxation of these in-state and out-of-state IIMS businesses changed in 2010 when the Legislature adopted a new economic nexus and apportionment standard. Washington

IIMS businesses are now taxed on the portion of their gross income attributable to customers located in Washington. Income from clients located outside the state or country is not subject to B&O tax under the new apportionment rules. In addition, businesses based outside of Washington with customers in the state that did not previously pay Washington's B&O tax now must pay Washington B&O tax if they meet minimum economic nexus levels, for instance, making annual sales of more than $250,000 a year in Washington.

As a result of these changes operating in tandem with the tax preference, Washington IIMS businesses pay B&O tax on a smaller percentage of their income, **and** they receive the preferential tax rate on that smaller income amount. Out-of-state IIMS businesses that pay Washington B&O taxes because they have established economic nexus here also receive the preferential rate. Thus, the out-of-state businesses now receive the preferential tax treatment that may have originally been intended as a way to reduce a competitive disadvantage for Washington IIMS businesses.

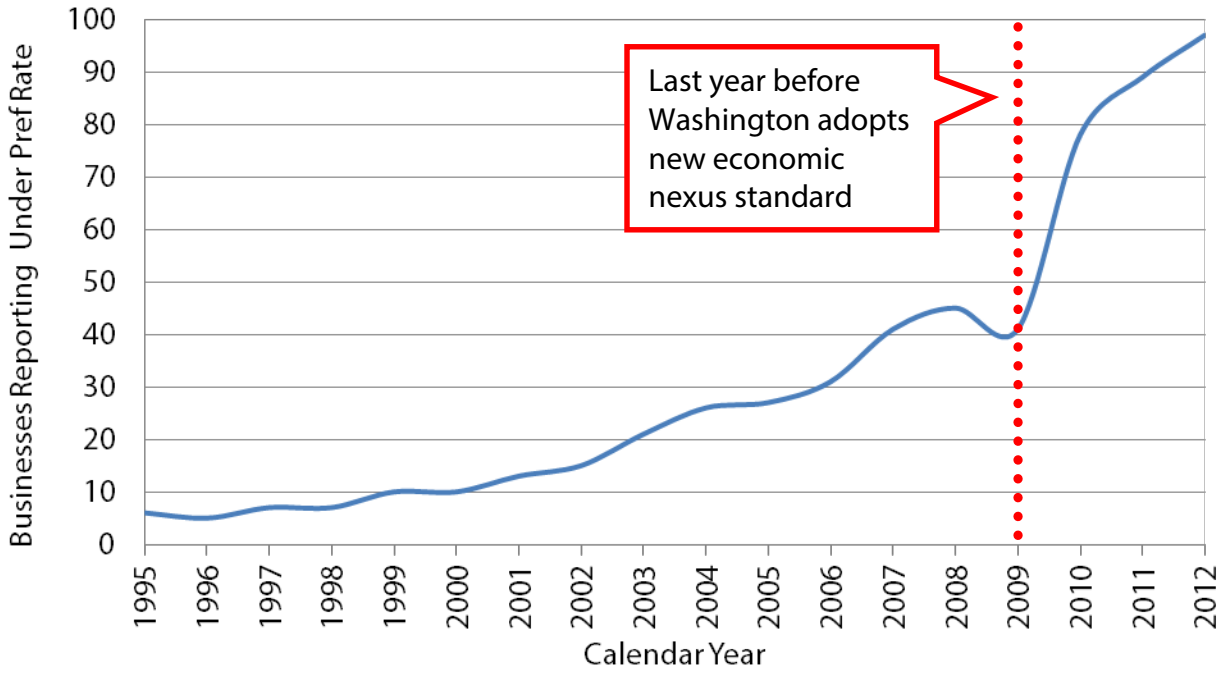
The Growing Number of Firms Claiming the Preference Includes Out-of-State Businesses and May Include Businesses that do not Qualify for the Preference

A second inferred public policy objective for the preference is to attract new international trade and finance businesses to the state. The number of businesses claiming the preference increased from six firms in 1995 to 97 firms in 2012. However, this increase is partially explained by:

- Beginning in June 2010, out-of-state businesses previously not subject to Washington taxation may now be reporting Washington B&O tax due to the economic nexus standard; and
- DOR states that it believes some businesses that do not meet the specific qualifying criteria for international investment management services have erroneously filed under the preferential rate.

With recognition of these two caveats, Exhibit 75, on the following page, shows the growth in the number of businesses using the preferential B&O tax rate from its inception in 1995 through Calendar Year 2012.

Exhibit 75 – Firms Claiming the Preference Increase, but Include Out-of-State Firms and Those That May Not Qualify



Source: Department of Revenue detailed tax data by industry and tax line classification, calendar years 1995-2012.

Implementation and Administration Challenges in Determining Which Businesses Qualify for the Preference and What Income the Preferential Rate Applies to

Which Businesses Qualify?

DOR notes it has experienced many challenges in determining **which businesses** qualify to use the preferential rate and in clarifying the qualifications. Reasons DOR offers for these challenges include: unclear and/or undefined statutory terms and definitions; the complexity of the IIMS industry; and a lack of synchronization with federal government and Securities and Exchange Commission definitions and classifications.

Beginning in 2011, DOR began working with stakeholders to draft an Excise Tax Advisory (ETA) to provide clarification and guidance on which businesses qualify for the preferential rate. DOR published the ETA on February 28, 2014.

What Income Does the Preferential Rate Apply to?

Statute does not clearly state **what income** the preferential tax rate applies to. At least three different interpretations are possible. The statute could be interpreted to mean that the preferential rate applies to income from:

- Only international investment management services; or
- All investment management services; or
- All sales and services, including non-investment management service income.

This topic was not covered in the DOR's recently issued ETA. The Department states its current policy is that the preferential rate applies to a business' investment management service income (the second bullet, above).

To what extent will continuation of the tax preference contribute to these public policy objectives?

Continuation of the preference will provide IIMS businesses based in Washington with a reduced B&O tax rate. Out-of-state businesses that meet minimum economic nexus standards will also continue to receive this reduced rate.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

Beneficiaries are certain businesses that conduct international investment management services. Some 116 businesses reported income under the preferential B&O tax rate in Fiscal Year 2013 and 93 firms reported income under the rate in Fiscal Year 2012. However, these numbers may include businesses that do not qualify for the preference. DOR states that it believes some businesses that do not meet the specific qualifying criteria for international investment management services have erroneously filed under the preferential rate.

Beneficiaries also include investment management businesses located outside of Washington that meet minimum nexus standards and have clients in Washington.

To what extent is the tax preference providing unintended benefits to entities other than those the Legislature intended?

Because Washington adopted new economic nexus and apportionment standards, out-of-state IIMS businesses now pay B&O tax at the preferential rate. Out-of-state businesses were likely not the focus of the preference when it was first established before the new nexus standard.

In addition, with Washington's adoption of a new apportionment standard, Washington-based businesses can gain parity with out-of-state firms without a reduced B&O rate.

Revenue and Economic Impacts

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?

There is no specific accountability reporting required for businesses using this preferential rate. JLARC staff were able to estimate the beneficiary savings using DOR tax return data.

JLARC staff estimate the beneficiary savings for this preference at $14.9 million in Fiscal Year 2013 and $24.6 million in the 2015-17 Biennium. The estimate for the 2015-17 Biennium may change depending on the outcomes of the recently issued ETA, disputed audits and refund requests, and other administrative and application challenges. See Exhibit 76, on the following page.

Exhibit 76 – Estimated Beneficiary Savings for International Investment Management Services Preferential B&O Tax Rate

Fiscal Year	Taxable Income	Tax Due Under:		Beneficiary Savings
		Service B&O Tax Rate	Preferential Rate	
2012	$913,003,000	$16,434,000	$2,511,000	$13,923,000
2013	$977,674,000	$17,598,000	$2,689,000	$14,909,000
2014	$1,008,742,000	$15,131,000*	$2,774,000	$12,357,000*
2015	$1,042,075,000	$15,631,000	$2,866,000	$12,765,000
2016	$1,072,653,000	$16,090,000	$2,950,000	$13,140,000
2017	$1,103,406,000	$16,551,000	$3,034,000	$13,517,000
2015-17 Biennium		**$32,641,000**	**$5,984,000**	**$26,657,000**

* B&O tax rate reduced from 1.8 percent to 1.5 percent effective July 1, 2013.

Source: Taxable income reported on Department of Revenue returns under NAICS codes 523* under line 28 for FY12 and FY13. Future growth estimated using Economic Revenue and Forecast Council estimated B&O tax growth rate, Nov. 2013 forecast.

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?

If this preference were terminated, the tax rate applied to Washington taxable income for qualifying IIMS providers would increase from 0.275 percent to the general service activities rate, currently 1.5 percent. This would be true for both in-state and out-of-state IIMS providers. Businesses would choose how much of the cost to either pass onto their customers or absorb.

Other States

Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

JLARC staff looked at the tax treatment for investment management companies in other states that were specifically mentioned by proponents in 1995 as having or considering legislation favoring the industry: Delaware, Kentucky, Massachusetts, New Jersey, Rhode Island, Texas, and Utah. The treatment in other states is not necessarily limited to international investment management. None of these states has a comparable preference to the lower B&O tax rate, but most offer preferential apportionment methods for financial service-type businesses, similar to Washington.

- Delaware uses a preferential apportionment method for asset management corporations.
- Kentucky and Texas use preferential apportionment methods for sales of management, distribution, or administration services to or on behalf of regulated investment companies.

- Massachusetts uses a preferential apportionment formula for mutual fund service corporations that meet job targets.
- New Jersey sets a certain income allocation percentage for investment companies.
- Rhode Island exempts from income tax amounts derived from the sale of IIMS to persons or investment funds located outside the United States. Qualifying businesses must employ an average of at least 500 full time employees in Rhode Island, and income may only be excluded from sales to persons who are not U.S. citizens or investment funds whose sole beneficiaries are not U.S. citizens.

We identified one other state with a special apportionment formula for income tax.

- New York allows investment companies to apportion income from the sale of management, administration, or distribution services based on the proportion of shares owned by shareholders domiciled in New York, meaning companies with a higher proportion of foreign clients had reduced tax liabilities regardless of where the services were performed.

Legislative Auditor Recommendation

Washington's adoption of an economic nexus and apportionment standard for businesses providing services to customers within and outside the state changed how international investment management service providers determine their Washington taxable income, reducing the perceived competitive disadvantage for in-state businesses providing services to foreign customers and requiring out-of-state businesses to pay B&O tax.

In addition, there are challenges associated with this tax preference as currently written. The Legislature could help address these challenges by providing more clarity in statute on which businesses qualify for the preference and what income the preferential rate applies to.

The Legislature should review and clarify to determine if the preference is still necessary in light of the fact that Washington's 2010 adoption of an economic nexus and apportionment standard has reduced the competitive disadvantage for international investment management businesses located in-state as compared to those located out-of-state.

If the Legislature determines it wants to maintain this tax preference, then the Legislature should consider clarifying the law to identify which businesses qualify for the preference and what income is subject to the preferential rate.

Legislation Required: Yes.

Fiscal Impact: $24.6 million in the 2015-17 Biennium.

SALES SUBJECT TO PUBLIC UTILITY TAX (SALES TAX, SALES AND USE TAX)

Report Summary			
What the Preference Does	**Public Policy Objectives**	**Estimated Beneficiary Savings**	**Auditor Recommendation**
Sales Subject to Public Utility Tax (Sales Tax, Sales and Use Tax)			
Two tax preferences provide: • A sales tax exemption for any income from activities specifically taxed under public utility tax (applies to electricity, water, and natural or manufactured gas); and • A more narrow sales and use tax exemption for sales of steam, electricity, or electrical energy.	The Legislature did not state the public policy objective for this preference. JLARC staff infer: • The public policy objective for the sales tax exemption was to avoid double taxation by ensuring that sales or distribution of items defined as "tangible personal property" that are taxed under public utility tax are not also subject to sales tax. • The public policy objective for the more narrow sales and use tax preference was to ensure Washington tax law conformed with National Streamlined Sales and Use Tax Agreement.	$1.85 billion in the 2015-17 Biennium.	**Continue:** Because the preferences are meeting the inferred public policy objectives of avoiding double taxation and ensuring Washington tax statutes conform with the National Streamlined Sales and Use Tax Agreement.

SALES SUBJECT TO PUBLIC UTILITY TAX (SALES TAX, SALES AND USE TAX)

Current Law

This review covers two tax preferences:

- A sales tax exemption for any income from activities that are specifically taxable under public utility tax, which applies to sales of electricity, water, and natural or manufactured gas; and
- A more narrow sales/use tax exemption for sales of steam, electricity, or electrical energy.

Without these two exemptions, electricity, water, and gas distribution would be subject to both sales tax **and** public utility tax (PUT). Electricity, water, and gas, which are taxable under public utility tax are also defined in Washington statute as "tangible personal property." Sales of tangible personal property are generally defined as retail sales, which are subject to sales tax.

The PUT applies to public or privately owned utilities, public service companies, and transportation businesses, including those providing:

- Utilities (light and power businesses, manufactured or natural gas distribution, water distribution, and sewerage collection); and
- Transportation (railroads, motor and urban transportation, tugboats, and watercraft under 65 feet long).

In 2008, JLARC staff reviewed a similar business and occupation (B&O) tax exemption for income upon which PUT was paid. The B&O tax preference applies to a broader spectrum of public service and utility companies than just electricity, water, and natural gas distribution.

See Appendix 3 for the current statutes, RCWs 82.08.0252; 82.08.950, and 82.12.950.

Legal History

1935 The Legislature passed the Revenue Act of 1935, enacting both a sales tax and a public utility tax. The PUT applied to a broad range of utility and public service activities, including: water distribution; gas distribution; light and power sales; telephone and telegraph services; highway and urban transportation services; and "all public services businesses." At that time, the Legislature enacted the first preference specifically exempting from sales tax income from activities that would normally be subject to sales tax if those activities were subject to PUT instead. This preference has not been substantively changed since enacted.

2003 The Legislature enacted the second preference, a separate sales/use tax exemption for sales of electricity, electrical energy, and steam, as part of ensuring Washington statutes conformed with the National Streamlined Sales and Use Tax Agreement.

Other Relevant Background

Currently there are seven specific state PUT reporting classifications for various utility activities with five different state PUT rates (including permanent surtaxes imposed on some activities). Counties or cities may also impose public utility taxes on such activities. Electricity, gas, and water distribution activities accounted for 88 percent ($350.8 million) of the total PUT collected in Fiscal Year 2013. See Exhibit 77, below.

Exhibit 77 – Electricity, Gas, and Water Distribution Account for 88 Percent of PUT Collections in Fiscal Year 2013

Utility Type	State PUT Rate	Total PUT Collected (in Millions)	% Total PUT Collected
Electricity Distribution	3.873%	$243.4	61%
Gas Distribution	3.852%	$54.7	14%
Water Distribution	5.029%	$52.7	13%
Motor/Rail Transportation	1.926%	$27.9	7%
Sewerage Collection	3.852%	$12.7	3%
Other Public Services (e.g., airplane or water transportation)	1.926%	$4.7	1%
Urban Transportation/Vessels under 65 feet	0.642%	$3.6	1%
Log Hauling on Public Highways*	1.369%*	$1.9	Less than 1%

*Special reporting classification and rate for log hauling on public highways expired 6/30/2013. Effective 7/01/2013, log hauling on public highways income is reported under the motor/rail transportation classification.

Source: Department of Revenue Fiscal Year 2013 Tax Return data and PUT addendum (for applicable rates).

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preferences? Is there any documentation on the purpose or intent of the tax preferences?

The Legislature did not state the public policy objective when it enacted the preference in 1935 or the conforming preference in 2003.

- JLARC staff infer the public policy objective for the sales tax preference was to avoid double taxation by ensuring that sales or distribution of items defined as "tangible personal property," that are specifically taxed under the public utility tax, are not also subject to sales tax.
- JLARC staff infer the public policy objective for the more narrow sales and use tax preference that specifically exempts electricity, steam, and electrical energy was to ensure Washington tax law conformed with National Streamlined Sales and Use Tax Agreement (SSUTA) definitions.

Avoiding Double Taxation

The Legislature made a specific choice to tax certain public service and utility-like activities involving tangible personal property under the PUT rather than under the sales tax and B&O tax when it created Washington's current tax structure. As noted earlier, Washington law generally subjects sales of tangible personal property to sales tax. Thus, this preference prevents sales of electricity, water, and gas from being taxed under both public utility tax and sales tax.

Conforming to National SSUTA Definitions

The more narrow preference for steam, electricity, and electrical energy was enacted in 2003 as part of Washington becoming a member of the National SSUTA. Although a broad sales tax exemption for products specifically taxed under the PUT already was in place, the Department of Revenue notes the more specific preference was necessary for Washington to become a member state in the SSUTA, as it ensured Washington's sales tax laws conformed with the SSUTA.

What evidence exists to show that the tax preferences have contributed to the achievement of any of these public policy objectives?

The preferences are achieving the inferred public policy objectives. They prevent gross income from sales or distribution of electricity, natural or manufactured gas, and water that are taxed under PUT from also being taxed under sales tax. In addition, they ensure Washington law is in compliance with National SSUTA definitions.

To what extent will continuation of the tax preferences contribute to these public policy objectives?

Continuing the preferences will ensure that activities involving tangible personal property that are subject to PUT are not taxed under both PUT and sales tax and that Washington law conforms with National SSUTA definitions.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preferences?

Beneficiaries of these preferences are customers (households, businesses, government, and other organizations) who purchase electricity, natural or manufactured gas, or water from utilities and public service entities. Without these preferences, these customers would owe sales tax on their purchases of these utility services.

Revenue and Economic Impacts

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?

JLARC staff estimate the beneficiary savings for Fiscal Year 2013 at $783.8 million and $1.85 billion in the 2015-17 Biennium. See Exhibit 78, on the following page.

Exhibit 78 – Estimated 2015-17 Beneficiary Savings for Sales Subject to Public Utility Tax

Fiscal Year	Taxable Income	State Sales Tax Exempted	Local Sales Tax Exempted	Beneficiary Savings
2012	$8,759,943,000	$569,296,000	$211,290,000	$780,686,000
2013	$8,752,260,000	$568,897,000	$214,885,000	$783,782,000
2014	$9,076,094,000	$589,946,000	$222,673,000	$812,619,000
2015	$9,548,050,000	$620,623,000	$234,252,000	$854,875,000
2016	$10,044,549,000	$652,896,000	$246,433,000	$899,329,000
2017	$10,576,910,000	$687,499,000	$259,494,000	$946,993,000
2015-17 Biennium Total				$1,846,322,000

Source: Department of Revenue Fiscal Year 2012, 2013 public utility tax reporting for electricity, water, and gas distribution, irrigation water. 2014 and beyond growth projected using September 2013 Economic & Revenue Forecast Council estimated PUT growth for 2014-2017.

The actual PUT paid under the electricity, gas distribution, and water distribution PUT classifications in Fiscal Year 2013 was $350.7 million. See Exhibit 79, below, which breaks out the number of active utilities and service providers reporting PUT tax in Fiscal Year 2013, and the breakdown of PUT paid.

Exhibit 79 – Electricity Distribution Accounts for Majority of Public Utility Tax Paid in Fiscal Year 2013

PUT Category	Number Filing PUT Return	PUT Paid
Electricity	200	$243,352,800
Water Distribution	713	$52,670,553
Gas Distribution	52	$54,710,966

Source: Department of Revenue Public Utility Tax Addendums, Fiscal Year 2013.

If the tax preferences were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preferences and the extent to which the resulting higher taxes would have an effect on employment and the economy?

If the tax preferences were terminated, then customers (households, businesses, government and other organizations) that purchase and receive electricity, natural or manufactured gas, and water from utilities or public service entities would owe sales tax on their utility purchases adding, on average, 8.9 percent to these bills. This would be in addition to the utilities and service providers paying public utility tax, which is generally passed on to customers on their utility bills.

Other States

Do other states have similar tax preferences and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

Of the 45 states (including Washington) and the District of Columbia that impose a sales tax, 42 impose sales tax or a similar tax on electricity, 42 on natural gas, and 32 on water. Most of these states provide at least some sales tax exemptions. The most common exemptions are sales or uses:

- For residential use;
- Delivered by mains, lines, or pipes;
- For use in manufacturing goods; or
- For various agricultural or irrigation uses.

Washington provides no such specific sales tax exemptions; instead, **all** sales of electricity, natural and manufactured gas, and water are exempt from sales tax when public utility tax has been paid. Exhibit 80 below provides analysis of the sales tax treatment of electricity sales in other states.

Exhibit 80 – State Sales Taxation of Electricity Sales Vary Widely

State	Electricity Sales Subject to Sales Tax?	Sales Tax Exemptions for:			
		Residential Use	Used in Manufacturing or Industry	Agricultural or Irrigation Use	Other
Alabama	No				
Alaska	*No Sales Tax in State*				
Arizona	Yes		Partly		
Arkansas	Yes		Reduced rate		
California	Yes				If delivered through lines
Colorado	Yes	Yes	Yes		
Connecticut	Yes		Yes		
Delaware	*No Sales Tax in State*				
District of Columbia	Yes		Yes		
Florida	Yes	Yes	Yes		
Georgia	Yes		Phasing in		
Hawaii	No				
Idaho	Yes				If delivered through lines
Illinois	Yes				
Indiana	Yes		Yes		
Iowa	Yes	Yes	Yes		Restaurants
Kansas	Yes	Yes	Yes	Yes	
Kentucky	Yes	Yes		Yes	
Louisiana	Yes	Yes			
Maine	Yes	Yes		Yes	
Maryland	Yes	Yes			Making snow, Nonprofits
Massachusetts	Yes	Yes	Yes		

Exhibit 80 – State Sales Taxation of Electricity Sales Vary Widely

State	Electricity Sales Subject to Sales Tax?	Sales Tax Exemptions for:			
		Residential Use	Used in Manufacturing or Industry	Agricultural or Irrigation Use	Other
Michigan	Yes	Yes			Industrial laundries
Minnesota	Yes		Yes		Between Nov - April If main heat source
Mississippi	Yes	Yes	Reduced rate	Reduced rate	
Missouri	Yes		Yes	Yes	
Montana	*No Sales Tax in State*				
Nebraska	Yes		Yes	Yes	Hospitals
Nevada	Yes	If delivered through lines			
New Hampshire	*No Sales Tax in State*				
New Jersey	Yes				Limited
New Mexico	Yes				
New York	Yes		Yes	Yes	
North Carolina	Yes	Yes	Yes	Yes	
North Dakota	No				
Ohio	Yes	If delivered through lines	Yes		
Oklahoma	Yes	Yes	Yes		
Oregon	*No Sales Tax in State*				
Pennsylvania	Yes	Yes	Yes	Yes	Nonprofits
Rhode Island	Yes	Yes	Yes		
South Carolina	Yes		Yes	Irrigation	
South Dakota	Yes			Irrigation	
Tennessee	Yes	Reduced rate			
Texas	Yes	Yes	Yes	Yes	
Utah	Yes		Yes		
Vermont	Yes	Yes	Yes	Yes	
Virginia	Yes	If delivered through lines			
Washington	Yes				If PUT paid
West Virginia	No				
Wisconsin	Yes	Between Nov-Apr	Yes	Yes	
Wyoming	Yes				

Source: JLARC staff analysis using 2013 U.S. Master Sales and Use Tax Guide, state web sites and state statutes.

Legislative Auditor Recommendation

The Legislature should continue these preferences because they are meeting the inferred public policy objectives of avoiding double taxation and ensuring Washington tax statutes conform with the National Streamlined Sales and Use Tax Agreement.

Legislation Required: No.

Fiscal Impact: None.

APPENDIX 1 – SCOPE AND OBJECTIVES

2014 TAX PREFERENCE PERFORMANCE REVIEWS

SCOPE AND OBJECTIVES

OCTOBER 2013

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Why a JLARC Study of Tax Preferences?

In 2006 the Legislature established the Citizen Commission for Performance Measurement of Tax Preferences and directed it to develop a schedule for periodic review of the state's tax preferences. The Legislature also directed the staff of the Joint Legislative Audit and Review Committee (JLARC) to conduct the periodic reviews.

Background

Statute details the process used to review preferences (Chapter 43.136, Revised Code of Washington) and defines tax preferences to include: exemptions, exclusions, or deductions from the base of a state tax; credits against a state tax; deferrals of a state tax; or preferential state tax rates. JLARC staff estimate the state has 624 tax preferences.

Recognizing the need to assess the effectiveness of these tax preferences through an orderly process, the Legislature directed the Commission to develop a schedule for the review of all tax preferences so that each preference is reviewed at least once every ten years. The Commission annually revises the resulting ten-year schedule to account for any new or terminated tax preferences.

Omitted from review are several categories of tax preferences identified by statute (e.g., tax preferences required by constitutional law). Any tax preference the Commission determines is critical to the structure of the tax system may also be omitted.

JLARC staff are to review tax preferences according to the schedule developed by the Commission. For each tax preference the Commission selects for a performance review, JLARC staff are to provide a recommendation to either: (1) continue; (2) allow to expire; (3) continue and modify the expiration date; (4) review and clarify; or (5) terminate the preference.

Study Scope

The Citizen Commission selected the following 20 tax preferences for a performance review by JLARC staff in 2014:

	Brief Description and Tax Type	RCW Citation	Year Enacted
Aerospace Industry Preferences			
1.	Aerospace Pre-Production Computer Expenditures (Sales and Use Tax)	82.08.975; 82.12.975	2003
2.	Aerospace Product Development (B&O Tax)	82.04.290(3)	2008
3.	Aircraft Part Prototypes (Sales and Use Tax)	82.08.02566; 82.12.02566	1997
4.	Airplane Pre-Production Expenditures (B&O Tax)	82.04.4461	2003
5.	Certified Aircraft Repair Firms (B&O Tax)	82.04.250(3)	2003
6.	Commercial Airplane Manufacturing – Credit for Taxes Paid (B&O Tax)	82.04.4463	2003
7.	Commercial Airplane Manufacturing – Preferential Rate (B&O Tax)	82.04.260(11)	2003
8.	Commercial Airplane Part Place of Sale (B&O Tax)	82.04.627	2008
9.	Superefficient Airplane Production (Sales and Use Tax)	82.08.980; 82.12.980	2003
10.	Superefficient Airplane Production Facilities (Leasehold Excise Tax)	82.29A.137	2003
11.	Superefficient Airplane Production Facilities (Property Tax)	84.36.655	2003

Brief Description and Tax Type		RCW Citation	Year Enacted
Fruit and Vegetable Processing Preferences			
12.	Dairy Products Manufacturing – Exemption (B&O Tax)	82.04.4268	2006
13.	Dairy Products Manufacturing – Preferential Rate (B&O Tax)	82.04.260(1)(c)	2001
14.	Fruit and Vegetable Manufacturing – Exemption (B&O Tax)	82.04.4266	2005
15.	Fruit and Vegetable Manufacturing – Preferential Rate (B&O Tax)	82.04.260(1)(d)	1965
16.	Seafood Products Manufacturing – Exemption (B&O Tax)	82.04.4269	2006
17.	Seafood Products Manufacturing – Preferential Rate (B&O Tax)	82.04.260(1)(b)	1959
Miscellaneous Preferences			
18.	Electric Power Exported or Resold (Public Utility Tax)	82.16.050(11)	1989
19.	International Investment Management (B&O Tax)	82.04.290(1)	1995
20.	Sales Subject to Public Utility Tax (Sales Tax)	82.08.0252	1935

In addition, using an expedited process, the Commission will consider the following 62 tax preferences. The expedited process is based on information published by the Department of Revenue in its most recent statutorily required tax exemption study.

Brief Description and Tax Type		RCW Citation	Year Enacted
1.	Academic Transcripts (B&O Tax)	82.04.399	1996
2.	Academic Transcripts (Sales and Use Tax)	82.08.02537; 82.12.0347	1996
3.	Air Pollution Control Facilities (Property Tax)	84.36.487	1997
4.	Air Pollution Control Facilities (Sales and Use Tax)	82.08.810; 82.12.810	1997
5.	Aluminum Master Alloy Producers (B&O Tax)	82.04.110(2)(b)	1997
6.	Bad Debts (Fuel Tax)	82.36.044	1998
7.	Baseball Stadiums (Leasehold Excise Tax)	82.29A.130(14)	1995
8.	Biodiesel and Alcohol Fuel Production Facilities (Leasehold Excise Tax)	82.29A.135(1)(a)-(d),(2)	1980
9.	Biodiesel and Alcohol Fuel Production Facilities (Property Tax)	84.36.635	2003
10.	Boats Under 16 Feet (Watercraft Excise Tax)	82.49.020(3)	1983
11.	Child Care (B&O Tax)	82.04.2905	1998
12.	Church Child Care (B&O Tax)	82.04.339	1992
13.	Coal for Thermal Generating Plants (Sales and Use Tax)	82.08.811; 82.12.811	1997
14.	Commuter Airplanes (Sales and Use Tax)	82.08.0262; 82.12.0254	2009
15.	Custom Computer Software (Property Tax)	84.36.600	1991
16.	Discount Program Memberships (B&O Tax)	82.04.421	1997
17.	Emergency Medical Air Transport (Aircraft Fuel Tax)	82.42.030(6)	2003
18.	Film and Video Production Equipment (Sales and Use Tax)	82.08.0315; 82.12.0315	1995
19.	Fish Cleaning (B&O Tax)	82.04.2403	1994
20.	Football Stadium and Exhibition Center Parking (Sales Tax)	82.08.02875	1997
21.	Football Stadiums (Leasehold Excise Tax)	82.29A.130(15)	1997
22.	Football Stadiums (Sales and Use Tax)	36.102.070	1997
23.	Gravitational Wave Observatory (Sales and Use Tax)	82.08.02569; 82.12.02569	1996
24.	Gun Safes (Sales and Use Tax)	82.08.832; 82.12.832	1998
25.	Habitat and Water Quality Improvements (Property Tax)	84.36.255	1997
26.	Historic Property (Property Tax)	84.26.070	1985

27.	Inmate Employment Programs (Leasehold Excise Tax)	82.29A.130(12)	1992
28.	International Services (B&O Tax)	82.04.44525	1998
29.	Low Value Parcels (Property Tax)	84.36.015	1997
30.	Mental Health Services (B&O Tax)	82.04.4277	2011
31.	Microbrewers (Beer Tax)	66.24.290(3)(b)	1993
32.	Multiple Activities Credit (B&O Tax)	82.04.440	1987
33.	Multi-Unit Urban Housing (Property Tax)	84.14.020	1995
34.	Natural Gas Subject to Public Utility Tax (Use Tax)	82.12.022(4)	1989
35.	Natural Gas Surplus Sales (B&O Tax)	82.04.310(3)	2007
36.	Nonprofit Camps and Conference Centers (B&O Tax)	82.04.363	1997
37.	Nonprofit Camps and Conference Centers (Sales Tax)	82.08.830	1997
38.	Nonprofit Developmentally Disabled Housing (Property Tax)	84.36.042	1998
39.	Nonprofit Fundraising (B&O Tax)	82.04.3651	1998
40.	Nonprofit Fundraising (Sales and Use Tax)	82.08.02573; 82.12.NEW	1998
41.	Nonresident Keeping Aircraft In-State (Aircraft Excise Tax)	82.48.100(7)	1999
42.	Prewritten Computer Software (Property Tax)	84.40.037	1991
43.	Products Shipped Out-of-State (Litter Tax)	82.19.050(1)	1992
44.	Public Records Copies (Sales and Use Tax)	82.08.02525; 82.12.02525	1996
45.	Racing Fuel (Fuel Tax)	82.38.080(2)(c)	1998
46.	Second Narrows Bridge (B&O Tax)	82.04.416	1998
47.	Second Narrows Bridge (Leasehold Excise Tax)	82.29A.132	1998
48.	Second Narrows Bridge (Property Tax)	84.36.010(1)	1998
49.	Second Narrows Bridge (Public Utility Tax)	82.16.046	1998
50.	Second Narrows Bridge (Real Estate Excise Tax)	82.45.190	1998
51.	Second Narrows Bridge (Sales and Use Tax)	47.46.060	1998
52.	Sewerage Processing and Disposal (Public Utility Tax)	82.16.050(13)	1987
53.	Trade Shows (B&O Tax)	82.04.4282(6)	1989
54.	Truck Auxiliary Power - Batteries and Infrastructure (Sales and Use Tax)	82.08.815; 82.12.815	2006
55.	Truck Auxiliary Power - Enabling Parked Operation (Sales and Use Tax)	82.08.825; 82.12.825	2006
56.	Tuna, Mackerel, and Jack Fish (Enhanced Food Fish Tax)	82.27.010	1995
57.	Vending Machine Sales (Sales Tax)	82.08.080	1963
58.	Vessel Use by Manufacturers or Dealers (Use Tax)	82.12.800; 82.12.801; 82.12.802	1997
59.	Wax and Ceramic Materials to Create Molds (Sales and Use Tax)	82.08.983; 82.12.983	2010
60.	Wholesale Auto Auctions (B&O Tax)	82.04.317; 82.04.422(1)	1997
61.	Wood Biomass Fuel Production Facilities (Leasehold Excise Tax)	82.29A.135(1)(e),(2)	2003
62.	Wood Biomass Fuel Production Facilities (Property Tax)	84.36.640	2003

Study Objectives

In response to the legislative directive, each performance review may answer questions relevant to the tax preference from the following list of questions.

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:

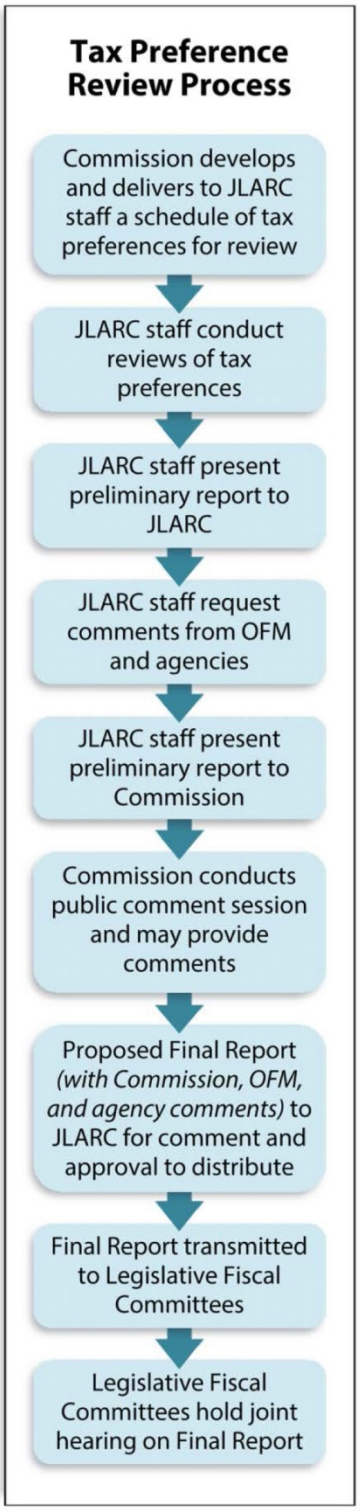
5. Who are the entities whose state tax liabilities are directly affected by the tax preference? (RCW 43.136.055(a))
6. To what extent is the tax preference providing unintended benefits to entities other than those the Legislature intended? (RCW 43.136.055(e))

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 impact of government activities funded by the tax? (This analysis involves conducting an economic impact study using OFM's input-output model.) (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))



Timeframe for the Study

A preliminary audit report is scheduled to be presented at the July 2014 JLARC meeting and at the August 2014 meeting of the Commission. A final report is scheduled to be presented to JLARC in December 2014.

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APPENDIX 2 – AGENCY RESPONSES

Agency responses will be included in the final report.

APPENDIX 3 – CURRENT LAW

Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) 172
Aerospace Product Development – Preferential Rate (B&O Tax) 176
Airplane Pre-Production Expenditures (B&O Tax) 177
Aerospace Pre-Production Computer Expenditures (Sales and Use Tax) 179
Commercial Airplane Manufacturing – Credit for Taxes Paid (B&O Tax) 181
Superefficient Airplane Production Facilities (Leasehold Excise Tax) 184
Superefficient Airplane Production Facilities (Property Tax) 185
Airplane Facilities (Sales and Use) 186
Certified Aircraft Repair Firms (B&O Tax) 188
Commercial Airplane Part Place of Sale (B&O tax) 188
Aircraft Part Prototypes (Sales and Use Tax) 189
Dairy Products Manufacturing – Deduction (B&O Tax) 189
Dairy Products Manufacturing – Preferential Rate (B&O Tax) 190
Fruit and Vegetable Manufacturing – Exemption (B&O Tax) 194
Fruit and Vegetable Manufacturing – Preferential Rate (B&O Tax) 194
Seafood Products Manufacturing – Exemption (B&O Tax) 198
Seafood Products Manufacturing – Preferential Rate (B&O Tax) 199
Electric Power Exported or Resold (Public Utility Tax, B&O Tax) 203
International Investment Management (B&O Tax) 206
Sales Subject to Public Utility Tax (Sales Tax, Sales and Use Tax) 207

Commercial Airplane Manufacturing – Preferential Rate (B&O Tax)

RCW 82.04.260

Tax on manufacturers and processors of various foods and by-products – Research and development organizations – Travel agents – Certain international activities – Stevedoring and associated activities – Low-level waste disposers – Insurance producers, surplus line brokers, and title insurance agents – Hospitals – Commercial airplane activities – Timber product activities – Canned salmon processors. (Contingent expiration date. Effective until July 1, 2015.)

(1) Upon every person engaging within this state in the business of manufacturing:

(a) Wheat into flour, barley into pearl barley, soybeans into soybean oil, canola into canola oil, canola meal, or canola by-products, or sunflower seeds into sunflower oil; as to such persons the amount of tax with respect to such business is equal to the value of the flour, pearl barley, oil, canola meal, or canola by-product manufactured, multiplied by the rate of 0.138 percent;

(b) Beginning July 1, 2015, seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing by that person; or selling manufactured seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing, to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business is equal to the value of the products manufactured or the gross proceeds derived from such sales, multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state;

(c)(i) Beginning July 1, 2015, dairy products; or selling dairy products that the person has manufactured to purchasers who either transport in the ordinary course of business the goods out of state or purchasers who use such dairy products as an ingredient or component in the manufacturing of a dairy product; as to such persons the tax imposed is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state or sold to a manufacturer for use as an ingredient or component in the manufacturing of a dairy product.

(ii) For the purposes of this subsection (1)(c), "dairy products" means:

(A) Products, not including any marijuana-infused product, that as of September 20, 2001, are identified in 21 C.F.R., chapter 1, parts 131, 133, and 135, including by-products from the manufacturing of the dairy products, such as whey and casein; and

(B) Products comprised of not less than seventy percent dairy products that qualify under (c)(ii)(A) of this subsection, measured by weight or volume.

(iii) The preferential tax rate provided to taxpayers under this subsection (1)(c) does not apply to sales of dairy products on or after July 1, 2023, where a dairy product is used by the purchaser as an ingredient or component in the manufacturing in Washington of a dairy product;

(d)(i) Beginning July 1, 2015, fruits or vegetables by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables, or selling at wholesale fruits or vegetables manufactured by the seller by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables and sold to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state.

(ii) For purposes of this subsection (1)(d), "fruits" and "vegetables" do not include marijuana, useable marijuana, or marijuana-infused products;

(e) Until July 1, 2009, alcohol fuel, biodiesel fuel, or biodiesel feedstock, as those terms are defined in RCW 82.29A.135; as to such persons the amount of tax with respect to the business is equal to the value of alcohol fuel, biodiesel fuel, or biodiesel feedstock manufactured, multiplied by the rate of 0.138 percent; and

(f) Wood biomass fuel as defined in RCW 82.29A.135; as to such persons the amount of tax with respect to the business is equal to the value of wood biomass fuel manufactured, multiplied by the rate of 0.138 percent.

(2) Upon every person engaging within this state in the business of splitting or processing dried peas; as to such persons the amount of tax with respect to such business is equal to the value of the peas split or processed, multiplied by the rate of 0.138 percent.

(3) Upon every nonprofit corporation and nonprofit association engaging within this state in research and development, as to such corporations and associations, the amount of tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.484 percent.

(4) Upon every person engaging within this state in the business of slaughtering, breaking and/or processing perishable meat products and/or selling the same at wholesale only and not at retail; as to such persons the tax imposed is equal to the gross proceeds derived from such sales multiplied by the rate of 0.138 percent.

(5) Upon every person engaging within this state in the business of acting as a travel agent or tour operator; as to such persons the amount of the tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.275 percent.

(6) Upon every person engaging within this state in business as an international steamship agent, international customs house broker, international freight forwarder, vessel and/or cargo charter broker in foreign commerce, and/or international air cargo agent; as to such persons the amount of the tax with respect to only international activities is equal to the gross income derived from such activities multiplied by the rate of 0.275 percent.

(7) Upon every person engaging within this state in the business of stevedoring and associated activities pertinent to the movement of goods and commodities in waterborne interstate or foreign commerce; as to such persons the amount of tax with respect to such business is equal to the gross proceeds derived from such activities multiplied by the rate of 0.275 percent. Persons subject to taxation under this subsection are exempt from payment of taxes imposed by chapter 82.16 RCW for that portion of their business subject to taxation under this subsection. Stevedoring and associated activities pertinent to the conduct of goods and commodities in waterborne interstate or foreign commerce are defined as all activities of a labor, service or transportation nature whereby cargo may be loaded or unloaded to or from vessels or barges, passing over, onto or under a wharf, pier, or similar structure; cargo may be moved to a warehouse or similar holding or storage yard or area to await further movement in import or export or may move to a consolidation freight station and be stuffed, unstuffed, containerized, separated or otherwise segregated or aggregated for delivery or loaded on any mode of transportation for delivery to its consignee. Specific activities included in this definition are: Wharfage, handling, loading, unloading, moving of cargo to a convenient place of delivery to the consignee or a convenient place for further movement to export mode; documentation services in connection with the receipt, delivery, checking, care, custody and control of cargo required in the transfer of cargo; imported automobile handling prior to delivery to consignee; terminal stevedoring and incidental vessel services, including but not limited to plugging and unplugging refrigerator service to containers, trailers, and other refrigerated cargo receptacles, and securing ship hatch covers.

(8) Upon every person engaging within this state in the business of disposing of low-level waste, as defined in RCW 43.145.010; as to such persons the amount of the tax with respect to such business is equal to the gross income of the business, excluding any fees imposed under chapter 43.200 RCW, multiplied by the rate of 3.3 percent.

If the gross income of the taxpayer is attributable to activities both within and without this state, the gross income attributable to this state must be determined in accordance with the methods of apportionment required under RCW 82.04.460.

(9) Upon every person engaging within this state as an insurance producer or title insurance agent licensed under chapter 48.17 RCW or a surplus line broker licensed under chapter 48.15 RCW; as to such persons, the amount of the tax with respect to such licensed activities is equal to the gross income of such business multiplied by the rate of 0.484 percent.

(10) Upon every person engaging within this state in business as a hospital, as defined in chapter 70.41 RCW, that is operated as a nonprofit corporation or by the state or any of its political subdivisions, as to such persons, the amount of tax with respect to such activities is equal to the gross income of the business multiplied by the rate of 0.75 percent through June 30, 1995, and 1.5 percent thereafter.

(11)(a) Beginning October 1, 2005, upon every person engaging within this state in the business of manufacturing commercial airplanes, or components of such airplanes, or making sales, at retail or wholesale, of commercial airplanes or components of such airplanes, manufactured by the seller, as to such persons the amount of tax with respect to such business is, in the case of manufacturers, equal to the value of the product manufactured and the gross proceeds of sales of the product manufactured, or in the case of processors for hire, equal to the gross income of the business, multiplied by the rate of:

(i) 0.4235 percent from October 1, 2005, through June 30, 2007; and

(ii) 0.2904 percent beginning July 1, 2007.

(b) Beginning July 1, 2008, upon every person who is not eligible to report under the provisions of (a) of this subsection (11) and is engaging within this state in the business of manufacturing tooling specifically designed for use in manufacturing commercial airplanes or components of such airplanes, or making sales, at retail or wholesale, of such tooling manufactured by the seller, as to such persons the amount of tax with respect to such business is, in the case of manufacturers, equal to the value of the product manufactured and the gross proceeds of sales of the product manufactured, or in the case of processors for hire, be equal to the gross income of the business, multiplied by the rate of 0.2904 percent.

(c) For the purposes of this subsection (11), "commercial airplane" and "component" have the same meanings as provided in RCW 82.32.550.

(d) In addition to all other requirements under this title, a person reporting under the tax rate provided in this subsection (11) must file a complete annual report with the department under RCW 82.32.534.

(e) This subsection (11) does not apply on and after July 1, 2024.

(12)(a) Until July 1, 2024, upon every person engaging within this state in the business of extracting timber or extracting for hire timber; as to such persons the amount of tax with respect to the business is, in the case of extractors, equal to the value of products, including by-products, extracted, or in the case of extractors for hire, equal to the gross income of the business, multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(b) Until July 1, 2024, upon every person engaging within this state in the business of manufacturing or processing for hire: (i) Timber into timber products or wood products; or (ii) timber products into other timber products or wood products; as to such persons the amount of the tax with respect to the business is, in the case of manufacturers, equal to the value of products, including by-products, manufactured, or in the case of processors for hire, equal to the gross income of the business, multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(c) Until July 1, 2024, upon every person engaging within this state in the business of selling at wholesale: (i) Timber extracted by that person; (ii) timber products manufactured by that person from timber or other timber products; or (iii) wood products manufactured by that person from timber or timber products; as to such persons the amount of the tax with respect to the business is equal to the gross proceeds of sales of the timber, timber products, or wood products multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(d) Until July 1, 2024, upon every person engaging within this state in the business of selling standing timber; as to such persons the amount of the tax with respect to the business is equal to the gross income of the business multiplied by the rate of 0.2904 percent. For purposes of this subsection (12)(d), "selling standing timber" means the sale of timber apart from the land, where the buyer is required to sever the timber within thirty months from the date of the original contract, regardless of the method of payment for the timber and whether title to the timber transfers before, upon, or after severance.

(e) For purposes of this subsection, the following definitions apply:

(i) "Biocomposite surface products" means surface material products containing, by weight or volume, more than fifty percent recycled paper and that also use nonpetroleum-based phenolic resin as a bonding agent.

(ii) "Paper and paper products" means products made of interwoven cellulosic fibers held together largely by hydrogen bonding. "Paper and paper products" includes newsprint; office, printing, fine, and pressure-sensitive papers; paper napkins, towels, and toilet tissue; kraft bag, construction, and other kraft industrial papers; paperboard, liquid packaging containers, containerboard, corrugated, and solid-fiber containers including linerboard and corrugated medium; and related types of cellulosic products containing primarily, by weight or volume, cellulosic materials. "Paper and paper products" does not include books, newspapers, magazines, periodicals, and other printed publications, advertising materials, calendars, and similar types of printed materials.

(iii) "Recycled paper" means paper and paper products having fifty percent or more of their fiber content that comes from postconsumer waste. For purposes of this subsection (12)(e)(iii), "postconsumer waste" means a finished material that would normally be disposed of as solid waste, having completed its life cycle as a consumer item.

(iv) "Timber" means forest trees, standing or down, on privately or publicly owned land. "Timber" does not include Christmas trees that are cultivated by agricultural methods or short-rotation hardwoods as defined in RCW 84.33.035.

(v) "Timber products" means:

(A) Logs, wood chips, sawdust, wood waste, and similar products obtained wholly from the processing of timber, short-rotation hardwoods as defined in RCW 84.33.035, or both;

(B) Pulp, including market pulp and pulp derived from recovered paper or paper products; and

(C) Recycled paper, but only when used in the manufacture of biocomposite surface products.

(vi) "Wood products" means paper and paper products; dimensional lumber; engineered wood products such as particleboard, oriented strand board, medium density fiberboard, and plywood; wood doors; wood windows; and biocomposite surface products.

(f) Except for small harvesters as defined in RCW 84.33.035, a person reporting under the tax rate provided in this subsection (12) must file a complete annual survey with the department under RCW 82.32.585.

(13) Upon every person engaging within this state in inspecting, testing, labeling, and storing canned salmon owned by another person, as to such persons, the amount of tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.484 percent.

(14)(a) Upon every person engaging within this state in the business of printing a newspaper, publishing a newspaper, or both, the amount of tax on such business is equal to the gross income of the business multiplied by the rate of 0.365 percent through June 30, 2013, and beginning July 1, 2013, multiplied by the rate of 0.35 percent.

(b) A person reporting under the tax rate provided in this subsection (14) must file a complete annual report with the department under RCW 82.32.534.

[2014 c 140 § 3; 2013 2nd sp.s. c 13 § 202. Prior: 2012 2nd sp.s. c 6 § 602; 2012 2nd sp.s. c 6 § 204; 2011 c 2 § 203 (Initiative Measure No. 1107, approved November 2, 2010); 2010 1st sp.s. c 23 § 506; (2010 1st sp.s. c 23 § 505 expired June 10, 2010); 2010 c 114 § 107; prior: 2009 c 479 § 64; 2009 c 461 § 1; 2009 c 162 § 34; prior: 2008 c 296 § 1; 2008 c 217 § 100; 2008 c 81 § 4; prior: 2007 c 54 § 6; 2007 c 48 § 2; prior: 2006 c 354 § 4; 2006 c 300 § 1; prior: 2005 c 513 § 2; 2005 c 443 § 4; prior: 2003 2nd sp.s. c 1 § 4; 2003 2nd sp.s. c 1 § 3; 2003 c 339 § 11; 2003 c 261 § 11; 2001 2nd sp.s. c 25 § 2; prior: 1998 c 312 § 5; 1998 c 311 § 2; prior: 1998 c 170 § 4; 1996 c 148 § 2; 1996 c 115 § 1; prior: 1995 2nd sp.s. c 12 § 1; 1995 2nd sp.s. c 6 § 1; 1993 sp.s. c 25 § 104; 1993 c 492 § 304; 1991 c 272 § 15; 1990 c 21 § 2; 1987 c 139 § 1; prior: 1985 c 471 § 1; 1985 c 135 § 2; 1983 2nd ex.s. c 3 § 5; prior: 1983 1st ex.s. c 66 § 4; 1983 1st ex.s. c 55 § 4; 1982

2nd ex.s. c 13 § 1; 1982 c 10 § 16; prior: 1981 c 178 § 1; 1981 c 172 § 3; 1979 ex.s. c 196 § 2; 1975 1st ex.s. c 291 § 7; 1971 ex.s. c 281 § 5; 1971 ex.s. c 186 § 3; 1969 ex.s. c 262 § 36; 1967 ex.s. c 149 § 10; 1965 ex.s. c 173 § 6; 1961 c 15 § 82.04.260; prior: 1959 c 211 § 2; 1955 c 389 § 46; prior: 1953 c 91 § 4; 1951 2nd ex.s. c 28 § 4; 1950 ex.s. c 5 § 1, part; 1949 c 228 § 1, part; 1943 c 156 § 1, part; 1941 c 178 § 1, part; 1939 c 225 § 1, part; 1937 c 227 § 1, part; 1935 c 180 § 4, part; Rem. Supp. 1949 § 8370-4, part.]

Aerospace Product Development – Preferential Rate (B&O Tax)

RCW 82.04.290

Tax on international investment management services or other business or service activities. (Contingent expiration date.)

(1) Upon every person engaging within this state in the business of providing international investment management services, as to such persons, the amount of tax with respect to such business shall be equal to the gross income or gross proceeds of sales of the business multiplied by a rate of 0.275 percent.

(2)(a) Upon every person engaging within this state in any business activity other than or in addition to an activity taxed explicitly under another section in this chapter or subsection (1) or (3) of this section; as to such persons the amount of tax on account of such activities shall be equal to the gross income of the business multiplied by the rate of 1.5 percent.

(b) This subsection (2) includes, among others, and without limiting the scope hereof (whether or not title to materials used in the performance of such business passes to another by accession, confusion or other than by outright sale), persons engaged in the business of rendering any type of service which does not constitute a "sale at retail" or a "sale at wholesale." The value of advertising, demonstration, and promotional supplies and materials furnished to an agent by his or her principal or supplier to be used for informational, educational, and promotional purposes shall not be considered a part of the agent's remuneration or commission and shall not be subject to taxation under this section.

(3)(a) Until July 1, 2024, upon every person engaging within this state in the business of performing aerospace product development for others, as to such persons, the amount of tax with respect to such business shall be equal to the gross income of the business multiplied by a rate of 0.9 percent.

(b) A person reporting under the tax rate provided in this subsection (3) must file a complete annual report with the department under RCW 82.32.534.

(c) "Aerospace product development" has the meaning as provided in RCW 82.04.4461.

[2014 c 97 § 403; 2013 c 23 § 314; 2011 c 174 § 101; 2008 c 81 § 6; 2005 c 369 § 8; 2004 c 174 § 2; 2003 c 343 § 2; 2001 1st sp.s. c 9 § 6; (2001 1st sp.s. c 9 § 4 expired July 1, 2001). Prior: 1998 c 343 § 4; 1998 c 331 § 2; 1998 c 312 § 8; 1998 c 308 § 5; 1998 c 308 § 4; 1997 c 7 § 2; 1996 c 1 § 2; 1995 c 229 § 3; 1993 sp.s. c 25 § 203; 1985 c 32 § 3; 1983 2nd ex.s. c 3 § 2; 1983 c 9 § 2; 1983 c 3 § 212; 1971 ex.s. c 281 § 8; 1970 ex.s. c 65 § 4; 1969 ex.s. c 262 § 39; 1967 ex.s. c 149 § 14; 1963 ex.s. c 28 § 2; 1961 c 15 § 82.04.290; prior: 1959 ex.s. c 5 § 5; 1955 c 389 § 49; prior: 1953 c 195 § 2; 1950 ex.s. c 5 § 1, part; 1949 c 228 § 1, part; 1943 c 156 § 1, part; 1941 c 178 § 1, part; 1939 c 225 § 1, part; 1937 c 227 § 1, part; 1935 c 180 § 4, part; Rem. Supp. 1949 § 8370-4, part.]

RCW 82.04.290

Tax on international investment management services or other business or service activities. (Contingent effective date (See RCW 82.32.850(1)).)

(1) Upon every person engaging within this state in the business of providing international investment management services, as to such persons, the amount of tax with respect to such business is equal to the gross income or gross proceeds of sales of the business multiplied by a rate of 0.275 percent.

(2)(a) Upon every person engaging within this state in any business activity other than or in addition to an activity taxed explicitly under another section in this chapter or subsection (1) or (3) of this section; as to such persons the amount of tax on account of such activities is equal to the gross income of the business multiplied by the rate of 1.5 percent.

(b) This subsection (2) includes, among others, and without limiting the scope hereof (whether or not title to materials used in the performance of such business passes to another by accession, confusion or other than by outright sale), persons engaged in the business of rendering any type of service which does not constitute a "sale at retail" or a "sale at wholesale." The value of advertising, demonstration, and promotional supplies and

materials furnished to an agent by his or her principal or supplier to be used for informational, educational, and promotional purposes is not considered a part of the agent's remuneration or commission and is not subject to taxation under this section.

(3)(a) Until July 1, 2040, upon every person engaging within this state in the business of performing aerospace product development for others, as to such persons, the amount of tax with respect to such business is equal to the gross income of the business multiplied by a rate of 0.9 percent.

(b) A person reporting under the tax rate provided in this subsection (3) must file a complete annual report with the department under RCW 82.32.534.

(c) "Aerospace product development" has the meaning as provided in RCW 82.04.4461.

[2014 c 97 § 404; 2013 3rd sp.s. c 2 § 8; 2013 c 23 § 314; 2011 c 174 § 101; 2008 c 81 § 6; 2005 c 369 § 8; 2004 c 174 § 2; 2003 c 343 § 2; 2001 1st sp.s. c 9 § 6; (2001 1st sp.s. c 9 § 4 expired July 1, 2001). Prior: 1998 c 343 § 4; 1998 c 331 § 2; 1998 c 312 § 8; 1998 c 308 § 5; 1998 c 308 § 4; 1997 c 7 § 2; 1996 c 1 § 2; 1995 c 229 § 3; 1993 sp.s. c 25 § 203; 1985 c 32 § 3; 1983 2nd ex.s. c 3 § 2; 1983 c 9 § 2; 1983 c 3 § 212; 1971 ex.s. c 281 § 8; 1970 ex.s. c 65 § 4; 1969 ex.s. c 262 § 39; 1967 ex.s. c 149 § 14; 1963 ex.s. c 28 § 2; 1961 c 15 § 82.04.290; prior: 1959 ex.s. c 5 § 5; 1955 c 389 § 49; prior: 1953 c 195 § 2; 1950 ex.s. c 5 § 1, part; 1949 c 228 § 1, part; 1943 c 156 § 1, part; 1941 c 178 § 1, part; 1939 c 225 § 1, part; 1937 c 227 § 1, part; 1935 c 180 § 4, part; Rem. Supp. 1949 § 8370-4, part.]

Airplane Pre-Production Expenditures (B&O Tax)

RCW 82.04.4461

Credit — Preproduction development expenditures. (Contingent expiration date. Expires July 1, 2024

(1)(a)(i) In computing the tax imposed under this chapter, a credit is allowed for each person for qualified aerospace product development. For a person who is a manufacturer or processor for hire of commercial airplanes or components of such airplanes, credit may be earned for expenditures occurring after December 1, 2003. For all other persons, credit may be earned only for expenditures occurring after June 30, 2008.

(ii) For purposes of this subsection, "commercial airplane" and "component" have the same meanings as provided in RCW 82.32.550.

(b) Before July 1, 2005, any credits earned under this section must be accrued and carried forward and may not be used until July 1, 2005. These carryover credits may be used at any time thereafter, and may be carried over until used. Refunds may not be granted in the place of a credit.

(2) The credit is equal to the amount of qualified aerospace product development expenditures of a person, multiplied by the rate of 1.5 percent.

(3) Except as provided in subsection (1)(b) of this section the credit must be claimed against taxes due for the same calendar year in which the qualified aerospace product development expenditures are incurred. Credit earned on or after July 1, 2005, may not be carried over. The credit for each calendar year may not exceed the amount of tax otherwise due under this chapter for the calendar year. Refunds may not be granted in the place of a credit.

(4) Any person claiming the credit must file a form prescribed by the department that must include the amount of the credit claimed, an estimate of the anticipated aerospace product development expenditures during the calendar year for which the credit is claimed, an estimate of the taxable amount during the calendar year for which the credit is claimed, and such additional information as the department may prescribe.

(5) The definitions in this subsection apply throughout this section.

(a) "Aerospace product" has the meaning given in RCW 82.08.975.

(b) "Aerospace product development" means research, design, and engineering activities performed in relation to the development of an aerospace product or of a product line, model, or model derivative of an aerospace product, including prototype development, testing, and certification. The term includes the

discovery of technological information, the translating of technological information into new or improved products, processes, techniques, formulas, or inventions, and the adaptation of existing products and models into new products or new models, or derivatives of products or models. The term does not include manufacturing activities or other production-oriented activities, however the term does include tool design and engineering design for the manufacturing process. The term does not include surveys and studies, social science and humanities research, market research or testing, quality control, sale promotion and service, computer software developed for internal use, and research in areas such as improved style, taste, and seasonal design.

(c) "Qualified aerospace product development" means aerospace product development performed within this state.

(d) "Qualified aerospace product development expenditures" means operating expenses, including wages, compensation of a proprietor or a partner in a partnership as determined by the department, benefits, supplies, and computer expenses, directly incurred in qualified aerospace product development by a person claiming the credit provided in this section. The term does not include amounts paid to a person or to the state and any of its departments and institutions, other than a public educational or research institution to conduct qualified aerospace product development. The term does not include capital costs and overhead, such as expenses for land, structures, or depreciable property.

(e) "Taxable amount" means the taxable amount subject to the tax imposed in this chapter required to be reported on the person's tax returns during the year in which the credit is claimed, less any taxable amount for which a credit is allowed under RCW 82.04.440.

(6) In addition to all other requirements under this title, a person claiming the credit under this section must file a complete annual report with the department under RCW 82.32.534.

(7) Credit may not be claimed for expenditures for which a credit is claimed under RCW 82.04.4452.

(8) This section expires July 1, 2024.

[2010 c 114 § 115; 2008 c 81 § 7; 2007 c 54 § 11; 2003 2nd sp.s. c 1 § 7.]

RCW 82.04.4461

Credit — Preproduction development expenditures. (Contingent effective date. Expires July 1, 2040.)

(1)(a)(i) In computing the tax imposed under this chapter, a credit is allowed for each person for qualified aerospace product development. For a person who is a manufacturer or processor for hire of commercial airplanes or components of such airplanes, credit may be earned for expenditures occurring after December 1, 2003. For all other persons, credit may be earned only for expenditures occurring after June 30, 2008.

(ii) For purposes of this subsection, "commercial airplane" and "component" have the same meanings as provided in RCW 82.32.550.

(b) Before July 1, 2005, any credits earned under this section must be accrued and carried forward and may not be used until July 1, 2005. These carryover credits may be used at any time thereafter, and may be carried over until used. Refunds may not be granted in the place of a credit.

(2) The credit is equal to the amount of qualified aerospace product development expenditures of a person, multiplied by the rate of 1.5 percent.

(3) Except as provided in subsection (1)(b) of this section the credit must be claimed against taxes due for the same calendar year in which the qualified aerospace product development expenditures are incurred. Credit earned on or after July 1, 2005, may not be carried over. The credit for each calendar year may not exceed the amount of tax otherwise due under this chapter for the calendar year. Refunds may not be granted in the place of a credit.

(4) Any person claiming the credit must file a form prescribed by the department that must include the amount of the credit claimed, an estimate of the anticipated aerospace product development expenditures

during the calendar year for which the credit is claimed, an estimate of the taxable amount during the calendar year for which the credit is claimed, and such additional information as the department may prescribe.

(5) The definitions in this subsection apply throughout this section.

(a) "Aerospace product" has the meaning given in RCW 82.08.975.

(b) "Aerospace product development" means research, design, and engineering activities performed in relation to the development of an aerospace product or of a product line, model, or model derivative of an aerospace product, including prototype development, testing, and certification. The term includes the discovery of technological information, the translating of technological information into new or improved products, processes, techniques, formulas, or inventions, and the adaptation of existing products and models into new products or new models, or derivatives of products or models. The term does not include manufacturing activities or other production-oriented activities, however the term does include tool design and engineering design for the manufacturing process. The term does not include surveys and studies, social science and humanities research, market research or testing, quality control, sale promotion and service, computer software developed for internal use, and research in areas such as improved style, taste, and seasonal design.

(c) "Qualified aerospace product development" means aerospace product development performed within this state.

(d) "Qualified aerospace product development expenditures" means operating expenses, including wages, compensation of a proprietor or a partner in a partnership as determined by the department, benefits, supplies, and computer expenses, directly incurred in qualified aerospace product development by a person claiming the credit provided in this section. The term does not include amounts paid to a person or to the state and any of its departments and institutions, other than a public educational or research institution to conduct qualified aerospace product development. The term does not include capital costs and overhead, such as expenses for land, structures, or depreciable property.

(e) "Taxable amount" means the taxable amount subject to the tax imposed in this chapter required to be reported on the person's tax returns during the year in which the credit is claimed, less any taxable amount for which a credit is allowed under RCW 82.04.440.

(6) In addition to all other requirements under this title, a person claiming the credit under this section must file a complete annual report with the department under RCW 82.32.534.

(7) Credit may not be claimed for expenditures for which a credit is claimed under RCW 82.04.4452.

(8) This section expires July 1, 2040.

[2013 3rd sp.s. c 2 § 9; 2010 c 114 § 115; 2008 c 81 § 7; 2007 c 54 § 11; 2003 2nd sp.s. c 1 § 7.]

Aerospace Pre-Production Computer Expenditures (Sales and Use Tax)

RCW 82.08.975

Exemptions – Computer parts and software related to the manufacture of commercial airplanes. (Contingent expiration date. Expires July 1, 2024.)

(1) The tax levied by RCW 82.08.020 shall not apply to sales of computer hardware, computer peripherals, or software, not otherwise eligible for exemption under RCW 82.08.02565, used primarily in the development, design, and engineering of aerospace products or in providing aerospace services, or to sales of or charges made for labor and services rendered in respect to installing the computer hardware, computer peripherals, or software.

(2) The exemption is available only when the buyer provides the seller with an exemption certificate in a form and manner prescribed by the department. The seller shall retain a copy of the certificate for the seller's files

(3) As used in this section, the following definitions apply:

(a) "Aerospace products" means:

(i) Commercial airplanes and their components;

(ii) Machinery and equipment that is designed and used primarily for the maintenance, repair, overhaul, or refurbishing of commercial airplanes or their components by federal aviation regulation part 145 certificated repair stations; and

(iii) Tooling specifically designed for use in manufacturing commercial airplanes or their components.

(b) "Aerospace services" means the maintenance, repair, overhaul, or refurbishing of commercial airplanes or their components, but only when such services are performed by a FAR part 145 certificated repair station.

(c) "Commercial airplane" and "component" have the same meanings provided in RCW 82.32.550.

(d) "Peripherals" includes keyboards, monitors, mouse devices, and other accessories that operate outside of the computer, excluding cables, conduit, wiring, and other similar property.

(4) This section expires July 1, 2024.

[2008 c 81 Â§ 2; 2003 2nd sp.s. c 1 Â§ 9.]

RCW 82.08.975

Exemptions – Computer parts and software related to the manufacture of commercial airplanes. (Contingent effective date. Expires July 1, 2040.)

(1) The tax levied by RCW 82.08.020 does not apply to sales of computer hardware, computer peripherals, or software, not otherwise eligible for exemption under RCW 82.08.02565, used primarily in the development, design, and engineering of aerospace products or in providing aerospace services, or to sales of or charges made for labor and services rendered in respect to installing the computer hardware, computer peripherals, or software.

(2) The exemption is available only when the buyer provides the seller with an exemption certificate in a form and manner prescribed by the department. The seller must retain a copy of the certificate for the seller's files.

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

(a) "Aerospace products" means:

(i) Commercial airplanes and their components;

(ii) Machinery and equipment that is designed and used primarily for the maintenance, repair, overhaul, or refurbishing of commercial airplanes or their components by federal aviation regulation part 145 certificated repair stations; and

(iii) Tooling specifically designed for use in manufacturing commercial airplanes or their components.

(b) "Aerospace services" means the maintenance, repair, overhaul, or refurbishing of commercial airplanes or their components, but only when such services are performed by a FAR part 145 certificated repair station.

(c) "Commercial airplane" and "component" have the same meanings provided in RCW 82.32.550.

(d) "Peripherals" includes keyboards, monitors, mouse devices, and other accessories that operate outside of the computer, excluding cables, conduit, wiring, and other similar property.

(4) This section expires July 1, 2040.

[2013 3rd sp.s. c 2 Â§ 11; 2008 c 81 Â§ 2; 2003 2nd sp.s. c 1 Â§ 9.]

RCW 82.12.975

Computer parts and software related to the manufacture of commercial airplanes. (Contingent expiration date. Expires July 1, 2024.)

(1) The provisions of this chapter shall not apply in respect to the use of computer hardware, computer peripherals, or software, not otherwise eligible for exemption under RCW 82.12.02565, used primarily in the development, design, and engineering of aerospace products or in providing aerospace services, or to the use of labor and services rendered in respect to installing the computer hardware, computer peripherals, or software.

(2) As used in this section, "peripherals," "aerospace products," and "aerospace services" have the same meanings as provided in RCW 82.08.975.

(3) This section expires July 1, 2024.

[2008 c 81 § 3; 2003 2nd sp.s. c 1 § 10.]

RCW 82.12.975

Computer parts and software related to the manufacture of commercial airplanes. (Contingent effective date. Expires July 1, 2040.)

(1) The provisions of this chapter do not apply in respect to the use of computer hardware, computer peripherals, or software, not otherwise eligible for exemption under RCW 82.12.02565, used primarily in the development, design, and engineering of aerospace products or in providing aerospace services, or to the use of labor and services rendered in respect to installing the computer hardware, computer peripherals, or software.

(2) As used in this section, "peripherals," "aerospace products," and "aerospace services" have the same meanings as provided in RCW 82.08.975.

(3) This section expires July 1, 2040.

[2013 3rd sp.s. c 2 § 12; 2008 c 81 § 3; 2003 2nd sp.s. c 1 § 10.]

Commercial Airplane Manufacturing – Credit for Taxes Paid (B&O Tax)

RCW 82.04.4463

Credit — Property and leasehold taxes paid on property used for manufacture of commercial airplanes. (Contingent expiration date. Expires July 1, 2024.)

(1) In computing the tax imposed under this chapter, a credit is allowed for property taxes and leasehold excise taxes paid during the calendar year.

(2) The credit is equal to:

(a)(i)(A) Property taxes paid on buildings, and land upon which the buildings are located, constructed after December 1, 2003, and used exclusively in manufacturing commercial airplanes or components of such airplanes; and

(B) Leasehold excise taxes paid with respect to buildings constructed after January 1, 2006, the land upon which the buildings are located, or both, if the buildings are used exclusively in manufacturing commercial airplanes or components of such airplanes; and

(C) Property taxes or leasehold excise taxes paid on, or with respect to, buildings constructed after June 30, 2008, the land upon which the buildings are located, or both, and used exclusively for aerospace product development, manufacturing tooling specifically designed for use in manufacturing commercial airplanes or their components, or in providing aerospace services, by persons not within the scope of (a)(i)(A) and (B) of this subsection (2) and are taxable under RCW 82.04.290(3), *82.04.260(10)(b), or 82.04.250(3); or

(ii) Property taxes attributable to an increase in assessed value due to the renovation or expansion, after: (A) December 1, 2003, of a building used exclusively in manufacturing commercial airplanes or components of such airplanes; and (B) June 30, 2008, of buildings used exclusively for aerospace product development, manufacturing tooling specifically designed for use in manufacturing commercial airplanes or their components, or in providing aerospace services, by persons not within the scope of (a)(ii)(A) of this subsection (2) and are taxable under RCW 82.04.290(3), *82.04.260(10)(b), or 82.04.250(3); and

(b) An amount equal to:

(i)(A) Property taxes paid, by persons taxable under *RCW 82.04.260(10)(a), on machinery and equipment exempt under RCW 82.08.02565 or 82.12.02565 and acquired after December 1, 2003;

(B) Property taxes paid, by persons taxable under *RCW 82.04.260(10)(b), on machinery and equipment exempt under RCW 82.08.02565 or 82.12.02565 and acquired after June 30, 2008; or

(C) Property taxes paid, by persons taxable under RCW 82.04.250(3) or 82.04.290(3), on computer hardware, computer peripherals, and software exempt under RCW 82.08.975 or 82.12.975 and acquired after June 30, 2008.

(ii) For purposes of determining the amount eligible for credit under (i)(A) and (B) of this subsection (2)(b), the amount of property taxes paid is multiplied by a fraction.

(A) The numerator of the fraction is the total taxable amount subject to the tax imposed under *RCW 82.04.260(10) (a) or (b) on the applicable business activities of manufacturing commercial airplanes, components of such airplanes, or tooling specifically designed for use in the manufacturing of commercial airplanes or components of such airplanes.

(B) The denominator of the fraction is the total taxable amount subject to the tax imposed under all manufacturing classifications in chapter 82.04 RCW.

(C) For purposes of both the numerator and denominator of the fraction, the total taxable amount refers to the total taxable amount required to be reported on the person's returns for the calendar year before the calendar year in which the credit under this section is earned. The department may provide for an alternative method for calculating the numerator in cases where the tax rate provided in *RCW 82.04.260(10) for manufacturing was not in effect during the full calendar year before the calendar year in which the credit under this section is earned.

(D) No credit is available under (b)(i)(A) or (B) of this subsection (2) if either the numerator or the denominator of the fraction is zero. If the fraction is greater than or equal to nine-tenths, then the fraction is rounded to one.

(E) As used in (b)(ii)(C) of this subsection (2), "returns" means the tax returns for which the tax imposed under this chapter is reported to the department.

(3) The definitions in this subsection apply throughout this section, unless the context clearly indicates otherwise.

(a) "Aerospace product development" has the same meaning as provided in RCW 82.04.4461.

(b) "Aerospace services" has the same meaning given in RCW 82.08.975.

(c) "Commercial airplane" and "component" have the same meanings as provided in RCW 82.32.550.

(4) A credit earned during one calendar year may be carried over to be credited against taxes incurred in a subsequent calendar year, but may not be carried over a second year. No refunds may be granted for credits under this section.

(5) In addition to all other requirements under this title, a person claiming the credit under this section must file a complete annual report with the department under RCW 82.32.534.

(6) This section expires July 1, 2024.

[2010 1st sp.s. c 23 § 515; (2010 1st sp.s. c 23 § 514 expired June 10, 2010); 2010 c 114 § 116; 2008 c 81 § 8; 2006 c 177 § 10; 2005 c 514 § 501; 2003 2nd sp.s. c 1 § 15.]

RCW 82.04.4463

Credit — Property and leasehold taxes paid on property used for manufacture of commercial airplanes. (Contingent effective date. Expires July 1, 2040.)

(1) In computing the tax imposed under this chapter, a credit is allowed for property taxes and leasehold excise taxes paid during the calendar year.

(2) The credit is equal to:

(a)(i)(A) Property taxes paid on buildings, and land upon which the buildings are located, constructed after December 1, 2003, and used exclusively in manufacturing commercial airplanes or components of such airplanes; and

(B) Leasehold excise taxes paid with respect to buildings constructed after January 1, 2006, the land upon which the buildings are located, or both, if the buildings are used exclusively in manufacturing commercial airplanes or components of such airplanes; and

(C) Property taxes or leasehold excise taxes paid on, or with respect to, buildings constructed after June 30, 2008, the land upon which the buildings are located, or both, and used exclusively for aerospace product development, manufacturing tooling specifically designed for use in manufacturing commercial airplanes or their components, or in providing aerospace services, by persons not within the scope of (a)(i)(A) and (B) of this subsection (2) and are taxable under RCW 82.04.290(3),82.04.260 (11)(b), or 82.04.250(3); or

(ii) Property taxes attributable to an increase in assessed value due to the renovation or expansion, after: (A) December 1, 2003, of a building used exclusively in manufacturing commercial airplanes or components of such airplanes; and (B) June 30, 2008, of buildings used exclusively for aerospace product development, manufacturing tooling specifically designed for use in manufacturing commercial airplanes or their components, or in providing aerospace services, by persons not within the scope of (a)(ii)(A) of this subsection (2) and are taxable under RCW 82.04.290(3), 82.04.260(11)(b), or 82.04.250(3); and

(b) An amount equal to:

(i)(A) Property taxes paid, by persons taxable under RCW 82.04.260(11)(a), on machinery and equipment exempt under RCW 82.08.02565 or 82.12.02565 and acquired after December 1, 2003;

(B) Property taxes paid, by persons taxable under RCW 82.04.260(11)(b), on machinery and equipment exempt under RCW 82.08.02565 or 82.12.02565 and acquired after June 30, 2008; or

(C) Property taxes paid, by persons taxable under RCW 82.04.250(3) or 82.04.290(3), on computer hardware, computer peripherals, and software exempt under RCW 82.08.975 or 82.12.975 and acquired after June 30, 2008.

(ii) For purposes of determining the amount eligible for credit under (i)(A) and (B) of this subsection (2)(b), the amount of property taxes paid is multiplied by a fraction.

(A) The numerator of the fraction is the total taxable amount subject to the tax imposed under RCW 82.04.260(11) (a) or (b) on the applicable business activities of manufacturing commercial airplanes, components of such airplanes, or tooling specifically designed for use in the manufacturing of commercial airplanes or components of such airplanes.

(B) The denominator of the fraction is the total taxable amount subject to the tax imposed under all manufacturing classifications in chapter 82.04 RCW.

(C) For purposes of both the numerator and denominator of the fraction, the total taxable amount refers to the total taxable amount required to be reported on the person's returns for the calendar year before the calendar year in which the credit under this section is earned. The department may provide for an alternative method for calculating the numerator in cases where the tax rate provided in RCW 82.04.260(11) for manufacturing was not in effect during the full calendar year before the calendar year in which the credit under this section is earned.

(D) No credit is available under (b)(i)(A) or (B) of this subsection (2) if either the numerator or the denominator of the fraction is zero. If the fraction is greater than or equal to nine-tenths, then the fraction is rounded to one.

(E) As used in (b)(ii)(C) of this subsection (2), "returns" means the tax returns for which the tax imposed under this chapter is reported to the department.

(3) The definitions in this subsection apply throughout this section, unless the context clearly indicates otherwise.

(a) "Aerospace product development" has the same meaning as provided in RCW 82.04.4461.

(b) "Aerospace services" has the same meaning given in RCW 82.08.975.

(c) "Commercial airplane" and "component" have the same meanings as provided in RCW 82.32.550.

(4) A credit earned during one calendar year may be carried over to be credited against taxes incurred in a subsequent calendar year, but may not be carried over a second year. No refunds may be granted for credits under this section.

(5) In addition to all other requirements under this title, a person claiming the credit under this section must file a complete annual report with the department under RCW 82.32.534.

(6) This section expires July 1, 2040.

[2013 3rd sp.s. c 2 § 10; 2010 1st sp.s. c 23 § 515; (2010 1st sp.s. c 23 § 514 expired June 10, 2010); 2010 c 114 § 116; 2008 c 81 § 8; 2006 c 177 § 10; 2005 c 514 § 501; 2003 2nd sp.s. c 1 § 15.]

Superefficient Airplane Production Facilities (Leasehold Excise Tax)

RCW 82.29A.137

Exemptions — Certain leasehold interests related to the manufacture of superefficient airplanes. (Contingent expiration date. Expires July 1, 2024.)

(1) All leasehold interests in port district facilities exempt from tax under RCW 82.08.980 or 82.12.980 and used by a manufacturer engaged in the manufacturing of superefficient airplanes, as defined in RCW 82.32.550, are exempt from tax under this chapter. A person claiming the credit under RCW 82.04.4463 is not eligible for the exemption under this section.

(2) In addition to all other requirements under this title, a person claiming the exemption under this section must file a complete annual report with the department under RCW 82.32.534.

(3) This section expires July 1, 2024.

[2010 c 114 § 134; 2003 2nd sp.s. c 1 § 13.]

RCW 82.29A.137

Exemptions — Certain leasehold interests related to the manufacture of superefficient airplanes. (Contingent effective date. Expires July 1, 2040.)

(1) All leasehold interests in port district facilities exempt from tax under RCW 82.08.980 or 82.12.980 and used by a manufacturer engaged in the manufacturing of superefficient airplanes, as defined in RCW 82.32.550, are exempt from tax under this chapter. A person claiming the credit under RCW 82.04.4463 is not eligible for the exemption under this section.

(2) In addition to all other requirements under this title, a person claiming the exemption under this section must file a complete annual report with the department under RCW 82.32.534.

(3) This section expires July 1, 2040.

[2013 3rd sp.s. c 2 § 13; 2010 c 114 § 134; 2003 2nd sp.s. c 1 § 13.]

Superefficient Airplane Production Facilities (Property Tax)

RCW 84.36.655

Property related to the manufacture of superefficient airplanes. (Contingent expiration date. Expires July 1, 2024.)

(1) Effective January 1, 2005, all buildings, machinery, equipment, and other personal property of a lessee of a port district eligible under RCW 82.08.980 and 82.12.980, used exclusively in manufacturing superefficient airplanes, are exempt from property taxation. A person taking the credit under RCW 82.04.4463 is not eligible for the exemption under this section. For the purposes of this section, "superefficient airplane" and "component" have the meanings given in RCW 82.32.550.

(2) In addition to all other requirements under this title, a person claiming the exemption under this section must file a complete annual report with the department under RCW 82.32.534.

(3) Claims for exemption authorized by this section must be filed with the county assessor on forms prescribed by the department and furnished by the assessor. The assessor must verify and approve claims as the assessor determines to be justified and in accordance with this section. No claims may be filed after December 31, 2023. The department may adopt rules, under the provisions of chapter 34.05 RCW, as necessary to properly administer this section.

(4) This section applies to taxes levied for collection in 2006 and thereafter.

(5) This section expires July 1, 2024.

[2010 c 114 § 151; 2003 2nd sp.s. c 1 § 14.]

RCW 84.36.655

Property related to the manufacture of superefficient airplanes. (Contingent effective date. Expires July 1, 2040.)

(1) Effective January 1, 2005, all buildings, machinery, equipment, and other personal property of a lessee of a port district eligible under RCW 82.08.980 and 82.12.980, used exclusively in manufacturing superefficient airplanes, are exempt from property taxation. A person taking the credit under RCW 82.04.4463 is not eligible for the exemption under this section. For the purposes of this section, "superefficient airplane" and "component" have the meanings given in RCW 82.32.550.

(2) In addition to all other requirements under this title, a person claiming the exemption under this section must file a complete annual report with the department under RCW 82.32.534.

(3) Claims for exemption authorized by this section must be filed with the county assessor on forms prescribed by the department and furnished by the assessor. The assessor must verify and approve claims as the assessor determines to be justified and in accordance with this section. No claims may be filed after December 31, 2039. The department may adopt rules, under the provisions of chapter 34.05 RCW, as necessary to properly administer this section.

(4) This section applies to taxes levied for collection in 2006 and thereafter.

(5) This section expires July 1, 2040.

[2013 3rd sp.s. c 2 § 14; 2010 c 114 § 151; 2003 2nd sp.s. c 1 § 14.]

Airplane Facilities (Sales and Use)

RCW 82.08.980

Exemptions — Labor, services, and personal property related to the manufacture of superefficient airplanes. (Contingent expiration date. Expires July 1, 2024.)

(1) The tax levied by RCW 82.08.020 does not apply to charges made for labor and services rendered in respect to the constructing of new buildings by a manufacturer engaged in the manufacturing of superefficient airplanes or by a port district, to be leased to a manufacturer engaged in the manufacturing of superefficient airplanes, to sales of tangible personal property that will be incorporated as an ingredient or component of such buildings during the course of the constructing, or to labor and services rendered in respect to installing, during the course of constructing, building fixtures not otherwise eligible for the exemption under RCW 82.08.02565(2)(b). The exemption is available only when the buyer provides the seller with an exemption certificate in a form and manner prescribed by the department. The seller must retain a copy of the certificate for the seller's files.

(2) No application is necessary for the tax exemption in this section, however in order to qualify under this section before starting construction the port district must have entered into an agreement with the manufacturer to build such a facility. A person claiming the exemption under this section is subject to all the requirements of chapter 82.32 RCW. In addition, the person must file a complete annual report with the department under RCW 82.32.534.

(3) The exemption in this section applies to buildings, or parts of buildings, that are used exclusively in the manufacturing of superefficient airplanes, including buildings used for the storage of raw materials and finished product.

(4) For the purposes of this section, "superefficient airplane" has the meaning given in RCW 82.32.550.

(5) This section expires July 1, 2024.

[2010 c 114 § 126; 2003 2nd sp.s. c 1 § 11.]

RCW 82.08.980

Exemptions — Labor, services, and personal property related to the manufacture of commercial airplanes. (Contingent effective date. Expires July 1, 2040.)

(1) The tax levied by RCW 82.08.020 does not apply to:

(a) Charges, for labor and services rendered in respect to the constructing of new buildings, made to (i) a manufacturer engaged in the manufacturing of commercial airplanes or the fuselages or wings of commercial airplanes or (ii) a port district, political subdivision, or municipal corporation, to be leased to a manufacturer engaged in the manufacturing of commercial airplanes or the fuselages or wings of commercial airplanes;

(b) Sales of tangible personal property that will be incorporated as an ingredient or component of such buildings during the course of the constructing; or

(c) Charges made for labor and services rendered in respect to installing, during the course of constructing such buildings, building fixtures not otherwise eligible for the exemption under RCW 82.08.02565(2)(b).

(2) The exemption is available only when the buyer provides the seller with an exemption certificate in a form and manner prescribed by the department. The seller must retain a copy of the certificate for the seller's files.

(3) No application is necessary for the tax exemption in this section. However, in order to qualify under this section before starting construction, the port district, political subdivision, or municipal corporation must have entered into an agreement with the manufacturer to build such a facility. A person claiming the

exemption under this section is subject to all the requirements of chapter 82.32 RCW. In addition, the person must file a complete annual report with the department under RCW 82.32.534.

(4) The exemption in this section applies to buildings or parts of buildings, including buildings or parts of buildings used for the storage of raw materials or finished product, that are used primarily in the manufacturing of any one or more of the following products:

(a) Commercial airplanes;

(b) Fuselages of commercial airplanes; or

(c) Wings of commercial airplanes.

(5) For the purposes of this section, "commercial airplane" has the meaning given in RCW 82.32.550.

(6) This section expires July 1, 2040.

[2013 3rd sp.s. c 2 § 3; 2010 c 114 § 126; 2003 2nd sp.s. c 1 § 11.]

RCW 82.12.980

Exemptions — Labor, services, and personal property related to the manufacture of superefficient airplanes. (Contingent expiration date. Expires July 1, 2024.)

(1) The provisions of this chapter do not apply with respect to the use of tangible personal property that will be incorporated as an ingredient or component of new buildings by a manufacturer engaged in the manufacturing of superefficient airplanes or owned by a port district and to be leased to a manufacturer engaged in the manufacturing of superefficient airplanes, during the course of constructing such buildings, or to labor and services rendered in respect to installing, during the course of constructing, building fixtures not otherwise eligible for the exemption under RCW 82.08.02565(2)(b).

(2) The eligibility requirements, conditions, and definitions in RCW 82.08.980 apply to this section, including the filing of a complete annual report with the department under RCW 82.32.534.

(3) This section expires July 1, 2024.

[2010 c 114 § 132; 2003 2nd sp.s. c 1 § 12.]

RCW 82.12.980

Exemptions — Labor, services, and personal property related to the manufacture of commercial airplanes. (Contingent effective date. Expires July 1, 2040.)

(1) The provisions of this chapter do not apply with respect to the use of:

(a) Tangible personal property that will be incorporated as an ingredient or component in constructing new buildings for (i) a manufacturer engaged in the manufacturing of commercial airplanes or the fuselages or wings of commercial airplanes or (ii) a port district, political subdivision, or municipal corporation, to be leased to a manufacturer engaged in the manufacturing of commercial airplanes or the fuselages or wings of commercial airplanes; or

(b) Labor and services rendered in respect to installing, during the course of constructing such buildings, building fixtures not otherwise eligible for the exemption under RCW 82.08.02565(2)(b).

(2) The eligibility requirements, conditions, and definitions in RCW 82.08.980 apply to this section, including the filing of a complete annual report with the department under RCW 82.32.534.

(3) This section expires July 1, 2040.

[2013 3rd sp.s. c 2 § 4; 2010 c 114 § 132; 2003 2nd sp.s. c 1 § 12.]

Certified Aircraft Repair Firms (B&O Tax)

RCW 82.04.250(3)

Tax on retailers.

(1) Upon every person engaging within this state in the business of making sales at retail, except persons taxable as retailers under other provisions of this chapter, as to such persons, the amount of tax with respect to such business is equal to the gross proceeds of sales of the business, multiplied by the rate of 0.471 percent.

(2) Upon every person engaging within this state in the business of making sales at retail that are exempt from the tax imposed under chapter 82.08 RCW by reason of RCW 82.08.0261, 82.08.0262, or 82.08.0263, except persons taxable under *RCW 82.04.260(10) or subsection (3) of this section, as to such persons, the amount of tax with respect to such business is equal to the gross proceeds of sales of the business, multiplied by the rate of 0.484 percent.

(3) Until July 1, 2024, upon every person classified by the federal aviation administration as a federal aviation regulation part 145 certificated repair station and that is engaging within this state in the business of making sales at retail that are exempt from the tax imposed under chapter 82.08 RCW by reason of RCW 82.08.0261, 82.08.0262, or 82.08.0263, as to such persons, the amount of tax with respect to such business is equal to the gross proceeds of sales of the business, multiplied by the rate of .2904 percent.

[2010 1st sp.s. c 23 § 509; (2010 1st sp.s. c 23 § 508 expired July 1, 2011); (2010 1st sp.s. c 23 § 507 expired July 13, 2010); 2010 1st sp.s. c 11 § 1; (2010 c 114 § 106 expired July 1, 2011); 2008 c 81 § 5; (2007 c 54 § 5 repealed by 2010 1st sp.s. c 11 § 7); 2006 c 177 § 5; 2003 2nd sp.s. c 1 § 2; (2003 1st sp.s. c 2 § 1 expired July 1, 2006). Prior: 1998 c 343 § 5; 1998 c 312 § 4; 1993 sp.s. c 25 § 103; 1981 c 172 § 2; 1971 ex.s. c 281 § 4; 1971 ex.s. c 186 § 2; 1969 ex.s. c 262 § 35; 1967 ex.s. c 149 § 9; 1961 c 15 § 82.04.250; prior: 1955 c 389 § 45; prior: 1950 ex.s. c 5 § 1, part; 1949 c 228 § 1, part; 1943 c 156 § 1, part; 1941 c 178 § 1, part; 1939 c 225 § 1, part; 1937 c 227 § 1, part; 1935 c 180 § 4, part; Rem. Supp. 1949 § 8370-4, part.]

Commercial Airplane Part Place of Sale (B&O tax)

RCW 82.04.627

Exemptions — Commercial airplane parts.

(1) Except as provided in subsection (2) of this section, for purposes of the taxes imposed under this chapter on the sale of parts to the manufacturer of a commercial airplane, the sale is deemed to take place at the site of the final testing or inspection as required by:

(a) An approved production inspection system under federal aviation regulation part 21, subpart F; or

(b) A quality control system for which a production certificate has been issued under federal aviation regulation part 21, subpart G.

(2) This section does not apply to:

(a) Sales of the types of parts listed in federal aviation regulation part 21, section 303(b)(2) through (4) or parts for which certification or approval under federal aviation regulation part 21 is not required; or

(b) Sales of parts in respect to which final testing or inspection as required by the approved production inspection system or quality control system takes place in this state.

(3) "Commercial airplane" has the same meaning given in RCW 82.32.550.

[2008 c 81 § 15.]

Aircraft Part Prototypes (Sales and Use Tax)

RCW 82.08.02566

Exemptions — Sales of tangible personal property incorporated in prototype for parts, auxiliary equipment, and aircraft modification — Limitations on yearly exemption.

(1) The tax levied by RCW 82.08.020 shall not apply to sales of tangible personal property incorporated into a prototype for aircraft parts, auxiliary equipment, or modifications; or to sales of tangible personal property that at one time is incorporated into the prototype but is later destroyed in the testing or development of the prototype.

(2) This exemption does not apply to sales to any person whose total taxable amount during the immediately preceding calendar year exceeds twenty million dollars. For purposes of this section, "total taxable amount" means gross income of the business and value of products manufactured, less any amounts for which a credit is allowed under RCW 82.04.440.

(3) State and local taxes for which an exemption is received under this section and RCW 82.12.02566 shall not exceed one hundred thousand dollars for any person during any calendar year.

(4) Sellers shall collect tax on sales subject to this exemption. The buyer shall apply for a refund directly from the department.

[2003 c 168 § 208; 1997 c 302 § 1; 1996 c 247 § 4.]

RCW 82.12.02566

Exemptions — Use of tangible personal property incorporated in prototype for aircraft parts, auxiliary equipment, and aircraft modification — Limitations on yearly exemption.

(1) The provisions of this chapter shall not apply with respect to the use of tangible personal property incorporated into a prototype for aircraft parts, auxiliary equipment, or modifications; or in respect to the use of tangible personal property that at one time is incorporated into the prototype but is later destroyed in the testing or development of the prototype.

(2) This exemption does not apply in respect to the use of tangible personal property by any person whose total taxable amount during the immediately preceding calendar year exceeds twenty million dollars. For purposes of this section, "total taxable amount" means gross income of the business and value of products manufactured, less any amounts for which a credit is allowed under RCW 82.04.440.

(3) State and local taxes for which an exemption is received under this section and RCW 82.08.02566 shall not exceed one hundred thousand dollars for any person during any calendar year.

(4) Sellers obligated to collect use tax shall collect tax on sales subject to this exemption. The buyer shall apply for a refund directly from the department.

[2003 c 168 § 209; 1997 c 302 § 2; 1996 c 247 § 5.]

Dairy Products Manufacturing – Deduction (B&O Tax)

RCW 82.04.4268

Exemptions — Dairy product businesses. (Expires July 1, 2015.)

1) In computing tax there may be deducted from the measure of tax, the value of products or the gross proceeds of sales derived from:

(a) Manufacturing dairy products; or

(b) Selling dairy products manufactured by the seller to purchasers who either transport in the ordinary course of business the goods out of this state or purchasers who use such dairy products as an ingredient or

component in the manufacturing of a dairy product. A person taking an exemption under this subsection (1)(b) must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state or sold to a manufacturer for use as an ingredient or component in the manufacturing of a dairy product.

(2) "Dairy products" has the same meaning as provided in RCW 82.04.260.

(3) A person claiming the exemption provided in this section must file a complete annual survey with the department under RCW 82.32.585.

(4) This section expires July 1, 2015.

[2013 2nd sp.s. c 13 § 204; 2012 2nd sp.s. c 6 § 202; 2010 c 114 § 112; 2006 c 354 § 1.]

Dairy Products Manufacturing – Preferential Rate (B&O Tax)

RCW 82.04.260

Tax on manufacturers and processors of various foods and by-products — Research and development organizations — Travel agents — Certain international activities — Stevedoring and associated activities — Low-level waste disposers — Insurance producers, surplus line brokers, and title insurance agents — Hospitals — Commercial airplane activities — Timber product activities — Canned salmon processors. (Contingent expiration date. Effective until July 1, 2015.)

(1) Upon every person engaging within this state in the business of manufacturing:

(a) Wheat into flour, barley into pearl barley, soybeans into soybean oil, canola into canola oil, canola meal, or canola by-products, or sunflower seeds into sunflower oil; as to such persons the amount of tax with respect to such business is equal to the value of the flour, pearl barley, oil, canola meal, or canola by-product manufactured, multiplied by the rate of 0.138 percent;

(b) Beginning July 1, 2015, seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing by that person; or selling manufactured seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing, to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business is equal to the value of the products manufactured or the gross proceeds derived from such sales, multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state;

(c)(i) Beginning July 1, 2015, dairy products; or selling dairy products that the person has manufactured to purchasers who either transport in the ordinary course of business the goods out of state or purchasers who use such dairy products as an ingredient or component in the manufacturing of a dairy product; as to such persons the tax imposed is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state or sold to a manufacturer for use as an ingredient or component in the manufacturing of a dairy product.

(ii) For the purposes of this subsection (1)(c), "dairy products" means:

(A) Products, not including any marijuana-infused product, that as of September 20, 2001, are identified in 21 C.F.R., chapter 1, parts 131, 133, and 135, including by-products from the manufacturing of the dairy products, such as whey and casein; and

(B) Products comprised of not less than seventy percent dairy products that qualify under (c)(ii)(A) of this subsection, measured by weight or volume.

(iii) The preferential tax rate provided to taxpayers under this subsection (1)(c) does not apply to sales of dairy products on or after July 1, 2023, where a dairy product is used by the purchaser as an ingredient or component in the manufacturing in Washington of a dairy product;

(d)(i) Beginning July 1, 2015, fruits or vegetables by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables, or selling at wholesale fruits or vegetables manufactured by the seller by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables and sold to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state.

(ii) For purposes of this subsection (1)(d), "fruits" and "vegetables" do not include marijuana, useable marijuana, or marijuana-infused products;

(e) Until July 1, 2009, alcohol fuel, biodiesel fuel, or biodiesel feedstock, as those terms are defined in RCW 82.29A.135; as to such persons the amount of tax with respect to the business is equal to the value of alcohol fuel, biodiesel fuel, or biodiesel feedstock manufactured, multiplied by the rate of 0.138 percent; and

(f) Wood biomass fuel as defined in RCW 82.29A.135; as to such persons the amount of tax with respect to the business is equal to the value of wood biomass fuel manufactured, multiplied by the rate of 0.138 percent.

(2) Upon every person engaging within this state in the business of splitting or processing dried peas; as to such persons the amount of tax with respect to such business is equal to the value of the peas split or processed, multiplied by the rate of 0.138 percent.

(3) Upon every nonprofit corporation and nonprofit association engaging within this state in research and development, as to such corporations and associations, the amount of tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.484 percent.

(4) Upon every person engaging within this state in the business of slaughtering, breaking and/or processing perishable meat products and/or selling the same at wholesale only and not at retail; as to such persons the tax imposed is equal to the gross proceeds derived from such sales multiplied by the rate of 0.138 percent.

(5) Upon every person engaging within this state in the business of acting as a travel agent or tour operator; as to such persons the amount of the tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.275 percent.

(6) Upon every person engaging within this state in business as an international steamship agent, international customs house broker, international freight forwarder, vessel and/or cargo charter broker in foreign commerce, and/or international air cargo agent; as to such persons the amount of the tax with respect to only international activities is equal to the gross income derived from such activities multiplied by the rate of 0.275 percent.

(7) Upon every person engaging within this state in the business of stevedoring and associated activities pertinent to the movement of goods and commodities in waterborne interstate or foreign commerce; as to such persons the amount of tax with respect to such business is equal to the gross proceeds derived from such activities multiplied by the rate of 0.275 percent. Persons subject to taxation under this subsection are exempt from payment of taxes imposed by chapter 82.16 RCW for that portion of their business subject to taxation under this subsection. Stevedoring and associated activities pertinent to the conduct of goods and commodities in waterborne interstate or foreign commerce are defined as all activities of a labor, service or transportation nature whereby cargo may be loaded or unloaded to or from vessels or barges, passing over, onto or under a wharf, pier, or similar structure; cargo may be moved to a warehouse or similar holding or storage yard or area to await further movement in import or export or may move to a consolidation freight station and be stuffed, unstuffed, containerized, separated or otherwise segregated or aggregated for delivery or loaded on any mode of transportation for delivery to its consignee. Specific activities included in this definition are: Wharfage, handling, loading, unloading, moving of cargo to a convenient place of delivery to

the consignee or a convenient place for further movement to export mode; documentation services in connection with the receipt, delivery, checking, care, custody and control of cargo required in the transfer of cargo; imported automobile handling prior to delivery to consignee; terminal stevedoring and incidental vessel services, including but not limited to plugging and unplugging refrigerator service to containers, trailers, and other refrigerated cargo receptacles, and securing ship hatch covers.

(8) Upon every person engaging within this state in the business of disposing of low-level waste, as defined in RCW 43.145.010; as to such persons the amount of the tax with respect to such business is equal to the gross income of the business, excluding any fees imposed under chapter 43.200 RCW, multiplied by the rate of 3.3 percent.

If the gross income of the taxpayer is attributable to activities both within and without this state, the gross income attributable to this state must be determined in accordance with the methods of apportionment required under RCW 82.04.460.

(9) Upon every person engaging within this state as an insurance producer or title insurance agent licensed under chapter 48.17 RCW or a surplus line broker licensed under chapter 48.15 RCW; as to such persons, the amount of the tax with respect to such licensed activities is equal to the gross income of such business multiplied by the rate of 0.484 percent.

(10) Upon every person engaging within this state in business as a hospital, as defined in chapter 70.41 RCW, that is operated as a nonprofit corporation or by the state or any of its political subdivisions, as to such persons, the amount of tax with respect to such activities is equal to the gross income of the business multiplied by the rate of 0.75 percent through June 30, 1995, and 1.5 percent thereafter.

(11)(a) Beginning October 1, 2005, upon every person engaging within this state in the business of manufacturing commercial airplanes, or components of such airplanes, or making sales, at retail or wholesale, of commercial airplanes or components of such airplanes, manufactured by the seller, as to such persons the amount of tax with respect to such business is, in the case of manufacturers, equal to the value of the product manufactured and the gross proceeds of sales of the product manufactured, or in the case of processors for hire, equal to the gross income of the business, multiplied by the rate of:

(i) 0.4235 percent from October 1, 2005, through June 30, 2007; and

(ii) 0.2904 percent beginning July 1, 2007.

(b) Beginning July 1, 2008, upon every person who is not eligible to report under the provisions of (a) of this subsection (11) and is engaging within this state in the business of manufacturing tooling specifically designed for use in manufacturing commercial airplanes or components of such airplanes, or making sales, at retail or wholesale, of such tooling manufactured by the seller, as to such persons the amount of tax with respect to such business is, in the case of manufacturers, equal to the value of the product manufactured and the gross proceeds of sales of the product manufactured, or in the case of processors for hire, be equal to the gross income of the business, multiplied by the rate of 0.2904 percent.

(c) For the purposes of this subsection (11), "commercial airplane" and "component" have the same meanings as provided in RCW 82.32.550.

(d) In addition to all other requirements under this title, a person reporting under the tax rate provided in this subsection (11) must file a complete annual report with the department under RCW 82.32.534.

(e) This subsection (11) does not apply on and after July 1, 2024.

(12)(a) Until July 1, 2024, upon every person engaging within this state in the business of extracting timber or extracting for hire timber; as to such persons the amount of tax with respect to the business is, in the case of extractors, equal to the value of products, including by-products, extracted, or in the case of extractors for hire, equal to the gross income of the business, multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(b) Until July 1, 2024, upon every person engaging within this state in the business of manufacturing or processing for hire: (i) Timber into timber products or wood products; or (ii) timber products into other

timber products or wood products; as to such persons the amount of the tax with respect to the business is, in the case of manufacturers, equal to the value of products, including by-products, manufactured, or in the case of processors for hire, equal to the gross income of the business, multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(c) Until July 1, 2024, upon every person engaging within this state in the business of selling at wholesale: (i) Timber extracted by that person; (ii) timber products manufactured by that person from timber or other timber products; or (iii) wood products manufactured by that person from timber or timber products; as to such persons the amount of the tax with respect to the business is equal to the gross proceeds of sales of the timber, timber products, or wood products multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(d) Until July 1, 2024, upon every person engaging within this state in the business of selling standing timber; as to such persons the amount of the tax with respect to the business is equal to the gross income of the business multiplied by the rate of 0.2904 percent. For purposes of this subsection (12)(d), "selling standing timber" means the sale of timber apart from the land, where the buyer is required to sever the timber within thirty months from the date of the original contract, regardless of the method of payment for the timber and whether title to the timber transfers before, upon, or after severance.

(e) For purposes of this subsection, the following definitions apply:

(i) "Biocomposite surface products" means surface material products containing, by weight or volume, more than fifty percent recycled paper and that also use nonpetroleum-based phenolic resin as a bonding agent.

(ii) "Paper and paper products" means products made of interwoven cellulosic fibers held together largely by hydrogen bonding. "Paper and paper products" includes newsprint; office, printing, fine, and pressure-sensitive papers; paper napkins, towels, and toilet tissue; kraft bag, construction, and other kraft industrial papers; paperboard, liquid packaging containers, containerboard, corrugated, and solid-fiber containers including linerboard and corrugated medium; and related types of cellulosic products containing primarily, by weight or volume, cellulosic materials. "Paper and paper products" does not include books, newspapers, magazines, periodicals, and other printed publications, advertising materials, calendars, and similar types of printed materials.

(iii) "Recycled paper" means paper and paper products having fifty percent or more of their fiber content that comes from postconsumer waste. For purposes of this subsection (12)(e)(iii), "postconsumer waste" means a finished material that would normally be disposed of as solid waste, having completed its life cycle as a consumer item.

(iv) "Timber" means forest trees, standing or down, on privately or publicly owned land. "Timber" does not include Christmas trees that are cultivated by agricultural methods or short-rotation hardwoods as defined in RCW 84.33.035.

(v) "Timber products" means:

(A) Logs, wood chips, sawdust, wood waste, and similar products obtained wholly from the processing of timber, short-rotation hardwoods as defined in RCW 84.33.035, or both;

(B) Pulp, including market pulp and pulp derived from recovered paper or paper products; and

(C) Recycled paper, but only when used in the manufacture of biocomposite surface products.

(vi) "Wood products" means paper and paper products; dimensional lumber; engineered wood products such as particleboard, oriented strand board, medium density fiberboard, and plywood; wood doors; wood windows; and biocomposite surface products.

(f) Except for small harvesters as defined in RCW 84.33.035, a person reporting under the tax rate provided in this subsection (12) must file a complete annual survey with the department under RCW 82.32.585.

(13) Upon every person engaging within this state in inspecting, testing, labeling, and storing canned salmon owned by another person, as to such persons, the amount of tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.484 percent.

(14)(a) Upon every person engaging within this state in the business of printing a newspaper, publishing a newspaper, or both, the amount of tax on such business is equal to the gross income of the business multiplied by the rate of 0.365 percent through June 30, 2013, and beginning July 1, 2013, multiplied by the rate of 0.35 percent.

(b) A person reporting under the tax rate provided in this subsection (14) must file a complete annual report with the department under RCW 82.32.534.

[2014 c 140 § 3; 2013 2nd sp.s. c 13 § 202. Prior: 2012 2nd sp.s. c 6 § 602; 2012 2nd sp.s. c 6 § 204; 2011 c 2 § 203 (Initiative Measure No. 1107, approved November 2, 2010); 2010 1st sp.s. c 23 § 506; (2010 1st sp.s. c 23 § 505 expired June 10, 2010); 2010 c 114 § 107; prior: 2009 c 479 § 64; 2009 c 461 § 1; 2009 c 162 § 34; prior: 2008 c 296 § 1; 2008 c 217 § 100; 2008 c 81 § 4; prior: 2007 c 54 § 6; 2007 c 48 § 2; prior: 2006 c 354 § 4; 2006 c 300 § 1; prior: 2005 c 513 § 2; 2005 c 443 § 4; prior: 2003 2nd sp.s. c 1 § 4; 2003 2nd sp.s. c 1 § 3; 2003 c 339 § 11; 2003 c 261 § 11; 2001 2nd sp.s. c 25 § 2; prior: 1998 c 312 § 5; 1998 c 311 § 2; prior: 1998 c 170 § 4; 1996 c 148 § 2; 1996 c 115 § 1; prior: 1995 2nd sp.s. c 12 § 1; 1995 2nd sp.s. c 6 § 1; 1993 sp.s. c 25 § 104; 1993 c 492 § 304; 1991 c 272 § 15; 1990 c 21 § 2; 1987 c 139 § 1; prior: 1985 c 471 § 1; 1985 c 135 § 2; 1983 2nd ex.s. c 3 § 5; prior: 1983 1st ex.s. c 66 § 4; 1983 1st ex.s. c 55 § 4; 1982 2nd ex.s. c 13 § 1; 1982 c 10 § 16; prior: 1981 c 178 § 1; 1981 c 172 § 3; 1979 ex.s. c 196 § 2; 1975 1st ex.s. c 291 § 7; 1971 ex.s. c 281 § 5; 1971 ex.s. c 186 § 3; 1969 ex.s. c 262 § 36; 1967 ex.s. c 149 § 10; 1965 ex.s. c 173 § 6; 1961 c 15 § 82.04.260; prior: 1959 c 211 § 2; 1955 c 389 § 46; prior: 1953 c 91 § 4; 1951 2nd ex.s. c 28 § 4; 1950 ex.s. c 5 § 1, part; 1949 c 228 § 1, part; 1943 c 156 § 1, part; 1941 c 178 § 1, part; 1939 c 225 § 1, part; 1937 c 227 § 1, part; 1935 c 180 § 4, part; Rem. Supp. 1949 § 8370-4, part.]

Fruit and Vegetable Manufacturing – Exemption (B&O Tax)

RCW 82.04.4266

Exemptions — Fruit and vegetable businesses. (Expires July 1, 2015.)

(1) This chapter does not apply to the value of products or the gross proceeds of sales derived from:

(a) Manufacturing fruits or vegetables by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables; or

(b) Selling at wholesale fruits or vegetables manufactured by the seller by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables and sold to purchasers who transport in the ordinary course of business the goods out of this state. A person taking an exemption under this subsection (1)(b) must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state.

(2) For purposes of this section, "fruits" and "vegetables" do not include marijuana, useable marijuana, or marijuana-infused products.

(3) A person claiming the exemption provided in this section must file a complete annual survey with the department under RCW 82.32.585.

(4) This section expires July 1, 2015.

[2014 c 140 § 9; 2012 2nd sp.s. c 6 § 201; 2011 c 2 § 202 (Initiative Measure No. 1107, approved November 2, 2010); 2010 1st sp.s. c 23 § 504; (2010 1st sp.s. c 23 § 503 expired June 10, 2010); 2010 c 114 § 111; 2006 c 354 § 3; 2005 c 513 § 1.]

Fruit and Vegetable Manufacturing – Preferential Rate (B&O Tax)

RCW 82.04.260

Tax on manufacturers and processors of various foods and by-products — Research and development organizations — Travel agents — Certain international activities — Stevedoring and associated activities — Low-level waste disposers — Insurance producers, surplus line brokers, and title insurance agents — Hospitals — Commercial airplane activities — Timber product activities — Canned salmon processors. (Contingent expiration date. Effective until July 1, 2015.)

(1) Upon every person engaging within this state in the business of manufacturing:

(a) Wheat into flour, barley into pearl barley, soybeans into soybean oil, canola into canola oil, canola meal, or canola by-products, or sunflower seeds into sunflower oil; as to such persons the amount of tax with

respect to such business is equal to the value of the flour, pearl barley, oil, canola meal, or canola by-product manufactured, multiplied by the rate of 0.138 percent;

(b) Beginning July 1, 2015, seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing by that person; or selling manufactured seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing, to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business is equal to the value of the products manufactured or the gross proceeds derived from such sales, multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state;

(c)(i) Beginning July 1, 2015, dairy products; or selling dairy products that the person has manufactured to purchasers who either transport in the ordinary course of business the goods out of state or purchasers who use such dairy products as an ingredient or component in the manufacturing of a dairy product; as to such persons the tax imposed is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state or sold to a manufacturer for use as an ingredient or component in the manufacturing of a dairy product.

(ii) For the purposes of this subsection (1)(c), "dairy products" means:

(A) Products, not including any marijuana-infused product, that as of September 20, 2001, are identified in 21 C.F.R., chapter 1, parts 131, 133, and 135, including by-products from the manufacturing of the dairy products, such as whey and casein; and

(B) Products comprised of not less than seventy percent dairy products that qualify under (c)(ii)(A) of this subsection, measured by weight or volume.

(iii) The preferential tax rate provided to taxpayers under this subsection (1)(c) does not apply to sales of dairy products on or after July 1, 2023, where a dairy product is used by the purchaser as an ingredient or component in the manufacturing in Washington of a dairy product;

(d)(i) Beginning July 1, 2015, fruits or vegetables by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables, or selling at wholesale fruits or vegetables manufactured by the seller by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables and sold to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state.

(ii) For purposes of this subsection (1)(d), "fruits" and "vegetables" do not include marijuana, useable marijuana, or marijuana-infused products;

(e) Until July 1, 2009, alcohol fuel, biodiesel fuel, or biodiesel feedstock, as those terms are defined in RCW 82.29A.135; as to such persons the amount of tax with respect to the business is equal to the value of alcohol fuel, biodiesel fuel, or biodiesel feedstock manufactured, multiplied by the rate of 0.138 percent; and

(f) Wood biomass fuel as defined in RCW 82.29A.135; as to such persons the amount of tax with respect to the business is equal to the value of wood biomass fuel manufactured, multiplied by the rate of 0.138 percent.

(2) Upon every person engaging within this state in the business of splitting or processing dried peas; as to such persons the amount of tax with respect to such business is equal to the value of the peas split or processed, multiplied by the rate of 0.138 percent.

(3) Upon every nonprofit corporation and nonprofit association engaging within this state in research and development, as to such corporations and associations, the amount of tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.484 percent.

(4) Upon every person engaging within this state in the business of slaughtering, breaking and/or processing perishable meat products and/or selling the same at wholesale only and not at retail; as to such persons the tax imposed is equal to the gross proceeds derived from such sales multiplied by the rate of 0.138 percent.

(5) Upon every person engaging within this state in the business of acting as a travel agent or tour operator; as to such persons the amount of the tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.275 percent.

(6) Upon every person engaging within this state in business as an international steamship agent, international customs house broker, international freight forwarder, vessel and/or cargo charter broker in foreign commerce, and/or international air cargo agent; as to such persons the amount of the tax with respect to only international activities is equal to the gross income derived from such activities multiplied by the rate of 0.275 percent.

(7) Upon every person engaging within this state in the business of stevedoring and associated activities pertinent to the movement of goods and commodities in waterborne interstate or foreign commerce; as to such persons the amount of tax with respect to such business is equal to the gross proceeds derived from such activities multiplied by the rate of 0.275 percent. Persons subject to taxation under this subsection are exempt from payment of taxes imposed by chapter 82.16 RCW for that portion of their business subject to taxation under this subsection. Stevedoring and associated activities pertinent to the conduct of goods and commodities in waterborne interstate or foreign commerce are defined as all activities of a labor, service or transportation nature whereby cargo may be loaded or unloaded to or from vessels or barges, passing over, onto or under a wharf, pier, or similar structure; cargo may be moved to a warehouse or similar holding or storage yard or area to await further movement in import or export or may move to a consolidation freight station and be stuffed, unstuffed, containerized, separated or otherwise segregated or aggregated for delivery or loaded on any mode of transportation for delivery to its consignee. Specific activities included in this definition are: Wharfage, handling, loading, unloading, moving of cargo to a convenient place of delivery to the consignee or a convenient place for further movement to export mode; documentation services in connection with the receipt, delivery, checking, care, custody and control of cargo required in the transfer of cargo; imported automobile handling prior to delivery to consignee; terminal stevedoring and incidental vessel services, including but not limited to plugging and unplugging refrigerator service to containers, trailers, and other refrigerated cargo receptacles, and securing ship hatch covers.

(8) Upon every person engaging within this state in the business of disposing of low-level waste, as defined in RCW 43.145.010; as to such persons the amount of the tax with respect to such business is equal to the gross income of the business, excluding any fees imposed under chapter 43.200 RCW, multiplied by the rate of 3.3 percent.

If the gross income of the taxpayer is attributable to activities both within and without this state, the gross income attributable to this state must be determined in accordance with the methods of apportionment required under RCW 82.04.460.

(9) Upon every person engaging within this state as an insurance producer or title insurance agent licensed under chapter 48.17 RCW or a surplus line broker licensed under chapter 48.15 RCW; as to such persons, the amount of the tax with respect to such licensed activities is equal to the gross income of such business multiplied by the rate of 0.484 percent.

(10) Upon every person engaging within this state in business as a hospital, as defined in chapter 70.41 RCW, that is operated as a nonprofit corporation or by the state or any of its political subdivisions, as to such persons, the amount of tax with respect to such activities is equal to the gross income of the business multiplied by the rate of 0.75 percent through June 30, 1995, and 1.5 percent thereafter.

(11)(a) Beginning October 1, 2005, upon every person engaging within this state in the business of manufacturing commercial airplanes, or components of such airplanes, or making sales, at retail or wholesale, of commercial airplanes or components of such airplanes, manufactured by the seller, as to such persons the amount of tax with respect to such business is, in the case of manufacturers, equal to the value of

the product manufactured and the gross proceeds of sales of the product manufactured, or in the case of processors for hire, equal to the gross income of the business, multiplied by the rate of:

(i) 0.4235 percent from October 1, 2005, through June 30, 2007; and

(ii) 0.2904 percent beginning July 1, 2007.

(b) Beginning July 1, 2008, upon every person who is not eligible to report under the provisions of (a) of this subsection (11) and is engaging within this state in the business of manufacturing tooling specifically designed for use in manufacturing commercial airplanes or components of such airplanes, or making sales, at retail or wholesale, of such tooling manufactured by the seller, as to such persons the amount of tax with respect to such business is, in the case of manufacturers, equal to the value of the product manufactured and the gross proceeds of sales of the product manufactured, or in the case of processors for hire, be equal to the gross income of the business, multiplied by the rate of 0.2904 percent.

(c) For the purposes of this subsection (11), "commercial airplane" and "component" have the same meanings as provided in RCW 82.32.550.

(d) In addition to all other requirements under this title, a person reporting under the tax rate provided in this subsection (11) must file a complete annual report with the department under RCW 82.32.534.

(e) This subsection (11) does not apply on and after July 1, 2024.

(12)(a) Until July 1, 2024, upon every person engaging within this state in the business of extracting timber or extracting for hire timber; as to such persons the amount of tax with respect to the business is, in the case of extractors, equal to the value of products, including by-products, extracted, or in the case of extractors for hire, equal to the gross income of the business, multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(b) Until July 1, 2024, upon every person engaging within this state in the business of manufacturing or processing for hire: (i) Timber into timber products or wood products; or (ii) timber products into other timber products or wood products; as to such persons the amount of the tax with respect to the business is, in the case of manufacturers, equal to the value of products, including by-products, manufactured, or in the case of processors for hire, equal to the gross income of the business, multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(c) Until July 1, 2024, upon every person engaging within this state in the business of selling at wholesale: (i) Timber extracted by that person; (ii) timber products manufactured by that person from timber or other timber products; or (iii) wood products manufactured by that person from timber or timber products; as to such persons the amount of the tax with respect to the business is equal to the gross proceeds of sales of the timber, timber products, or wood products multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(d) Until July 1, 2024, upon every person engaging within this state in the business of selling standing timber; as to such persons the amount of the tax with respect to the business is equal to the gross income of the business multiplied by the rate of 0.2904 percent. For purposes of this subsection (12)(d), "selling standing timber" means the sale of timber apart from the land, where the buyer is required to sever the timber within thirty months from the date of the original contract, regardless of the method of payment for the timber and whether title to the timber transfers before, upon, or after severance.

(e) For purposes of this subsection, the following definitions apply:

(i) "Biocomposite surface products" means surface material products containing, by weight or volume, more than fifty percent recycled paper and that also use nonpetroleum-based phenolic resin as a bonding agent.

(ii) "Paper and paper products" means products made of interwoven cellulosic fibers held together largely by hydrogen bonding. "Paper and paper products" includes newsprint; office, printing, fine, and pressure-sensitive papers; paper napkins, towels, and toilet tissue; kraft bag, construction, and other kraft industrial papers; paperboard, liquid packaging containers, containerboard, corrugated, and solid-fiber containers including linerboard and corrugated medium; and related types of cellulosic products containing primarily,

by weight or volume, cellulosic materials. "Paper and paper products" does not include books, newspapers, magazines, periodicals, and other printed publications, advertising materials, calendars, and similar types of printed materials.

(iii) "Recycled paper" means paper and paper products having fifty percent or more of their fiber content that comes from postconsumer waste. For purposes of this subsection (12)(e)(iii), "postconsumer waste" means a finished material that would normally be disposed of as solid waste, having completed its life cycle as a consumer item.

(iv) "Timber" means forest trees, standing or down, on privately or publicly owned land. "Timber" does not include Christmas trees that are cultivated by agricultural methods or short-rotation hardwoods as defined in RCW 84.33.035.

(v) "Timber products" means:

(A) Logs, wood chips, sawdust, wood waste, and similar products obtained wholly from the processing of timber, short-rotation hardwoods as defined in RCW 84.33.035, or both;

(B) Pulp, including market pulp and pulp derived from recovered paper or paper products; and

(C) Recycled paper, but only when used in the manufacture of biocomposite surface products.

(vi) "Wood products" means paper and paper products; dimensional lumber; engineered wood products such as particleboard, oriented strand board, medium density fiberboard, and plywood; wood doors; wood windows; and biocomposite surface products.

(f) Except for small harvesters as defined in RCW 84.33.035, a person reporting under the tax rate provided in this subsection (12) must file a complete annual survey with the department under RCW 82.32.585.

(13) Upon every person engaging within this state in inspecting, testing, labeling, and storing canned salmon owned by another person, as to such persons, the amount of tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.484 percent.

(14)(a) Upon every person engaging within this state in the business of printing a newspaper, publishing a newspaper, or both, the amount of tax on such business is equal to the gross income of the business multiplied by the rate of 0.365 percent through June 30, 2013, and beginning July 1, 2013, multiplied by the rate of 0.35 percent.

(b) A person reporting under the tax rate provided in this subsection (14) must file a complete annual report with the department under RCW 82.32.534.

[2014 c 140 § 3; 2013 2nd sp.s. c 13 § 202. Prior: 2012 2nd sp.s. c 6 § 602; 2012 2nd sp.s. c 6 § 204; 2011 c 2 § 203 (Initiative Measure No. 1107, approved November 2, 2010); 2010 1st sp.s. c 23 § 506; (2010 1st sp.s. c 23 § 505 expired June 10, 2010); 2010 c 114 § 107; prior: 2009 c 479 § 64; 2009 c 461 § 1; 2009 c 162 § 34; prior: 2008 c 296 § 1; 2008 c 217 § 100; 2008 c 81 § 4; prior: 2007 c 54 § 6; 2007 c 48 § 2; prior: 2006 c 354 § 4; 2006 c 300 § 1; prior: 2005 c 513 § 2; 2005 c 443 § 4; prior: 2003 2nd sp.s. c 1 § 4; 2003 2nd sp.s. c 1 § 3; 2003 c 339 § 11; 2003 c 261 § 11; 2001 2nd sp.s. c 25 § 2; prior: 1998 c 312 § 5; 1998 c 311 § 2; prior: 1998 c 170 § 4; 1996 c 148 § 2; 1996 c 115 § 1; prior: 1995 2nd sp.s. c 12 § 1; 1995 2nd sp.s. c 6 § 1; 1993 sp.s. c 25 § 104; 1993 c 492 § 304; 1991 c 272 § 15; 1990 c 21 § 2; 1987 c 139 § 1; prior: 1985 c 471 § 1; 1985 c 135 § 2; 1983 2nd ex.s. c 3 § 5; prior: 1983 1st ex.s. c 66 § 4; 1983 1st ex.s. c 55 § 4; 1982 2nd ex.s. c 13 § 1; 1982 c 10 § 16; prior: 1981 c 178 § 1; 1981 c 172 § 3; 1979 ex.s. c 196 § 2; 1975 1st ex.s. c 291 § 7; 1971 ex.s. c 281 § 5; 1971 ex.s. c 186 § 3; 1969 ex.s. c 262 § 36; 1967 ex.s. c 149 § 10; 1965 ex.s. c 173 § 6; 1961 c 15 § 82.04.260; prior: 1959 c 211 § 2; 1955 c 389 § 46; prior: 1953 c 91 § 4; 1951 2nd ex.s. c 28 § 4; 1950 ex.s. c 5 § 1, part; 1949 c 228 § 1, part; 1943 c 156 § 1, part; 1941 c 178 § 1, part; 1939 c 225 § 1, part; 1937 c 227 § 1, part; 1935 c 180 § 4, part; Rem. Supp. 1949 § 8370-4, part.]

Seafood Products Manufacturing – Exemption (B&O Tax)

RCW 82.04.4269

Exemptions — Seafood product businesses. (Expires July 1, 2015.)

1) This chapter does not apply to the value of products or the gross proceeds of sales derived from:

(a) Manufacturing seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing by that person; or

(b) Selling manufactured seafood products that remain in a raw, raw frozen, or raw salted state to purchasers who transport in the ordinary course of business the goods out of this state. A person taking an

exemption under this subsection (1)(b) must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state.

(2) A person claiming the exemption provided in this section must file a complete annual survey with the department under RCW 82.32.585.

(3) This section expires July 1, 2015.

Seafood Products Manufacturing – Preferential Rate (B&O Tax)

RCW 82.04.260

Tax on manufacturers and processors of various foods and by-products — Research and development organizations — Travel agents — Certain international activities — Stevedoring and associated activities — Low-level waste disposers — Insurance producers, surplus line brokers, and title insurance agents — Hospitals — Commercial airplane activities — Timber product activities — Canned salmon processors. (Contingent expiration date. Effective until July 1, 2015.)

(1) Upon every person engaging within this state in the business of manufacturing:

(a) Wheat into flour, barley into pearl barley, soybeans into soybean oil, canola into canola oil, canola meal, or canola by-products, or sunflower seeds into sunflower oil; as to such persons the amount of tax with respect to such business is equal to the value of the flour, pearl barley, oil, canola meal, or canola by-product manufactured, multiplied by the rate of 0.138 percent;

(b) Beginning July 1, 2015, seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing by that person; or selling manufactured seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing, to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business is equal to the value of the products manufactured or the gross proceeds derived from such sales, multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state;

(c)(i) Beginning July 1, 2015, dairy products; or selling dairy products that the person has manufactured to purchasers who either transport in the ordinary course of business the goods out of state or purchasers who use such dairy products as an ingredient or component in the manufacturing of a dairy product; as to such persons the tax imposed is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state or sold to a manufacturer for use as an ingredient or component in the manufacturing of a dairy product.

(ii) For the purposes of this subsection (1)(c), "dairy products" means:

(A) Products, not including any marijuana-infused product, that as of September 20, 2001, are identified in 21 C.F.R., chapter 1, parts 131, 133, and 135, including by-products from the manufacturing of the dairy products, such as whey and casein; and

(B) Products comprised of not less than seventy percent dairy products that qualify under (c)(ii)(A) of this subsection, measured by weight or volume.

(iii) The preferential tax rate provided to taxpayers under this subsection (1)(c) does not apply to sales of dairy products on or after July 1, 2023, where a dairy product is used by the purchaser as an ingredient or component in the manufacturing in Washington of a dairy product;

(d)(i) Beginning July 1, 2015, fruits or vegetables by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables, or selling at wholesale fruits or vegetables manufactured by the seller by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables and sold to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state.

(ii) For purposes of this subsection (1)(d), "fruits" and "vegetables" do not include marijuana, useable marijuana, or marijuana-infused products;

(e) Until July 1, 2009, alcohol fuel, biodiesel fuel, or biodiesel feedstock, as those terms are defined in RCW 82.29A.135; as to such persons the amount of tax with respect to the business is equal to the value of alcohol fuel, biodiesel fuel, or biodiesel feedstock manufactured, multiplied by the rate of 0.138 percent; and

(f) Wood biomass fuel as defined in RCW 82.29A.135; as to such persons the amount of tax with respect to the business is equal to the value of wood biomass fuel manufactured, multiplied by the rate of 0.138 percent.

(2) Upon every person engaging within this state in the business of splitting or processing dried peas; as to such persons the amount of tax with respect to such business is equal to the value of the peas split or processed, multiplied by the rate of 0.138 percent.

(3) Upon every nonprofit corporation and nonprofit association engaging within this state in research and development, as to such corporations and associations, the amount of tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.484 percent.

(4) Upon every person engaging within this state in the business of slaughtering, breaking and/or processing perishable meat products and/or selling the same at wholesale only and not at retail; as to such persons the tax imposed is equal to the gross proceeds derived from such sales multiplied by the rate of 0.138 percent.

(5) Upon every person engaging within this state in the business of acting as a travel agent or tour operator; as to such persons the amount of the tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.275 percent.

(6) Upon every person engaging within this state in business as an international steamship agent, international customs house broker, international freight forwarder, vessel and/or cargo charter broker in foreign commerce, and/or international air cargo agent; as to such persons the amount of the tax with respect to only international activities is equal to the gross income derived from such activities multiplied by the rate of 0.275 percent.

(7) Upon every person engaging within this state in the business of stevedoring and associated activities pertinent to the movement of goods and commodities in waterborne interstate or foreign commerce; as to such persons the amount of tax with respect to such business is equal to the gross proceeds derived from such activities multiplied by the rate of 0.275 percent. Persons subject to taxation under this subsection are exempt from payment of taxes imposed by chapter 82.16 RCW for that portion of their business subject to taxation under this subsection. Stevedoring and associated activities pertinent to the conduct of goods and commodities in waterborne interstate or foreign commerce are defined as all activities of a labor, service or transportation nature whereby cargo may be loaded or unloaded to or from vessels or barges, passing over, onto or under a wharf, pier, or similar structure; cargo may be moved to a warehouse or similar holding or storage yard or area to await further movement in import or export or may move to a consolidation freight station and be stuffed, unstuffed, containerized, separated or otherwise segregated or aggregated for delivery or loaded on any mode of transportation for delivery to its consignee. Specific activities included in this definition are: Wharfage, handling, loading, unloading, moving of cargo to a convenient place of delivery to the consignee or a convenient place for further movement to export mode; documentation services in connection with the receipt, delivery, checking, care, custody and control of cargo required in the transfer of cargo; imported automobile handling prior to delivery to consignee; terminal stevedoring and incidental

vessel services, including but not limited to plugging and unplugging refrigerator service to containers, trailers, and other refrigerated cargo receptacles, and securing ship hatch covers.

(8) Upon every person engaging within this state in the business of disposing of low-level waste, as defined in RCW 43.145.010; as to such persons the amount of the tax with respect to such business is equal to the gross income of the business, excluding any fees imposed under chapter 43.200 RCW, multiplied by the rate of 3.3 percent.

If the gross income of the taxpayer is attributable to activities both within and without this state, the gross income attributable to this state must be determined in accordance with the methods of apportionment required under RCW 82.04.460.

(9) Upon every person engaging within this state as an insurance producer or title insurance agent licensed under chapter 48.17 RCW or a surplus line broker licensed under chapter 48.15 RCW; as to such persons, the amount of the tax with respect to such licensed activities is equal to the gross income of such business multiplied by the rate of 0.484 percent.

(10) Upon every person engaging within this state in business as a hospital, as defined in chapter 70.41 RCW, that is operated as a nonprofit corporation or by the state or any of its political subdivisions, as to such persons, the amount of tax with respect to such activities is equal to the gross income of the business multiplied by the rate of 0.75 percent through June 30, 1995, and 1.5 percent thereafter.

(11)(a) Beginning October 1, 2005, upon every person engaging within this state in the business of manufacturing commercial airplanes, or components of such airplanes, or making sales, at retail or wholesale, of commercial airplanes or components of such airplanes, manufactured by the seller, as to such persons the amount of tax with respect to such business is, in the case of manufacturers, equal to the value of the product manufactured and the gross proceeds of sales of the product manufactured, or in the case of processors for hire, equal to the gross income of the business, multiplied by the rate of:

(i) 0.4235 percent from October 1, 2005, through June 30, 2007; and

(ii) 0.2904 percent beginning July 1, 2007.

(b) Beginning July 1, 2008, upon every person who is not eligible to report under the provisions of (a) of this subsection (11) and is engaging within this state in the business of manufacturing tooling specifically designed for use in manufacturing commercial airplanes or components of such airplanes, or making sales, at retail or wholesale, of such tooling manufactured by the seller, as to such persons the amount of tax with respect to such business is, in the case of manufacturers, equal to the value of the product manufactured and the gross proceeds of sales of the product manufactured, or in the case of processors for hire, be equal to the gross income of the business, multiplied by the rate of 0.2904 percent.

(c) For the purposes of this subsection (11), "commercial airplane" and "component" have the same meanings as provided in RCW 82.32.550.

(d) In addition to all other requirements under this title, a person reporting under the tax rate provided in this subsection (11) must file a complete annual report with the department under RCW 82.32.534.

(e) This subsection (11) does not apply on and after July 1, 2024.

(12)(a) Until July 1, 2024, upon every person engaging within this state in the business of extracting timber or extracting for hire timber; as to such persons the amount of tax with respect to the business is, in the case of extractors, equal to the value of products, including by-products, extracted, or in the case of extractors for hire, equal to the gross income of the business, multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(b) Until July 1, 2024, upon every person engaging within this state in the business of manufacturing or processing for hire: (i) Timber into timber products or wood products; or (ii) timber products into other timber products or wood products; as to such persons the amount of the tax with respect to the business is, in the case of manufacturers, equal to the value of products, including by-products, manufactured, or in the case

of processors for hire, equal to the gross income of the business, multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(c) Until July 1, 2024, upon every person engaging within this state in the business of selling at wholesale: (i) Timber extracted by that person; (ii) timber products manufactured by that person from timber or other timber products; or (iii) wood products manufactured by that person from timber or timber products; as to such persons the amount of the tax with respect to the business is equal to the gross proceeds of sales of the timber, timber products, or wood products multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(d) Until July 1, 2024, upon every person engaging within this state in the business of selling standing timber; as to such persons the amount of the tax with respect to the business is equal to the gross income of the business multiplied by the rate of 0.2904 percent. For purposes of this subsection (12)(d), "selling standing timber" means the sale of timber apart from the land, where the buyer is required to sever the timber within thirty months from the date of the original contract, regardless of the method of payment for the timber and whether title to the timber transfers before, upon, or after severance.

(e) For purposes of this subsection, the following definitions apply:

(i) "Biocomposite surface products" means surface material products containing, by weight or volume, more than fifty percent recycled paper and that also use nonpetroleum-based phenolic resin as a bonding agent.

(ii) "Paper and paper products" means products made of interwoven cellulosic fibers held together largely by hydrogen bonding. "Paper and paper products" includes newsprint; office, printing, fine, and pressure-sensitive papers; paper napkins, towels, and toilet tissue; kraft bag, construction, and other kraft industrial papers; paperboard, liquid packaging containers, containerboard, corrugated, and solid-fiber containers including linerboard and corrugated medium; and related types of cellulosic products containing primarily, by weight or volume, cellulosic materials. "Paper and paper products" does not include books, newspapers, magazines, periodicals, and other printed publications, advertising materials, calendars, and similar types of printed materials.

(iii) "Recycled paper" means paper and paper products having fifty percent or more of their fiber content that comes from postconsumer waste. For purposes of this subsection (12)(e)(iii), "postconsumer waste" means a finished material that would normally be disposed of as solid waste, having completed its life cycle as a consumer item.

(iv) "Timber" means forest trees, standing or down, on privately or publicly owned land. "Timber" does not include Christmas trees that are cultivated by agricultural methods or short-rotation hardwoods as defined in RCW 84.33.035.

(v) "Timber products" means:

(A) Logs, wood chips, sawdust, wood waste, and similar products obtained wholly from the processing of timber, short-rotation hardwoods as defined in RCW 84.33.035, or both;

(B) Pulp, including market pulp and pulp derived from recovered paper or paper products; and

(C) Recycled paper, but only when used in the manufacture of biocomposite surface products.

(vi) "Wood products" means paper and paper products; dimensional lumber; engineered wood products such as particleboard, oriented strand board, medium density fiberboard, and plywood; wood doors; wood windows; and biocomposite surface products.

(f) Except for small harvesters as defined in RCW 84.33.035, a person reporting under the tax rate provided in this subsection (12) must file a complete annual survey with the department under RCW 82.32.585.

(13) Upon every person engaging within this state in inspecting, testing, labeling, and storing canned salmon owned by another person, as to such persons, the amount of tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.484 percent.

(14)(a) Upon every person engaging within this state in the business of printing a newspaper, publishing a newspaper, or both, the amount of tax on such business is equal to the gross income of the business

multiplied by the rate of 0.365 percent through June 30, 2013, and beginning July 1, 2013, multiplied by the rate of 0.35 percent.

(b) A person reporting under the tax rate provided in this subsection (14) must file a complete annual report with the department under RCW 82.32.534.

[2014 c 140 § 3; 2013 2nd sp.s. c 13 § 202. Prior: 2012 2nd sp.s. c 6 § 602; 2012 2nd sp.s. c 6 § 204; 2011 c 2 § 203 (Initiative Measure No. 1107, approved November 2, 2010); 2010 1st sp.s. c 23 § 506; (2010 1st sp.s. c 23 § 505 expired June 10, 2010); 2010 c 114 § 107; prior: 2009 c 479 § 64; 2009 c 461 § 1; 2009 c 162 § 34; prior: 2008 c 296 § 1; 2008 c 217 § 100; 2008 c 81 § 4; prior: 2007 c 54 § 6; 2007 c 48 § 2; prior: 2006 c 354 § 4; 2006 c 300 § 1; prior: 2005 c 513 § 2; 2005 c 443 § 4; prior: 2003 2nd sp.s. c 1 § 4; 2003 2nd sp.s. c 1 § 3; 2003 c 339 § 11; 2003 c 261 § 11; 2001 2nd sp.s. c 25 § 2; prior: 1998 c 312 § 5; 1998 c 311 § 2; prior: 1998 c 170 § 4; 1996 c 148 § 2; 1996 c 115 § 1; prior: 1995 2nd sp.s. c 12 § 1; 1995 2nd sp.s. c 6 § 1; 1993 sp.s. c 25 § 104; 1993 c 492 § 304; 1991 c 272 § 15; 1990 c 21 § 2; 1987 c 139 § 1; prior: 1985 c 471 § 1; 1985 c 135 § 2; 1983 2nd ex.s. c 3 § 5; prior: 1983 1st ex.s. c 66 § 4; 1983 1st ex.s. c 55 § 4; 1982 2nd ex.s. c 13 § 1; 1982 c 10 § 16; prior: 1981 c 178 § 1; 1981 c 172 § 3; 1979 ex.s. c 196 § 2; 1975 1st ex.s. c 291 § 7; 1971 ex.s. c 281 § 5; 1971 ex.s. c 186 § 3; 1969 ex.s. c 262 § 36; 1967 ex.s. c 149 § 10; 1965 ex.s. c 173 § 6; 1961 c 15 § 82.04.260; prior: 1959 c 211 § 2; 1955 c 389 § 46; prior: 1953 c 91 § 4; 1951 2nd ex.s. c 28 § 4; 1950 ex.s. c 5 § 1, part; 1949 c 228 § 1, part; 1943 c 156 § 1, part; 1941 c 178 § 1, part; 1939 c 225 § 1, part; 1937 c 227 § 1, part; 1935 c 180 § 4, part; Rem. Supp. 1949 § 8370-4, part.]

Electric Power Exported or Resold (Public Utility Tax, B&O Tax)

RCW 82.16.050

Deductions in computing tax

In computing tax there may be deducted from the gross income the following items:

(1) Amounts derived by municipally owned or operated public service businesses, directly from taxes levied for the support or maintenance thereof. This subsection may not be construed to exempt service charges which are spread on the property tax rolls and collected as taxes;

(2) Amounts derived from the sale of commodities to persons in the same public service business as the seller, for resale as such within this state. This deduction is allowed only with respect to water distribution, gas distribution or other public service businesses which furnish water, gas or any other commodity in the performance of public service businesses;

(3) Amounts actually paid by a taxpayer to another person taxable under this chapter as the latter's portion of the consideration due for services furnished jointly by both, if the total amount has been credited to and appears in the gross income reported for tax by the former;

(4) The amount of cash discount actually taken by the purchaser or customer;

(5) The amount of bad debts, as that term is used in 26 U.S.C. Sec. 166, as amended or renumbered as of January 1, 2003, on which tax was previously paid under this chapter;

(6) Amounts derived from business which the state is prohibited from taxing under the Constitution of this state or the Constitution or laws of the United States;

(7) Amounts derived from the distribution of water through an irrigation system, for irrigation purposes other than the irrigation of marijuana as defined under RCW 69.50.101;

(8) Amounts derived from the transportation of commodities from points of origin in this state to final destination outside this state, or from points of origin outside this state to final destination in this state, with respect to which the carrier grants to the shipper the privilege of stopping the shipment in transit at some point in this state for the purpose of storing, manufacturing, milling, or other processing, and thereafter forwards the same commodity, or its equivalent, in the same or converted form, under a through freight rate from point of origin to final destination;

(9) Amounts derived from the transportation of commodities from points of origin in the state to an export elevator, wharf, dock or ship side on tidewater or its navigable tributaries to be forwarded, without intervening transportation, by vessel, in their original form, to interstate or foreign destinations. No deduction is allowed under this subsection when the point of origin and the point of delivery to the export elevator, wharf, dock, or ship side are located within the corporate limits of the same city or town;

(10) Amounts derived from the transportation of agricultural commodities, not including manufactured substances or articles, from points of origin in the state to interim storage facilities in this state for transshipment, without intervening transportation, to an export elevator, wharf, dock, or ship side on tidewater or its navigable tributaries to be forwarded, without intervening transportation, by vessel, in their original form, to interstate or foreign destinations. If agricultural commodities are transshipped from interim storage facilities in this state to storage facilities at a port on tidewater or its navigable tributaries, the same agricultural commodity dealer must operate both the interim storage facilities and the storage facilities at the port.

(a) The deduction under this subsection is available only when the person claiming the deduction obtains a certificate from the agricultural commodity dealer operating the interim storage facilities, in a form and manner prescribed by the department, certifying that:

(i) More than ninety-six percent of all of the type of agricultural commodity delivered by the person claiming the deduction under this subsection and delivered by all other persons to the dealer's interim storage facilities during the preceding calendar year was shipped by vessel in original form to interstate or foreign destinations; and

(ii) Any of the agricultural commodity that is transshipped to ports on tidewater or its navigable tributaries will be received at storage facilities operated by the same agricultural commodity dealer and will be shipped from such facilities, without intervening transportation, by vessel, in their original form, to interstate or foreign destinations.

(b) As used in this subsection, "agricultural commodity" has the same meaning as agricultural product in RCW 82.04.213;

(11) Amounts derived from the production, sale, or transfer of electrical energy for resale within or outside the state or for consumption outside the state;

(12) Amounts derived from the distribution of water by a nonprofit water association and used for capital improvements by that nonprofit water association;

(13) Amounts paid by a sewerage collection business taxable under RCW 82.16.020(1)(a) to a person taxable under chapter 82.04 RCW for the treatment or disposal of sewage;

(14) Amounts derived from fees or charges imposed on persons for transit services provided by a public transportation agency. For the purposes of this subsection, "public transportation agency" means a municipality, as defined in RCW 35.58.272, and urban public transportation systems, as defined in RCW 47.04.082. Public transportation agencies must spend an amount equal to the reduction in tax provided by this tax deduction solely to adjust routes to improve access for citizens using food banks and senior citizen services or to extend or add new routes to assist low-income citizens and seniors.

[2014 c 140 § 25; 2007 c 330 § 1; 2006 c 336 § 1; 2004 c 153 § 308; 2000 c 245 § 1; 1994 c 124 § 12; 1989 c 302 § 103; 1987 c 207 § 1; 1982 2nd ex.s. c 9 § 3; 1977 ex.s. c 368 § 1; 1967 ex.s. c 149 § 25; 1965 ex.s. c 173 § 22; 1961 c 15 § 82.16.050. Prior: 1959 ex.s. c 3 § 18; 1949 c 228 § 11; 1937 c 227 § 12; 1935 c 180 § 40; Rem. Supp. 1949 § 8370-40.]

RCW 82.04.310

Exemptions — Public utilities — Electrical energy — Natural or manufactured gas. (Effective until June 30, 2015.)

(1) This chapter does not apply to any person in respect to a business activity with respect to which tax liability is specifically imposed under the provisions of chapter 82.16 RCW including amounts derived from activities for which a deduction is allowed under RCW 82.16.050.

(2) This chapter does not apply to amounts received by any person for the sale of electrical energy for resale within or outside the state.

(3)(a) This chapter does not apply to amounts received by any person for the sale of natural or manufactured gas in a calendar year if that person sells within the United States a total amount of natural or manufactured gas in that calendar year that is no more than twenty percent of the amount of natural or manufactured gas that it consumes within the United States in the same calendar year.

(b) For purposes of determining whether a person has sold within the United States a total amount of natural or manufactured gas in a calendar year that is no more than twenty percent of the amount of natural or manufactured gas that it consumes within the United States in the same calendar year, the following transfers of gas are not considered to be the sale of natural or manufactured gas:

(i) The transfer of any natural or manufactured gas as a result of the acquisition of another business, through merger or otherwise; or

(ii) The transfer of any natural or manufactured gas accomplished solely to comply with federal regulatory requirements imposed on the pipeline transportation of such gas when it is shipped by a third-party manager of a person's pipeline transportation.

(4) This chapter does not apply to amounts received by any person in the form of credits against power contracts with the Bonneville power administration, or funds provided by the Bonneville power administration, for the purpose of implementing energy conservation programs or demand-side management programs.

[2010 c 295 § 1; 2007 c 58 § 1; 2000 c 245 § 2; 1989 c 302 § 202; 1961 c 15 § 82.04.310. Prior: 1959 c 197 § 15; prior: 1945 c 249 § 2, part; 1943 c 156 § 4, part; 1941 c 178 § 6, part; 1939 c 225 § 5, part; 1937 c 227 § 4, part; 1935 c 180 § 11, part; Rem. Supp. 1945 § 8370-11, part.]

RCW 82.04.310

Exemptions — Public utilities — Electrical energy — Natural or manufactured gas. (Effective July 1, 2015.)

(1) This chapter does not apply to any person in respect to a business activity with respect to which tax liability is specifically imposed under the provisions of chapter 82.16 RCW including amounts derived from activities for which a deduction is allowed under RCW 82.16.050. The exemption in this subsection does not apply to sales of natural gas, including compressed natural gas and liquefied natural gas, by a gas distribution business, if such sales are exempt from the tax imposed under chapter 82.16 RCW as provided in RCW 82.16.310.

(2) This chapter does not apply to amounts received by any person for the sale of electrical energy for resale within or outside the state.

(3)(a) This chapter does not apply to amounts received by any person for the sale of natural or manufactured gas in a calendar year if that person sells within the United States a total amount of natural or manufactured gas in that calendar year that is no more than twenty percent of the amount of natural or manufactured gas that it consumes within the United States in the same calendar year.

(b) For purposes of determining whether a person has sold within the United States a total amount of natural or manufactured gas in a calendar year that is no more than twenty percent of the amount of natural or manufactured gas that it consumes within the United States in the same calendar year, the following transfers of gas are not considered to be the sale of natural or manufactured gas:

(i) The transfer of any natural or manufactured gas as a result of the acquisition of another business, through merger or otherwise; or

(ii) The transfer of any natural or manufactured gas accomplished solely to comply with federal regulatory requirements imposed on the pipeline transportation of such gas when it is shipped by a third-party manager of a person's pipeline transportation.

[2014 c 216 § 302; 2007 c 58 § 1; 2000 c 245 § 2; 1989 c 302 § 202; 1961 c 15 § 82.04.310. Prior: 1959 c 197 § 15; prior: 1945 c 249 § 2, part; 1943 c 156 § 4, part; 1941 c 178 § 6, part; 1939 c 225 § 5, part; 1937 c 227 § 4, part; 1935 c 180 § 11, part; Rem. Supp. 1945 § 8370-11, part.]

International Investment Management (B&O Tax)

RCW 82.04.290

Tax on international investment management services or other business or service activities.

(1) Upon every person engaging within this state in the business of providing international investment management services, as to such persons, the amount of tax with respect to such business shall be equal to the gross income or gross proceeds of sales of the business multiplied by a rate of 0.275 percent.

(2)(a) Upon every person engaging within this state in any business activity other than or in addition to an activity taxed explicitly under another section in this chapter or subsection (1) or (3) of this section; as to such persons the amount of tax on account of such activities shall be equal to the gross income of the business multiplied by the rate of 1.5 percent.

(b) This subsection (2) includes, among others, and without limiting the scope hereof (whether or not title to materials used in the performance of such business passes to another by accession, confusion or other than by outright sale), persons engaged in the business of rendering any type of service which does not constitute a "sale at retail" or a "sale at wholesale." The value of advertising, demonstration, and promotional supplies and materials furnished to an agent by his or her principal or supplier to be used for informational, educational, and promotional purposes shall not be considered a part of the agent's remuneration or commission and shall not be subject to taxation under this section.

(3)(a) Until July 1, 2024, upon every person engaging within this state in the business of performing aerospace product development for others, as to such persons, the amount of tax with respect to such business shall be equal to the gross income of the business multiplied by a rate of 0.9 percent.

(b) "Aerospace product development" has the meaning as provided in RCW 82.04.4461.

[2013 c 23 § 314; 2011 c 174 § 101; 2008 c 81 § 6; 2005 c 369 § 8; 2004 c 174 § 2; 2003 c 343 § 2; 2001 1st sp.s. c 9 § 6; (2001 1st sp.s. c 9 § 4 expired July 1, 2001). Prior: 1998 c 343 § 4; 1998 c 331 § 2; 1998 c 312 § 8; 1998 c 308 § 5; 1998 c 308 § 4; 1997 c 7 § 2; 1996 c 1 § 2; 1995 c 229 § 3; 1993 sp.s. c 25 § 203; 1985 c 32 § 3; 1983 2nd ex.s. c 3 § 2; 1983 c 9 § 2; 1983 c 3 § 212; 1971 ex.s. c 281 § 8; 1970 ex.s. c 65 § 4; 1969 ex.s. c 262 § 39; 1967 ex.s. c 149 § 14; 1963 ex.s. c 28 § 2; 1961 c 15 § 82.04.290; prior: 1959 ex.s. c 5 § 5; 1955 c 389 § 49; prior: 1953 c 195 § 2; 1950 ex.s. c 5 § 1, part; 1949 c 228 § 1, part; 1943 c 156 § 1, part; 1941 c 178 § 1, part; 1939 c 225 § 1, part; 1937 c 227 § 1, part; 1935 c 180 § 4, part; Rem. Supp. 1949 § 8370-4, part.]

RCW 82.04.293

International investment management services — Definitions.

For purposes of RCW 82.04.290:

(1) A person is engaged in the business of providing international investment management services, if:

(a) Such person is engaged primarily in the business of providing investment management services; and

(b) At least ten percent of the gross income of such person is derived from providing investment management services to any of the following: (i) Persons or collective investment funds residing outside the United States; or (ii) persons or collective investment funds with at least ten percent of their investments located outside the United States.

(2) "Investment management services" means investment research, investment consulting, portfolio management, fund administration, fund distribution, investment transactions, or related investment services.

(3) "Collective investment fund" includes:

(a) A mutual fund or other regulated investment company, as defined in section 851(a) of the internal revenue code of 1986, as amended;

(b) An "investment company," as that term is used in section 3(a) of the investment company act of 1940, as well as any entity that would be an investment company for this purpose but for the exemptions contained in section 3(c)(1) or (11);

(c) An "employee benefit plan," which includes any plan, trust, commingled employee benefit trust, or custodial arrangement that is subject to the employee retirement income security act of 1974, as amended, 29

U.S.C. Sec. 1001 et seq., or that is described in sections 125, 401, 403, 408, 457, and 501(c)(9) and (17) through (23) of the internal revenue code of 1986, as amended, or a similar plan maintained by a state or local government, or a plan, trust, or custodial arrangement established to self-insure benefits required by federal, state, or local law;

(d) A fund maintained by a tax-exempt organization, as defined in section 501(c)(3) of the internal revenue code of 1986, as amended, for operating, quasi-endowment, or endowment purposes;

(e) Funds that are established for the benefit of such tax-exempt organizations, such as charitable remainder trusts, charitable lead trusts, charitable annuity trusts, or other similar trusts; or

(f) Collective investment funds similar to those described in (a) through (e) of this subsection created under the laws of a foreign jurisdiction.

(4) Investments are located outside the United States if the underlying assets in which the investment constitutes a beneficial interest reside or are created, issued or held outside the United States.

[1997 c 7 § 3; 1995 c 229 § 1.]

Sales Subject to Public Utility Tax (Sales Tax, Sales and Use Tax)

RCW 82.08.0252

Exemptions — Sales by persons taxable under chapter 82.16 RCW

The tax levied by RCW 82.08.020 shall not apply to sales made by persons in the course of business activities with respect to which tax liability is specifically imposed under chapter 82.16 RCW, when the gross proceeds from such sales must be included in the measure of the tax imposed under said chapter.

[1980 c 37 § 20. Formerly RCW 82.08.030(2).]

RCW 82.08.950

Exemptions — Steam, electricity, electrical energy

The tax levied by RCW 82.08.020 shall not apply to sales of steam, electricity, or electrical energy.

[2003 c 168 § 703.]

RCW 82.12.950

Exemptions — Steam, electricity, electrical energy

The provisions of this chapter shall not apply in respect to the use of steam, electricity, or electrical energy.

[2003 c 168 § 704.]