

Citizen Commission for Performance Measurement of Tax Preferences



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Seattle University Law School
Ronald Bueing
PricewaterhouseCoopers

Dr. Grant D. Forsyth
Avista Corp
Stephen B. Miller
Washington Education Association

NON-VOTING MEMBERS:
Representative Kathy Haigh
Chair, Joint Legislative Audit and Review Committee
Troy Kelley
State Auditor

Citizen Commission for Performance Measurement of Tax Preferences

Draft Meeting Minutes
October 17, 2014
John A. Cherberg Building
Senate Hearing Room 3
Olympia, WA

Members Present:

William A. Longbrake
Ron Bueing
Stephen Miller
State Auditor Troy Kelley

Lily Kahng
Grant Forsyth
Rep. Kathy Haigh

Members Absent: None

Staff:

Keenan Konopaski
Mary Welsh
Peter Heineccius
Ashley Elliott
Stacia Hollar, AGO

John Woolley
Eric Whitaker
Marilyn Richter
Mallory Jennings

CALL TO ORDER AND WELCOME

Chair Longbrake welcomed those in attendance and called the meeting to order at 1:00 p.m.

MOTION: A motion was made to approve the September 19, 2014, meeting minutes.
The motion was seconded and carried. (See TVW recording at [0:00:00](#))

2015 COMMISSION MEETING SCHEDULE

The Commission discussed the proposed schedule for Commission meetings in 2015. (See TVW recording at [0:00:39](#))

DISCUSSION AND ADOPTION OF COMMISSION COMMENTS

The Chair outlined the process by which the Commission will discuss and adopt comments on the 2014 Tax Preference Reviews. Prior to the meeting, the Commission had grouped preferences by the Legislative Auditor recommendation and whether any Commissioner had submitted a proposed comment. (See TVW recording at [0:01:42](#))

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Group A

The Chair asked whether any Commissioners had any proposed comments on the preferences in Group A. The preferences in Group A had received a recommendation of "**Continue**" by the Legislative Auditor, and no Commissioner had proposed any comments prior to the meeting. No Commissioners had any additional comments on these preferences.

MOTION: The Commission acknowledges receipt of the 2014 JLARC Tax Preference Reviews of **Electric Power Exported or Resold (Public Utility Tax); Sales Subject to Public Utility Tax (Sales Tax); and Electricity and Steam (Sales and Use Tax)**. The Commission endorses the Legislative Auditor recommendations for these preferences. The Commission does not have additional comments to append to the 2014 JLARC reports related to these preferences.

The motion was seconded and carried unanimously. (See TVW recording at [0:03:24](#))

Group B

Group B was reserved for any preference that had received a recommendation of "Continue" and where the Commission had a proposed comment. There were no preferences in Group B. (See TVW recording at [0:05:24](#))

Group C

The Chair asked whether any Commissioners had any proposed comments on the preference in Group C. The preference in Group C had received a recommendation of "**Review and Clarify**" by the Legislative Auditor, and no Commissioner had proposed any comments prior to the meeting. No Commissioners had any additional comments on this preference.

MOTION: The Commission acknowledges receipt of the 2014 JLARC Tax Preference Review of **Electricity Sales for Resale (B&O Tax)**. The Commission endorses the Legislative Auditor recommendation for this preference. The Commission does not have additional comments to append to the 2014 JLARC reports related to these preferences.

The motion was seconded and carried unanimously. (See TVW recording at [0:05:32](#))

Group D

The Commission discussed the preferences in Group D. The preferences in Group D had received a recommendation of "Review and Clarify" by the Legislative Auditor, and Commissioners had provided proposed comments.

MOTION: The Commission acknowledges receipt of the 2014 JLARC Tax Preference Reviews of **Commercial Airplane Manufacturing – Preferential Rate (B&O Tax); Aerospace Product Development (B&O Tax); Aerospace Product Development Expenditures (B&O Tax); Aerospace Product Development Computer Expenditures (Sales and Use Tax); Commercial Airplane Manufacturing – Credit for Taxes Paid (B&O Tax); Superefficient Airplane Production Facilities (Leasehold Excise Tax); Superefficient Airplane Production Facilities (Property Tax); Commercial Airplane Production Facilities (Sales and Use Tax); Certified Aircraft Repair Firms (B&O Tax); and Commercial Airplane Part Place of Sale (B&O Tax)**. The Commission endorses the Legislative Auditor recommendations for

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these preferences. The Commission provides the following additional comments to append to the 2014 JLARC report related to these preferences.

Comment: The Legislature should establish specific economic development metrics and reporting mechanisms that facilitate determination of whether the intended public policy objectives are being met.

Rationale: 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 indicated that these preferences suffer from some significant long-run "moral hazard" problems. Moral hazard problems occur when the recipient of an economic benefit is incited to behave in a way inconsistent with the welfare of those granting the benefit. For example, this is 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, 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, creditors, and ultimately taxpayers.

In the case of the aerospace industry, the lack of verifiable metrics that measure the extent to which the public policy objectives of the tax preference are being met may encourage firms to move employment out of state to gain the benefit of more favorable labor costs, while still benefiting from the tax preferences. However, the establishment of verifiable metrics will need to balance compliance and monitoring costs with the benefits received by the firms. Testimony noted that firms may forego taking advantage of tax preferences with onerous reporting standards, possibly to the detriment of economic development in the state.

In addition to compliance and monitoring costs, it is challenging to determine how to measure whether employment objectives are being met over time. Some employment changes may not be related to the tax preferences. For example, depending upon the industry, technological change can be a significant driver of changes in employment. To isolate the impact of a tax preference on employment levels, changes in technology need to be taken into consideration.

Finally, as with most tax preferences, there is also lack of transparency on how the preferential benefits should be established. Although making all discussions between the state and the industry public is not practical for a variety of reasons, there is still a public interest in additional transparency in how the state and industry determine the preferential benefits. The public should be given information about why a particular preferential benefit structure was chosen. This might include information on costs and competitive pressures faced by an industry, or the influence of competing preferential benefits offered by other states. Given the amounts involved in the aerospace preferences, all of these issues deserve careful consideration by the Legislature. It would be helpful to examine how other states are structuring preferences and performance metrics to achieve public policy objectives.

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The motion was seconded and carried by a vote of four to one. Commissioner Bueing voted in opposition to the comment and will provide a minority report. (See TVW recording at [0:06:36](#))

MOTION: The Commission acknowledges receipt of the 2014 JLARC Tax Preference Reviews of **Dairy Product Processors – Deduction (B&O Tax); Dairy Product Processors – Preferential Rate (B&O Tax); Dairy Product Ingredient Sales – Deduction (B&O Tax);** and **Dairy Product Ingredient Sales – Preferential Rate (B&O Tax).** The Commission endorses the Legislative Auditor recommendations for these preferences. The Commission provides the following additional comments to append to the 2014 JLARC report related to these preferences.

Comment: Although the preference appears to be meeting its public policy objective, the dairy industry is subject to technological change that reduces the need for labor. Therefore, the Legislature should not limit its review to the number of jobs created, but should also consider other factors such as locational choice.

The motion was seconded and carried unanimously. (See TVW recording at [0:45:30](#))

MOTION: The Commission acknowledges receipt of the 2014 JLARC Tax Preference Reviews of **Fruit and Vegetable Processors – Exemption (B&O Tax)** and **Fruit and Vegetable Processors – Preferential Rate (B&O Tax).** The Commission endorses the Legislative Auditor recommendations for these preferences. The Commission provides the following additional comments to append to the 2014 JLARC report related to these preferences.

Comment: Although the preference appears to be meeting its public policy objective, the fruit and vegetable industry is subject to technological change that reduces the need for labor. Therefore, the Legislature should not limit its review to the number of jobs created, but should also consider other factors such as locational choice.

The motion was seconded and carried unanimously. (See TVW recording at [0:45:30](#))

MOTION: The Commission acknowledges receipt of the 2014 JLARC Tax Preference Reviews of **Seafood Product Processors and Certain Sellers – Exemption (B&O Tax)** and **Seafood Product Processors and Certain Sellers – Preferential Rate (B&O Tax).** The Commission endorses the Legislative Auditor recommendations for these preferences. The Commission provides the following additional comments to append to the 2014 JLARC report related to these preferences.

Comment: Although the preference appears to be meeting its public policy objective, the seafood product industry is subject to technological change that reduces the need for labor. Therefore, the Legislature should not limit its review to the number of jobs created, but should also consider other factors such as locational choice.

The motion was seconded and carried unanimously. (See TVW recording at [0:45:30](#))

MOTION: The Commission acknowledges receipt of the 2014 JLARC Tax Preference Review of **International Investment Management Services (B&O Tax).** The Commission endorses the Legislative Auditor recommendation for this preference. The Commission

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provides the following additional comments to append to the 2014 JLARC report related to this preference.

Comment: The Legislature in its review of this preference should take into consideration the Department of Revenue's findings from its review of approximately 70 refund requests, which will take some time to complete. In addition, the Legislature should consider the financial and competitive impact this preference has on beneficiaries resulting from the typical business structure involving use of multiple affiliates in the international investment management services business.

Rationale: The Department of Revenue issued an Excise Tax Advisory on International Management Services on February 28, 2014, which clarifies the Department's position on eligibility and what income is taxable. The Department is currently reviewing approximately 70 refund requests and has completed one-third of these reviews. It will take additional time to complete the remaining reviews and determine the viability of these refunds under existing rules. The conclusions reached by the Legislative Auditor based on the existence of these refunds and the timing of the economic nexus and single sales factor apportionment standards are premature given the status of the current refund request reviews. While the Excise Tax Advisory addresses many of the issues revolving around who is eligible for the preferential rate and the Department of Revenue has a position on what income is taxable, not all taxpayers agree.

The Commission received testimony from a beneficiary that described how the B&O tax, which applies both to inter-affiliate transactions as well as to the gross receipts of the parent company, poses an undue tax burden compared to taxation methodologies in other states. This burden arguably could be reduced by merging affiliates; however, the affiliate business structure is a standard feature of businesses involved in international investment management services that is generally required by state and federal securities regulations. In states that tax income rather than receipts, the income of the parent is typically taxed, not the income of each individual affiliate. This issue arises from the structure of the B&O tax and is not unique to the international investment management services business. However, the B&O tax structure frequently results in a larger B&O tax burden for international investment services businesses located in Washington than for such businesses located outside of Washington.

The motion was seconded and carried unanimously. (See TVW recording at [1:01:30](#))

Group E

The Chair asked whether any Commissioners had any proposed comments on the preference in Group E. The preference in Group E had received a recommendation of "**Terminate**" by the Legislative Auditor, and no Commissioner had proposed any comments prior to the meeting. No Commissioners had any additional comments on this preference.

MOTION: The Commission acknowledges receipt of the 2014 JLARC Tax Preference Review of **Aircraft Part Prototypes (Sales and Use Tax)**. The Commission endorses the Legislative Auditor recommendation for this preference. The Commission does not have additional comments to append to the 2014 JLARC reports related to these preferences.

The motion was seconded and carried unanimously. (See TVW recording at [1:22:32](#))

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Group F

The Commission discussed the preferences in Group F. The preferences in Group F had received an expedited review, which means that the Legislative Auditor did not provide analysis or recommendations, rather information is supplied by the Department of Revenue for these preferences. Commissioners organized these preferences into ten subcategories and had provided proposed comments. (See TVW recording at [1:23:16](#))

MOTION: The Commission acknowledges receipt of the 2014 Expedited Tax Preferences Report of **Biodiesel and Alcohol Fuel Production Facilities (Leasehold Excise Tax)** and **Biodiesel and Alcohol Fuel Production Facilities (Property Tax)**. The Commission provides the following comments to append to the 2014 expedited report and the 2008 JLARC review related to these preferences.

Comment: The Legislature should determine whether these preferences continue to meet their public policy objective. If they do, the Legislature should modify the expiration date; if they do not, the Legislature should allow the preferences to expire.

The motion was seconded and carried unanimously. (See TVW recording at [1:24:57](#))

MOTION: The Commission acknowledges receipt of the 2014 Expedited Tax Preferences Report of **Wood Biomass Fuel Production Facilities (Leasehold Excise Tax)** and **Wood Biomass Fuel Production Facilities (Property Tax)**. The Commission provides the following comments to append to the 2014 expedited report and the 2008 JLARC review related to these preferences.

Comment: Because there are no beneficiaries, the Legislature should determine whether these preferences continue to meet their public policy objective. If they do, the Legislature should modify the expiration date; if they do not, the Legislature should allow the preferences to expire.

The motion was seconded and carried unanimously. (See TVW recording at [1:26:42](#))

MOTION: The Commission acknowledges receipt of the 2014 Expedited Tax Preference Report of **Aluminum Master Alloy Producers (B&O Tax)**. The Commission provides the following comments to append to the 2014 expedited report related to this preference.

Comment: Because there are no beneficiaries, the Legislature should determine whether this preference continues to meet its public policy objective. If it does not, the Legislature should terminate this preference.

The motion was seconded and carried unanimously. (See TVW recording at [1:30:21](#))

MOTION: The Commission acknowledges receipt of the 2014 Expedited Tax Preference Report of **Bad Debts (Fuel Tax)**. The Commission provides the following comments to append to the 2014 expedited report related to this preference.

Comment: The Legislature should consider whether this preference continues to serve its purpose, and if not, let it expire. No public testimony covering this preference was submitted.

The motion was seconded and carried unanimously. (See TVW recording at [1:35:52](#))

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MOTION: The Commission acknowledges receipt of the 2014 Expedited Tax Preferences Report of **Multi-Unit Urban Housing (Property Tax); Nonprofit Developmentally Disabled Housing (Property Tax); and Prewritten Computer Software (Property Tax)**. The Commission provides the following comments to append to the 2014 expedited report related to these preferences.

Comment: The Legislature could review whether these preferences are meeting their public policy objectives. If any of them is not, the Legislature should consider modifying or terminating the preference because other taxpayers are bearing the tax burden if the preference is continued.

The motion was seconded and carried unanimously. (See TVW recording at [1:39:47](#))

MOTION: The Commission acknowledges receipt of the 2014 Expedited Tax Preferences Report of **Second Narrows Bridge (Leasehold Excise Tax); Second Narrows Bridge (Property Tax); Second Narrows Bridge (Public Utility Tax); and Second Narrows Bridge (Real Estate Excise Tax)**. The Commission provides the following comments to append to the 2014 expedited report related to these preferences.

Comment: These preferences were enacted in 1998 and anticipated the possibility of private funding, ownership, or lease of the bridge. These preferences are inoperative because that possibility was not pursued. For this reason the Legislature could consider terminating them.

The motion was seconded and carried unanimously. (See TVW recording at [1:49:19](#))

MOTION: The Commission acknowledges receipt of the 2014 Expedited Tax Preference Report of **Multiple Activities Credit (B&O Tax)**. The Commission recommends the Legislature continue this preference and provides the following comments to append to the 2014 expedited report related to this preference.

Comment: This preference is a structural provision of the B&O tax necessary to comply with a ruling of the U.S. Supreme Court interpreting the U.S. Constitution.

The motion was seconded and carried unanimously. (See TVW recording at [1:51:03](#))

Commissioners indicated that during the next May meeting, the Commission might wish to remove Multiple Activities Credit (B&O Tax) from the Ten-Year Review Schedule, since it may be a critical part of the tax structure.

Commissioner Forsyth disclosed that his employer might be a beneficiary of the preference for Natural Gas Subject to Public Utility Tax (Use Tax).

MOTION: The Commission acknowledges receipt of the 2014 Expedited Tax Preference Report of **Natural Gas Subject to Public Utility Tax (Use Tax)**. The Commission recommends the Legislature continue this preference and provides the following comments to append to the 2014 expedited report related to this preference.

Comment: The preference is meeting its public policy objective.

The motion was seconded and carried unanimously. (See TVW recording at [1:53:27](#))

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MOTION: The Commission acknowledges receipt of the 2014 Expedited Tax Preferences Report of **Baseball Stadiums (Leasehold Excise Tax); Football Stadiums (Leasehold Excise Tax); and Football Stadium and Exhibition Center Parking (Sales Tax)**. The Commission recommends the Legislature review and clarify these preferences and provides the following comments to append to the 2014 expedited report related to these preferences.

Comment: The baseball stadium preference was enacted in 1995 as part of a comprehensive package to finance construction of Safeco Field and the football stadium preference was enacted in 1997 as part of a comprehensive package to finance construction of CenturyLink Field. Both of these involved public and private investment. Because nearly 20 years has passed, the Legislature should consider reviewing these preferences to determine whether they are continuing to meet their public policy objectives.

The motion was seconded and carried unanimously. (See TVW recording at [1:55:35](#))

MOTION: The Commission acknowledges receipt of the 2014 Expedited Tax Preferences Report of **all other preferences not mentioned above**. The Commission provides the following comments to append to the 2014 expedited report related to these preferences.

Comment: The Citizen Commission solicited public testimony for all expedited preferences. No public testimony was submitted for any of the expedited preferences in this group. Tax revenue is a public asset that should be utilized in the best overall interests of citizens of Washington State.

The Commission requested beneficiaries to provide responses to the following four questions:

1. Is there evidence that the tax preference achieved its purpose, as noted in the 2014 tax preferences reports? Please provide any relevant evidence.
2. Does the preference provide benefits in addition to those stated in its intended or implied purpose?
3. Does the economic activity stimulated by this tax preference exceed the loss of revenue to the state?
4. Does this preference have negative consequences? For example, were other industries, workers, or the environment harmed by activities stimulated by this tax preference?

The Commission encourages the Legislature to examine these preferences and gather responses to the four questions posed by the Commission from beneficiaries and then determine whether to continue, modify, or terminate each preference.

The motion was seconded and carried unanimously. (See TVW recording at [2:10:50](#))

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OTHER COMMISSION BUSINESS

The Commission decided to defer consideration until next year on a proposed recommendation to the Legislature concerning overall economic development performance standards and reporting mechanisms. (See TVW recording at [2:18:20](#))

The Commission agreed to delegate the drafting of the transmission cover letter to the Chair. Commissioners Lilly Kahng, Stephen Miller, and Ron Bueing indicated they could be available to attend the December JLARC meeting. (See TVW recording at [2:34:05](#))

Stacia Hollar, from the Attorney General's Office, reminded Commissioners that the May meeting will include a discussion of a proposed policy regarding the disclosure of third-party contacts outside of public meetings. She also reminded the Commission that the Open Public Meetings Act permits Commissioners to gather outside of a public meeting for social purposes as long as there is no discussion of public business. (See TVW recording at [2:37:12](#))

PUBLIC TESTIMONY

The Chair reminded the other Commissioners that all written testimony submitted to the Commission is posted on the public website.

Amber Carter, representing the Association of Washington Business, testified regarding requirements for specific economic metrics and best practices for reporting. (See TVW recording at [2:39:58](#))

The Chair adjourned the meeting at 3:57 p.m.