

# Citizen Commission for Performance Measurement of Tax Preferences

## Comments on 2015 Legislative Auditor Recommendations

Adopted October 16, 2015

Comment	Rationale for comment
<p><b>1. <u>Commercially Grown Fish and Shellfish (Enhanced Food Fish Tax)</u></b></p>	
<p><b>Legislative Auditor recommendation:</b>      <b>Review and clarify</b></p> <ul style="list-style-type: none"> <li>• If the objective is to re-establish historic tax treatment that taxes fish and shellfish harvested in the wild but not fish and shellfish grown on farms, then the Legislature should affirm this purpose and continue the exemption; or</li> <li>• If the Legislature wants those who have fishing activities that fall under the management authority of the Department of Fish and Wildlife to pay the tax, the Legislature may want to reconsider the existing full exemption for food fish and shellfish farmers.</li> </ul>	
<p>The Commission endorses the Legislative Auditor’s recommendation without comment.</p>	
<p><b>2. <u>Family Business Property (Estate Tax)</u></b></p>	
<p><b>Legislative Auditor recommendation:</b>      <b>Continue</b></p> <p>Because the tax preference is meeting the inferred public policy objective of reducing the likelihood of heirs being forced to sell the property to pay estate taxes.</p>	
<p>The Commission endorses the Legislative Auditor’s recommendation without comment.</p>	
<p><b>3. <u>Family Farm Property (Estate Tax)</u></b></p>	
<p><b>Legislative Auditor recommendation:</b>      <b>Review and clarify</b></p> <p>To determine whether there are unintended beneficiaries because the heirs may immediately sell the farm without penalty.</p>	
<p>The Commission endorses the Legislative Auditor’s recommendation without comment.</p>	
<p><b>4. <u>Farm Machinery Replacement Parts (Sales and Use Tax)</u></b></p>	
<p><b>Legislative Auditor recommendation:</b>      <b>Review and clarify</b></p> <ul style="list-style-type: none"> <li>• It is unclear whether the combined circumstance of stagnant crop prices and rising input costs still applies, and what changes in prices and costs would be appropriate for continuing the preferences relative to farm profits;</li> <li>• It is unclear what participation level of eligible farmers and the total fiscal impact of the preference the Legislature intended; and</li> <li>• The Legislature may want to consider adding reporting or other accountability requirements that would provide better information on the use of this preference.</li> </ul>	
<p>The Commission endorses the Legislative Auditor’s recommendation with comment. The Legislature is encouraged to clearly state the public policy of the preference and make sure it is designed effectively to achieve that purpose.</p>	<p>Washington State agricultural producers compete with their counterparts in other states who are subject to different tax regimes. Research by JLARC staff shows other major agricultural states also provide tax exceptions for machinery parts. This was also confirmed by testimony from agricultural producers. This implies that the existing preference may be necessary to enable Washington State agricultural producers to compete effectively. However, as currently designed, this preference may be more than sufficient or inadequate to assure competitive equity.</p>

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<b>5. <u>Fuel Used on Farms (Sales and Use Tax)</u></b>	
<b>Legislative Auditor recommendation:      Review and clarify</b>	
To provide a performance statement that specifies a public policy objective and provides a metric, such as a metric based on the price of diesel, to determine when the preference is necessary.	
The Commission endorses the Legislative Auditor's recommendation with comment.  The Legislature is encouraged to clearly state the public policy of the preference and make sure it is designed effectively to achieve that purpose.	Washington State agricultural producers compete with their counterparts in other states who are subject to different tax regimes. Research by JLARC staff shows other major agricultural states also provide tax exceptions for farm fuel. This was also confirmed by testimony from agricultural producers. This implies that the existing preference may be necessary to enable Washington State agricultural producers to compete effectively. Nevertheless, the preference was passed to alleviate the impact of rising diesel costs in 2006 without an explicit review clause. For tax preferences that are enacted to deal with potentially transitory market shocks, the legislature should consider a clause that triggers an automatic review should market conditions return to pre-shock levels. In addition, as currently designed and given the drop in fuel costs, this preference may be more than sufficient or inadequate to assure competitive equity.
<b>6. <u>Fuel Used to Heat Chicken Houses; Chicken Bedding Materials (Sales and Use Tax)</u></b>	
<b>Legislative Auditor recommendation:      Review and clarify</b>	
Because the two inferred objectives lead to different conclusions.	
<ul style="list-style-type: none"><li>• If the objective was to help chicken farmers at a time when agriculture was struggling, then the Legislature should consider whether assistance is still needed in light of increases in sales, and commodity prices relative to the increase in propane costs.</li><li>• If the objective was to make taxation of Washington chicken farmers more consistent with other states, that objective has been achieved. The taxation of propane and natural gas to heat chicken structures and bedding materials is similar to that of other states with which Washington competes.</li></ul>	
The Legislature may want to consider adding reporting or other accountability requirements that would provide better information on the use of this preference.	
The Commission endorses the Legislative Auditor's recommendation without comment.	
<b>7. <u>Grain and Unprocessed Milk Wholesaling (B&amp;O Tax)</u></b>	
<b>Legislative Auditor recommendation:      Review and clarify</b>	
Because it is unclear why the Legislature chose to provide preferential treatment to wholesale sales of certain crops but not to other agricultural products.	
The Commission endorses the Legislative Auditor recommendation's without comment.	

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<p><b>8. <u>Horticultural Services for Farmers (Sales and Use Tax)</u></b></p> <p><b>Legislative Auditor recommendation: Continue</b></p> <p>Because the preference is achieving the inferred public policy objective of treating horticultural services provided to farmers as nondiscretionary services rather than as discretionary services subject to sales tax.</p>
<p>The Commission endorses the Legislative Auditor recommendation without comment.</p>
<p><b>9. <u>Livestock Medicine (Sales and Use Tax)</u></b></p> <p><b>Legislative Auditor recommendation: Review and clarify</b></p> <p>To provide a performance statement that includes a public policy objective and specifies metrics to determine if the objectives have been achieved.</p>
<p>The Commission endorses the Legislative Auditor's recommendation without comment.</p>
<p><b>10. <u>Aluminum Industry Tax Preferences for Smelters:</u></b></p> <p><i>Reduced B&amp;O Rate (B&amp;O Tax)</i></p> <p><i>B&amp;O Credit Taxes Paid on Property (Property Tax)</i></p> <p><i>Sales and Use Tax Credit (Sales and Use Tax)</i></p> <p><i>Brokered Natural Gas Exemption (Use Tax)</i></p> <p><b>Legislative Auditor recommendation: Review and clarify</b></p> <p>Because future reviews will be facilitated by:</p> <ul style="list-style-type: none"><li>• Specifying jobs and commodity pricing metrics that can be used to determine if the objective for the four preferences directly available to aluminum smelters has been achieved;</li><li>• Providing a performance statement that includes a public policy objective and specifies metrics to determine if the objectives for the two preferences available for businesses selling power to aluminum smelters have been achieved; and</li><li>• Adding a requirement for the beneficiaries of the aluminum preferences to disclose their beneficiary savings because otherwise the fiscal impact of the preferences may not be identified in the future.</li></ul>
<p>The Commission endorses the Legislative Auditor's recommendation with comment.</p> <p>In reviewing these preferences, the Legislature should consider industry testimony suggesting that the aluminum market is facing a significant downturn due to weak global demand and over production from Chinese producers.</p>

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### **11. Aluminum Industry Tax Preferences for Energy Sellers:**

*Public Utility Tax Credit (Public Utility Tax)*

*B&O Credit for Electric and Gas Sales (B&O Tax)*

**Legislative Auditor recommendation: Review and clarify**

Because future reviews will be facilitated by:

- Specifying jobs and commodity pricing metrics that can be used to determine if the objective for the four preferences directly available to aluminum smelters has been achieved;
- Providing a performance statement that includes a public policy objective and specifies metrics to determine if the objectives for the two preferences available for businesses selling power to aluminum smelters have been achieved; and
- Adding a requirement for the beneficiaries of the aluminum preferences to disclose their beneficiary savings because otherwise the fiscal impact of the preferences may not be identified in the future.

The Commission endorses the Legislative Auditor's recommendation without comment.

### **12. Interest on Real Estate Loans (B&O Tax)**

**Legislative Auditor recommendation: Review and clarify**

Because:

- The application of different definitions for "community bank" changes the pool of lenders who qualify for the preference; and
- The original inferred public policy objective of stimulating the residential housing market may no longer apply given the changes in the lending industry and the rise of the secondary mortgage market.

The Commission does not endorse the Legislative Auditor's recommendation and recommends that the Legislature should maintain the 2012 legislation defining which lenders qualify for the preference.

Washington State financial institutions that portfolio mortgage loans compete with their counterparts in other states who are subject to different tax regimes. The industry's testimony made the reasonable argument that the current tax preference helps mitigate the competitive disadvantage created by recent federal regulatory changes. In this new environment, smaller financial institutions are struggling to absorb the increase in regulatory costs associated with lending. Although offsetting regulatory costs was not the preference's original stated intent, the preference appears to enable smaller financial firms to compete with (1) large nationally-based financial firms whose size enables them to absorb these additional costs and (2) credit unions, which have special tax status. Indicative of increased cost pressures facing smaller community banks, the number of community banks nationally has fallen from about 7,000 in 2008 to 5,400 recently (a 23% decline). Over this same time period, the number of commercial banks headquartered in Washington State has declined from 81 to 45 (a 44% decline). While there are many factors driving shrinkage in the number of community banks, limiting the current preference in same fashion could aggravate that trend.

Furthermore, the inferred public policy objectives do not capture the legislative debate and compromise that surrounded the compromise reached to determine the class and type of banks that

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	<p>would continue to qualify for the exemption. Specifically, the current testimony and debate at the time of the 2012 legislation indicated the restructuring of the exemption was to provide a benefit to a certain population of smaller, local lending institutions without violating commerce clause restrictions imposed by the courts. The community bank definitions considered by JLARC staff were not adopted during legislative debate of these provisions because they would not have encompassed the full population of banks the Legislature determined should be covered.</p>
<p><b>13. <u>Motion Picture Program Contributions (B&amp;O Tax)</u></b></p>	
<p><b>Legislative Auditor recommendation:</b>      <b>Review and clarify</b>          To provide additional detail on the target for Washington’s film industry relative to other states, as well as desired employment outcomes for jobs, average hourly wages, and health and benefits coverage.</p>	
<p>The Commission endorses the Legislative Auditor’s recommendation without comment.</p>	
<p><b>14. <u>Public Facilities Districts (Leasehold Excise Tax)</u></b></p>	
<p><b>Legislative Auditor recommendation:</b>      <b>Review and clarify</b>          To provide a performance statement that includes a public policy objective and specifies metrics to determine if the objectives have been achieved, and to add reporting or other accountability requirements to provide better information on the use of the preference.</p>	
<p>The Commission endorses the Legislative Auditor’s recommendation without comment.</p>	
<p><b>15. <u>Warehouse and Grain Elevator Remittance (Sales and Use Tax)</u></b></p>	
<p><b>Legislative Auditor recommendation:</b>      <b>Review and clarify</b>          To provide more specificity about what trade and what kinds of jobs the Legislature has as its objectives, measurable targets for these objectives, and data collection mechanisms that can be used to assess performance in meeting these objectives.</p>	
<p>The Commission endorses the Legislative Auditor’s recommendation without comment.</p>	

<h3>Comments on Expedited Reviews</h3>	
<ul style="list-style-type: none"> <li>● <b>Natural Gas Purchased by DSI Customers (Use Tax)</b></li> <li>● <b>Natural Gas Purchases by DSI Industry (B&amp;O Tax)</b></li> <li>● <b>Electricity Purchased by DSI Industry (Public Utility Tax)</b></li> </ul>	<p>The Commission notes that these preferences have not been utilized, and recommends that the Legislature consider whether they should be continued.</p>