

Citizen Commission for Performance Measurement of Tax Preferences

Draft Consolidated Commissioner Comments on 2014 Preferences

Name	Possible Comment	Rationale for comment
1. <u>Electric Power Exported or Resold (Public Utility Tax)</u>		
Legislative Auditor recommendation: Continue Because the preference is achieving the inferred public policy objectives.		
Grant Forsyth	I concur with the findings of the JLARC staff.	The preference appears to be meeting its intent.
2. <u>Sales Subject to Public Utility Tax (Sales/Sales Use Tax)</u>		
Legislative Auditor recommendation: Continue Because the preferences are meeting the inferred public policy objectives of avoiding double taxation and the more narrow sales and use tax preference is ensuring Washington tax statutes conform with National Streamline Sales and Use Tax Agreement.		
Grant Forsyth	I concur with the findings of the JLARC staff.	The preference appears to be meeting its intent.
3. <u>AEROSPACE INDUSTRY TAX PREFERENCES (package of 8 preferences)</u>		
<p><i>Commercial Airplane Manufacturing—Preferential Rate B&O Tax</i> <i>Aerospace Product Development—Preferential Rate B&O Tax</i> <i>Airplane Pre-Production Expenditures B&O Tax</i> <i>Aerospace Pre-Production Computer Expenditures Sales & Use Tax</i> <i>Commercial Airplane Manufacturing—Credit for Taxes Paid B&O Tax</i> <i>Superefficient Airplane Production Facilities—Leasehold Excise Tax</i> <i>Superefficient Airplane Production Facilities—Property Tax</i> <i>Airplane Facilities—Sales & Use Tax</i></p>		
Legislative Auditor recommendation: 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.		
Grant Forsyth	I concur with the findings of the JLARC staff with additional concerns.	The competition for Washington’s aerospace firms is intense. Given this intensity, and the state’s need to maintain its job base following the Great Recession, these preferences mitigated some near- and medium term risk for Washington’s economy. However, testimony indicates these preferences suffer from significant long-run “moral hazard” problems. Moral hazard problems occur when the recipient of an economic benefit is incented to behave in way inconsistent with the welfare of those granting the benefit. For example, this is a common with deposit insurance. Evidence suggests that deposit insurance (an insurance benefit) in the absence of bank examinations (i.e., prudential supervision) encourages banks to take excessive risk since bank owners and depositors are,

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		<p>to varying degrees, insulated from the bank’s lending decisions. In effect, without bank examinations, risk is shifted to agents such as the bank’s employees and creditors, and taxpayers.</p> <p>In the case of the aerospace industry, the lack of verifiable guidelines for keeping the tax preferences may encourage the industry in the long-run to move employment out of the state to gain the benefit of more favorable labor costs while still benefiting from the tax preferences. However, the establishment of verifiable guidelines will need to balance compliance and monitoring costs with the benefits received by the industry. Testimony from the industry noted that firms may forgo tax preferences with onerous reporting standards, which would undermine the goals of the preferences.</p> <p>In addition to compliance and monitoring costs, how to account for employment changes over time is problematic. That is, some employment changes may not be related to the tax preferences. For example, depending on the industry, technological change can be a significant driver of employment changes. To isolate the impact of a tax preference on employment levels, changes in technology (as well as other factors) should be controlled for. Not doing so may lead to incorrect conclusions regarding the preference’s efficacy.</p> <p>Finally, as with most tax preferences, there also is a lack of transparency on how the preferential rate is set. Although revealing all discussions between the state and an industry is not practical for a variety of reasons, there is still a public interest in additional transparency in how the state and industry arrive at the final preferential rate. The public should be given some additional information as to why a X% rate was chosen. This might include some additional information on cost and competitive pressures faced by an industry, or the influence played by competing preferential rates offered by other states.</p> <p>Given the dollars involved in the aerospace preferences, the issues outlined above deserve additional consideration by the legislature. As was suggested in testimony, it would be helpful to examine how other states manage these issues.</p>
<p>4. Certified Aircraft Repair Firms (B&O Tax)</p>		
<p>Legislative Auditor recommendation: 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.</p>		
<p>Grant Forsyth</p>	<p>I concur with the findings of the JLARC staff with additional concerns.</p>	<p>The additional concerns are the same as those outlined in the “Rationale for comment” for “Aerospace Industry Tax Preferences.”</p>
<p>5. Commercial Airplane Part Place of Sale (B&O Tax)</p>		
<p>Legislative Auditor recommendation: Review and clarify</p>		

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	<p>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.</p> <p>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.</p>	
Grant Forsyth	I concur with the findings of the JLARC staff with additional concerns.	The additional concerns are the same as those outlined in the “Rationale for comment” for “Aerospace Industry Tax Preferences.”
<p>6. Dairy Product Processors – Deduction And Preferential Rate (B&O Tax)</p>		
	<p>Legislative Auditor recommendation: Review and clarify</p> <p>DEDUCTION: 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.</p> <p>PREFERENTIAL RATE: 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.</p>	
Grant Forsyth	I concur with the findings of the JLARC staff with an additional concern.	Although the preference appears to be meeting its intent, the agricultural industry is subject to substantial technological change that reduces the need for labor. Therefore, in the long-run it’s unclear how effective this type of tax preference will be in preventing job losses in this industry.
<p>7. Fruit and Vegetable Processors – Exemption and Preferential Rate (B&O Tax)</p>		
	<p>Legislative Auditor recommendation: Review and clarify</p> <p>EXEMPTION: 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.</p> <p>PREFERENTIAL RATE: 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.</p>	
Grant Forsyth	I concur with the findings of the JLARC staff with an additional concern.	Although the preference appears to be meeting its intent, the agricultural industry is subject to substantial technological change that reduces the need for labor. Therefore, in the long-run it’s unclear how effective this type of tax preference will be in preventing job losses in this industry.

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<p>8. <u>Seafood Product Processors and Certain Sellers – Exemption and Preferential Rate (B&O Tax)</u></p>		
<p>Legislative Auditor recommendation: Review and clarify EXEMPTION: 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. PREFERENTIAL RATE: 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.</p>		
<p>Grant Forsyth</p>	<p>I concur with the findings of the JLARC staff with an additional concern.</p>	<p>Although the preference appears to be meeting its intent, the agricultural industry is subject to substantial technological change that reduces the need for labor. Therefore, in the long-run it's unclear how effective this type of tax preference will be in preventing job losses in this industry.</p>
<p>9. <u>Electric Power Exported or Resold (B&O)</u></p>		
<p>Legislative Auditor recommendation: Review and clarify Because the Legislature may want to add accountability requirements, it is unclear whether the preference is still needed due to 2010 changes in how service businesses calculate taxable income, and it is unclear if the Legislature intended the preference to apply to commission or fee income from electricity brokering.</p>		
<p>Grant Forsyth</p>	<p>I concur with the findings of the JLARC staff.</p>	<p>The power market has changed sufficiently that additional review is warranted.</p>
<p>10. <u>International Investment Management (B&O Tax)</u></p>		
<p>Legislative Auditor recommendation: 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.</p>		
<p>Ron Bueing</p>	<p>Continue, with additional review at the conclusion of the DOR regulatory process.</p>	<p>Credible testimony indicates that the Washington B&O tax, which is specifically designed to apply to transactions between related companies, creates a disproportionate tax obligation on Washington based investment management firms especially in highly regulated industries that are required to legally separate certain activities into multiple entities. The primary beneficiary of this preferential rate provided testimony that there is</p>

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		<p>continuing need for this preferential rate to remedy these inequities in the B&O tax system that would otherwise occur. The Washington DOR is in the middle of a process that should result in the clarification of significant issues regarding the use of this preference. It appears premature to make conclusions on the efficacy of the preference until the DOR's regulatory process is substantially finished.</p>
<p>Grant Forsyth</p>	<p>I concur with the findings of the JLARC staff with additional concerns.</p>	<p>This tax preference raises broader issues related to business structure and taxation in Washington. The use of affiliates as form of corporate structure is fairly typical. However, the Commission learned that in states with income taxes, the affiliate structure is not subject to a tax penalty. This is because the exchange of goods and services between affiliated entities disappears in the parent company's consolidated income statements. As a result, the taxation of affiliate transactions is a problem that extends beyond the International Investment Management industry. The legislature needs to consider again a 2012 WA DOR study on this issue and, if possible, expand on the analysis.</p>
<p>11. Aircraft Part Prototypes (Sales and Use Tax)</p>		
<p>Legislative Auditor recommendation: Terminate Because the tax preferences are not being used and have not contributed to the stated public policy objectives.</p>		
<p>Grant Forsyth</p>	<p>I concur with the findings of the JLARC staff.</p>	<p>Due to the lack of use, the preference should be terminated.</p>

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Comments on Expedited Reviews

Expedited Review – [Baseball Stadiums \(Leasehold Excise Tax\)](#) Pg. 9

Legislative Auditor recommendation: None

Grant Forsyth	“Review and Clarify” is probably needed.	This preference was passed in 1995 and intended to benefit Safeco Field. After nearly 20 years, it may be time for the legislature to review this preference to determine if changes are required. The commission received several written testimonies from beneficiaries of this tax preference. All testimonies are in support of continuing the current tax preference.
Stephen Miller	We recommend the state legislature eliminate the Baseball Stadiums Leasehold Excise Tax exemption.	When this exemption was enacted there was a real chance the Mariners would leave Seattle. Nearly 20 years later it is no longer justifiable that public assets, such as tax revenues, are being used to subsidize a privately owned and profitable entertainment business. It is unlikely the reduction of this \$ 109,000 annual tax exemption will cause the Mariners to leave Seattle.

Expedited Review – [Football Stadium and Exhibition Center Parking \(Sales Tax\)](#) Pg. 22

Legislative Auditor recommendation: None

Stephen Miller	We recommend the state legislature eliminate the Football Stadium and Exhibition Center Parking Sales Tax exemption.	The citizens of Washington State should not be subsidizing the parking of individuals who choose to attend events at Century Link Field and the Exhibition Center.
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Expedited Review – [Football Stadiums \(Leasehold Excise Tax\)](#) Pg. 23

Legislative Auditor recommendation: None

Stephen Miller	We recommend the state legislature eliminate the Football Stadiums Leasehold Excise Tax exemption.	When this exemption was enacted there was a chance the Seahawks would leave Seattle. Over 15 years later it is no longer justifiable that public assets, such as tax revenue, are being used to subsidize a privately owned and profitable entertainment business. It is unlikely the reduction of this \$ 145,000 annual tax exemption will cause the Seahawks or Sounders to leave Seattle.
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Expedited Review – [Multiple Activities Credit \(B&O Tax\)](#) Pg. 34

Legislative Auditor recommendation: None

Ron Bueing	Omit from consideration as a tax preference.	This provision is a structural provision of the Washington B&O tax necessary to avoid infirmity of the Washington B&O tax under U.S. Constitutional precedent.
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<p>Expedited Review – Natural Gas Subject to Public Utility Tax (Use Tax) Pg. 37</p> <p>Legislative Auditor recommendation: None</p>		
<p>Ron Bueing</p>	<p>Omit from consideration as a tax preference.</p>	<p>This provision is necessary to avoid use taxation of natural gas, the taxation of which is properly preempted by the public utility tax.</p>
<p>Expedited Review – Wood Biomass Fuel Production Facilities (Leasehold Excise Tax) Pg. 64</p> <p>Legislative Auditor recommendation: None</p>		
<p>Lily Kahng</p>	<p>Allow to expire.</p>	<p>The Commission recommended in 2008 that the preference be allowed to expire in 2009 because no one uses it. The Legislature renewed it through 2015. It continues to be unused and there is still no evidence that anyone plans to use it.</p>
<p>Expedited Review – Wood Biomass Fuel Production Facilities (Property Tax) Pg. 65</p> <p>Legislative Auditor recommendation: None</p>		
<p>Lily Kahng</p>	<p>Allow to expire.</p>	<p>The Commission recommended in 2008 that the preference be allowed to expire in 2009 because no one uses it. The Legislature renewed it through 2015. It continues to be unused and there is still no evidence that anyone plans to use it.</p>
<p>Expedited Review – Any 2014 Expedited Tax Exemption that would increase revenues in state or local taxes upon their repeal.</p> <p>Legislative Auditor recommendation: None</p>		
<p>Stephen Miller</p>	<p>We recommend the state legislature eliminate all the 2014 Expedited Tax Preferences received by private companies, groups, and individuals that would increase revenues in state or local taxes upon their repeal.</p>	<p>Tax revenue is a public asset that should be utilized in the best interest of the citizens of Washington State. The vast majority of companies, groups, and individuals receiving the Tax Exemptions outlined in JLARC’s 2014 Expedited Tax Preferences list avoided the opportunity to explain the public benefit of their tax exemption. The written testimony supporting the tax exemptions associated with Comcast Field, Safeco Field, and the Exhibition Center did not make a convincing argument that it is in the public’s best interest that for profit businesses and services using these facilities should receive a tax exemption.</p>