HOUSE BILL REPORT
HB 2530

As Reported by House Committee On:
Ways & Means

Title: An act relating to improving accountability for tax preferences.

Brief Description: Improving accountability for tax preferences.

Sponsors: Representatives Carlyle, Hunter, Reykdal, Roberts and Pollet; by request of Department of Revenue.

Brief History:
Committee Activity:
Ways & Means: 1/30/12, 2/7/12 [DPS].

Brief Summary of Substitute Bill

- Consolidates the annual survey and annual report into a single document.
- Requires the filing of an annual accountability report for all future tax preferences.
- Expires new tax preferences 10 years after enactment.
- Requires information on the amount of new capital investment in Washington in the annual accountability report.
- Requires the Department of Revenue to determine the relative tax burden for taxpayers claiming tax preferences.
- Adds the rate of return of the tax preference to the list of factors for Joint Legislative Audit and Review Committee consideration when evaluating tax preferences.
- Requires the Joint Legislative Audit and Review Committee to review tax preferences every 10 years for those tax preferences that require an annual accountability report.

HOUSE COMMITTEE ON WAYS & MEANS

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 16 members: Representatives Hunter, Chair; Darneille, Vice Chair; Hasegawa,

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This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Vice Chair; Carlyle, Cody, Dickerson, Haigh, Hudgins, Hunt, Kagi, Kenney, Ormsby, Pettigrew, Seaquist, Springer and Sullivan.

Minority Report: Do not pass. Signed by 11 members: Representatives Alexander, Ranking Minority Member; Bailey, Assistant Ranking Minority Member; Dammeier, Assistant Ranking Minority Member; Orcutt, Assistant Ranking Minority Member; Chandler, Haler, Hinkle, Parker, Ross, Schmick and Wilcox.

Staff: Rick Peterson (786-7150).

Background:

Washington's tax revenue is derived from various excise taxes and the state property tax. The major excise taxes are the state sales and use tax and business and occupation tax. Washington law also provides numerous reductions in these various taxes through tax exemptions, deductions, credits, deferrals, and preferential tax rates. Collectively, these tax reductions are referred to as "tax preferences."

In recent years the Legislature has enacted or extended numerous tax preferences that require the annual reporting of information to the Department of Revenue (DOR) by the taxpayer. These documents are collectively referred to as annual accountability reports. A taxpayer submits the initial accountability report in the year following the year in which a tax preference, which is subject to reporting, is first claimed. Taxpayers must pay the tax associated with the tax preference if they fail to file a report.

There are two specific types of accountability documents—annual reports and annual surveys. (A major consolidation of the accountability reporting documents was done in 2010.) Both of these documents are fairly similar. Both documents require taxpayers to report the number of employment positions and certain types of wage and benefit information for the prior calendar year. One important difference between the annual report and the annual survey is that the annual survey also requires a taxpayer to report the amount of tax preference claimed in the prior year. This particular information is not required for the annual report. Another difference between the two documents relates to the confidentiality of the information contained in the document. For annual reports, all information may be disclosed. For annual surveys, the amount of the tax preference claimed in the prior year is not confidential and may be disclosed. Taxpayers with an amount of tax preference claimed of less than $10,000 may request confidentiality. All other information in the annual survey is confidential. A taxpayer is required to submit an annual report or survey by April 30 of each year. The DOR prepares summary statistics of the data contained within the documents by October 1 of each year.

State law requires a periodic review of most excise and property tax preferences to determine if their continued existence or modification serves the public interest. The enabling legislation assigns specific roles in the review process to two different entities. The job of scheduling tax preferences, holding public hearings, and commenting on the reviews is assigned to the Citizen Commission for Performance Measurement of Tax Preferences (Commission). The responsibility for conducting the reviews is assigned to the staff of the Joint Legislative Audit and Review Committee (JLARC).

The Commission develops a schedule to accomplish a review of tax preferences at least once every 10 years. The Commission is authorized to omit certain tax preferences from the schedule such as those required by constitutional law, the sales and use tax exemptions for machinery and equipment and food, the small business credit for the business and occupation tax, the property tax relief program for retired persons, and tax preferences that the Commission determines are a critical part of the tax structure.

Tax preferences that have a statutory expiration date are scheduled for review before the preference expires. When reviewing tax preferences, the JLARC considers a number of factors including: the public policy objectives of the exemption; whether terminating the tax preference may have negative effects on the category of taxpayers that currently benefit from the tax preference; the extent to which resulting higher taxes may have negative effects on employment and the economy; and the economic impact of the tax preference compared to the economic impact of government activities funded at the same level of expenditure as the tax preference.

Each year the JLARC prepares a final report containing its recommendations as to whether tax preferences reviewed that year should be continued without modification, modified, or terminated. The fiscal committees of the Legislature are required to jointly hold a public hearing to consider the final report.

Washington law provides a state sales and use tax exemption for materials and labor used in the construction of warehouses, grain elevators, or distribution centers. The purchase of material-handling, racking equipment, and installation and repair services for this equipment are also exempt from sales and use tax. An accountability report is not required to be filed by taxpayers taking this exemption.

Summary of Substitute Bill:

The two types of annual accountability reports are consolidated into a single annual survey. All taxpayers currently filing an annual report will begin filing an annual survey beginning in 2013.

Taxpayers must file an annual survey for any tax preference enacted after the effective date of the bill unless otherwise provided in law.

Beginning with annual surveys submitted in 2013, all information contained in the survey is not confidential and may be disclosed. The taxpayer option to request confidentiality for tax preferences of less than $10,000 is eliminated.

The annual survey must include the amount of new capital investment in Washington. "Capital investment" means the cost of land, structures, and other property in Washington that is integral to the activities that qualify the business for the tax preference requiring a survey.

Using the information contained in the annual survey, the Department of Revenue is required to compute the relative tax burden for each taxpayer and the aggregate relative tax burden for all taxpayers claiming a particular tax preference. "Relative tax burden" is the ratio, measured as a percentage, between the amount of tax paid and the amount of tax that would have been paid without the application of the tax preference.

An automatic 10-year expiration date applies to all tax preferences enacted after the effective date of the bill. This automatic 10-year expiration date also applies to the continuation of a tax preference that is set to expire or the expansion of a previously enacted tax preference. Newly adopted, extended, or expanded tax preferences are required to file an annual survey. Bills proposing new, extended, or expanded tax preferences must contain a statement of legislative intent that describes the context making the tax preference necessary and providing measurable public policy objectives. A tax preference includes exemptions, deductions, credits, deferrals, reduced tax rates, and remittances or refunds of tax paid.

The Joint Legislative Audit and Review Committee (JLARC) is required to review a tax preference every 10 years if the tax preference requires an annual survey. The rate of return of a tax preference is added to the list of factors for JLARC consideration when evaluating tax preferences. The rate of return is the ratio of the amount of state taxes that are paid as a result of the tax preference to the amount of state tax savings claimed by taxpayers. Local taxes may be included in the analysis if the tax preference reduces local taxes. The rate of return may be considered only for exemptions where the purpose of the tax expenditure is job creation or retention. The rate of return analysis begins with tax preference reviews starting in 2013.

The JLARC is required to submit draft legislation whenever a tax preference review recommends a modification or termination of a tax preference.

The fiscal committees of the Legislature are required to jointly hold a public hearing no later than the end of the second week of a regular session regarding its most recent tax preference review.

Taxpayers claiming the state sales and use tax exemption for warehouses and grain elevators are required to submit an annual survey beginning in 2012. For 2012 the April 30 filing deadline is extended to October 31.

Taxpayers that use the business and occupation tax deduction on compensation for providing mental health services under a government-funded program are no longer required to file an annual report.

Numerous conforming amendments are made.

Substitute Bill Compared to Original Bill:

The substitute bill extends the automatic expiration date and the Joint Legislative Audit and Review Committee (JLARC) review on newly adopted, extended, or expanded tax preferences from five years to 10 years. The substitute bill adds a requirement that bills proposing new, extended, or expanded tax preferences contain a statement of legislative intent that describes the context making the tax preference necessary and providing measurable public policy objectives. The rate of return of a tax preference is added to the list of factors for JLARC consideration when evaluating tax preferences. Taxpayers claiming the state sales and use tax exemption for warehouses and grain elevators are required to submit an annual survey beginning in 2012.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill takes effect 90 days after adjournment of the session in which the bill is passed, except for section 7, relating to the new consolidated accountability survey, which takes effect January 1, 2013, and sections 45 and 46, relating to the annual survey for the warehouses and grain elevators tax preference, which takes effect July 1, 2012.

Staff Summary of Public Testimony:

(In support) This bill puts a framework in place around Washington's 560 tax exemptions. This legislation is limited to prospective application. The framework is put in place for tax preferences adopted in future legislation. Tax preferences will be more easily quantifiable in terms of the return on investment. The surveys filed by the entities using these preferences might be made simpler so that it is not a burden for them. The bill will provide good transparent access to data. These reporting changes do not include the tax credit for aerospace development expenditures. Today the two types of reports ask for information differently. The confidentiality of data is treated differently in the survey and the report. The bill will make reporting by firms using tax incentives consistent. The new calculation of relative tax burden will allow a comparison of the level of tax preference across businesses and industries. The Legislature needs to get serious about tax exemption control. A number of tax expenditures are exempt from the Joint Legislative Audit and Review Committee review and should be included. Expenditures are subject to a two-year budget cycle. Five years is too long for tax exemptions. This bill moves us forward a little, but is a small step. Tax exemptions should be listed in the state budget.

(Opposed) We request a number of amendments: do not apply the new policy to the continuation of existing exemptions; require a statement of intent for each new exemption; allow a greater stakeholder process to ensure that the data is easily obtainable by the taxpayer; remove the reporting of the amount of products and capital investment since this may not be part of businesses accounting information; retain the confidentially of the data reported by firms; remove the relative tax burden calculation; scale back the penalty for failing to file since it is punitive; and extend the five-year sunset because it is too short and does not work for economic incentives.

Persons Testifying: (In support) Representative Carlyle, prime sponsor; Drew Shirk, Department of Revenue; Steve Zemke, King County Democrats; and Andrew Villeneuve, Northwest Progressive Institute.

(Opposed) Amber Carter, Association of Washington Business.

Persons Signed In To Testify But Not Testifying: None.