HOUSE BILL REPORT
HB 2201

As Reported by House Committee On:
Finance

Title: An act relating to improving fiscal accountability and transparency standards with respect to state tax preferences.

Brief Description: Improving fiscal accountability and transparency standards with respect to state tax preferences.

Sponsors: Representatives Carlyle, Pollet, Jinkins, Tharinger, Ormsby, Walkinshaw and Hudgins.

Brief History:

Committee Activity:

Finance: 1/23/14, 2/11/14 [DPS].

Brief Summary of Substitute Bill

- Consolidates and streamlines the Annual Report and Annual Survey into a single accountability document.
- Increases the availability and consistency on tax preference data reported to the Department of Revenue (Department).
- Authorizes the public disclosure of certain tax information of publicly traded companies annually claiming one or more tax preferences in excess of $10,000, if the tax information was reported to the Department at least 24 months prior to the date of disclosure.

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 9 members: Representatives Carlyle, Chair; Tharinger, Vice Chair; Nealey, Ranking Minority Member; Fitzgibbon, Hansen, Lytton, Pollet, Reykdal and Springer.

Minority Report: Do not pass. Signed by 4 members: Representatives Orcutt, Assistant Ranking Minority Member; Condotta, Vick and Wilcox.

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.

Staff: Jeff Mitchell (786-7139).

Background:

Tax Preferences.
A tax preference confers reduced tax liability upon a designated class of taxpayer. Tax preferences include tax exclusions, deductions, exemptions, preferential tax rates, deferrals, and credits. Currently, Washington has over 650 tax preferences.

Annual Surveys and Reports.
Over the last 10 years, the Legislature has required taxpayers to file the Annual Survey (Survey) or the Annual Report (Report) in order to qualify for a variety of new economic development-related tax preferences, or in some cases, when extending existing economic development-related preferences. There are currently 32 economic development-related tax preferences that require one of these supplemental filings. While the Report and the Survey are similar in that both documents require the annual reporting of employment and wage information, there are a couple of differences. Most notably, the Survey requires the taxpayer to report the tax savings associated with a tax preference requiring the Survey and the taxpayer's savings amounts are subject to public disclosure; however, the Report does not require firm-specific tax savings to be reported. The table below highlights these distinctions:

	Is Employment/ Wage Data Required to be Reported to DOR?	**Is Employment/ Wage Data Subject to Public Disclosure?**	**Are Firm-Specific Taxpayer Savings Reported to DOR?**	**Are Firm-Specific Taxpayer Savings Subject to Public Disclosure?**
Annual Report	Yes	Yes	No	No
Annual Survey	Yes	No	Yes	Yes

In the 2013 session, the Legislature directed the Department of Revenue (Department), in consultation with the Joint Legislative Audit and Review Committee (JLARC), to recommend improvements for the Survey and the Report. The Department made the following six recommendations to ensure more meaningful data is provided, reduce the administrative burden on taxpayers, and improve transparency:

- combine the Report and the Survey into a single tax preference accountability document for all job creation and competitiveness preferences that currently utilize the Survey or the Report;
- eliminate reporting of information that does not help the Legislative Auditor provide meaningful recommendations on the legislation's effectiveness in creating jobs or improving competiveness;

- requires usable tax data accessible from tax returns and employment data. For example, wage bands and detailed breakdowns of job types currently required on the Survey and the Report have been found to be of limited analytical value;
- for sales and use tax deferrals, require taxpayers to file for the calendar year in which they first purchase tax exempt goods and services. Taxpayers participating in current programs are not required to file the Survey until the construction or refurbishment project is certified by the Department as *operationally complete*. This means that certification could occur several years after the initial tax-exempt capital investment is made and the tax benefit is received by the taxpayer. The reporting delay impacts the timeliness of staff analysis of these preferences;
- allow taxpayers to qualify for a preference under an amended return even after the accountability document filing due date. The strict filing deadlines for the Report and the Survey can prevent taxpayers from fully utilizing tax preferences; and
- make disclosure of taxpayer information and disclosure waivers consistent.

<u>Tax Data Collection by the Department of Revenue</u>.
The Department requires tax preferences structured as deductions to be reported on the return. However, taxpayers will sometimes report a net amount. For example, if a taxpayer has gross income of $1 million but is eligible for an $800,000 deduction, taxpayers may report only the net $200,000 amount. Therefore, the taxpayer's tax liability will be correctly reported; however, the $800,000 data point for the deduction will not exist within the Department's taxpayer database.

Currently, sellers, as part of their tax reporting responsibilities, report their aggregate retail sales during the tax reporting period and any associated sales tax collections. Sales exempt from sales tax are also reported in aggregate. A separate tax reporting code does not exist for all sales tax exemptions. Under current law, buyers claiming sales and use tax exemptions do not report exempt amounts to the Department.

<u>Public Disclosure of Tax Information</u>.
Generally, firm-specific tax information is confidential unless a specific exception is provided in the law. Examples of existing exceptions include disclosure of tax information as part of a judicial proceeding and disclosure of tax information to certain federal agencies. As noted above, firm-specific taxpayer savings reported on the Survey is an exception to this general rule as well, and may be disclosed.

Summary of Substitute Bill:

<u>Annual Survey and Annual Report</u>.
The Survey and the Report are consolidated into a single Annual Accountability Report reflecting the recommendations of the Department. More specifically, the consolidated Accountability Report: (1) eliminates reporting of information that does not help the Legislative Auditor provide meaningful recommendations on the legislation's effectiveness in creating jobs or improving competiveness. This would include questions such as the number of patents applied for or tons of product produced; (2) requires useable tax data accessible from tax returns and employment data. For example, requirements to report wage bands and

detailed breakdowns of job types are replaced with average wages for positions within five basic job categories; (3) for sales and use tax deferrals, taxpayers must initially file the Accountability Report in the calendar year in which the firm first purchases tax exempt goods and services; (4) taxpayers are allowed to qualify for a tax preference under an amended return even after the accountability document filing due date; and (5) makes disclosures of taxpayer information and disclosure waivers consistent. Employment data and tax savings data is subject to public disclosure.

Tax Data Collection by the Department of Revenue.
The Department is required to establish unique reporting codes for data tracking for: all business and occupation tax (B&O) and Public Utility Tax (PUT) deductions, all sales and use tax exemptions reported by sellers, and the sales and use tax exemptions reported by buyers required to report tax savings on an addendum. This requirement only applies to returns filed electronically.

A penalty is imposed for taxpayers not reporting sales and use tax savings on an addendum or B&O tax and PUT deductions. The penalty amount is the lesser of: $25 or .05 percent of the unreported amount.

Public Disclosure of Tax Information.
In addition to the public disclosure requirements for the information reported on the new Annual Accountability Report, disclosure is authorized for certain tax information of publicly traded companies if: (1) The taxpayer electronically files a state tax return on a monthly or quarterly basis; (2) the taxpayer claims one or more tax preferences and the annual amount claimed for any single tax preference exceeds $10,000; and (3) the tax information is for a tax reporting period that is at least 24 months prior to the date of disclosure.

The Department is required to provide tax information subject to disclosure on its website in the form of a searchable database and any other format it deems appropriate.

Substitute Bill Compared to Original Bill:

The requirement that buyers submit a sales tax addendum is eliminated. The annual tax preference accountability report is further streamlined to eliminate the reporting of unnecessary information, including information that can be obtained from the Employment Security Department or the Department. The maximum penalty amount for not accurately reporting deductions is reduced from $50 to $25 per reporting period ($300 per year for monthly filers). The assignment of unique reporting codes by the Department for tax preferences is substantially integrated with the Legacy business systems update to reduce costs. The tax information of publicly traded companies that is subject to disclosure is modified as follows:
- Taxable income as opposed to gross income is used.
- With respect to the disclosure of tax preference amounts, only the tax savings from preferential tax rates, tax credits, and the first mortgage deduction may be disclosed.

Appropriation: None.

Fiscal Note: Requested on February 12, 2014.

Effective Date of Substitute Bill: The bill takes effect 90 days after adjournment of the session in which the bill is passed, except for sections 212 and 214 relating to tax rates, which take effect July 1, 2015.

Staff Summary of Public Testimony:

(In support) The purpose of this legislation is to give legislators and the public access to information about the value of a tax preference. Washington has the among the most tax preferences in the country. Economic development tax incentives can be very difficult to evaluate. This bill streamlines the reporting on these incentives. Extraneous data that is not directly linked to assessing efficacy is eliminated. Legislators and the public need context to evaluate tax preferences. Foundational data is needed to allow legislators and the public to properly evaluate tax preferences. This is a modest and reasonable step forward for tax transparency. These are reasonable reforms. This bill represents a small, but significant step toward a more transparent and effective process in evaluating tax preferences. There is little evidence that disclosure of the information provided in this bill would lead to a competitive disadvantage for businesses. Struggling workers in this state are required to disclose much more invasive information. The information is high level and would be of little value to competitors. The benefits of transparency and accountability always outweigh the costs.

(In support with concerns) This legislation adopts a number of recommendations to improve the Survey and the Report, which we support including streamlining. The hope is to be able to pull the data from existing sources and not ask the taxpayer to report it. Under current law, a taxpayer cannot amend a prior return to claim tax incentives that require the Report or the Survey. This proposal allows taxpayers to amend their return and go back and claim a tax incentive for prior years. We support increased accountability and transparency of tax preferences. The information is valuable, but if the Legislature does not act on the data, it does not do anybody any good. The JLARC has reviewed a lot of tax preferences, which the Legislature has largely ignored. We would like to move from a position of concern to being in support. We agree that there should be accurate, timely, and meaningful data to assess tax preferences. It is important that the Legislature and public have the tools before them to make informed decisions. The penalty is excessive and we would encourage modifying it to be more reasonable. The Web Portal should be improved. We have concerns about the reporting requirements in section 201. It would not capture the Stevedoring jobs and many of the other jobs on the waterfront. Therefore, we are not sure the data will be collected that the Legislature needs to evaluate the tax preference.

(Opposed) We support the concept of consolidating and simplifying the Report and Survey; however, we oppose the bill for a number of reasons, including the fact that the Department's recommendations are not fully implemented. This bill increases reporting and record-keeping requirements. We thought that Senate Bill 5882 accomplished a lot of what is being talked about today. We thought we fixed the problem moving forward with respect to future tax preferences. Because state law now requires a detailed tax preference statement, the Legislature will have the appropriate data for understanding future tax incentives, their purpose, and what benefit the state is getting back. This bill will require an investment by the state and we would rather see the money go to the Legacy system update. There is concern about the potential costs by businesses to modify their accounting systems to comply with this bill. Accounting systems don't always capture every piece of information. The bill is looking for perfection in every reporting detail. Furthermore, businesses can be penalized even if the business is paying the correct amount of taxes. Economic development incentives were created to promote job creation. However, this bill will discourage those that don't want to disclose everything to the public. We are very concerned about the disclosure provisions of this bill. Some businesses choose to not claim certain tax incentives because they do not want the information publicly disclosed. The Security and Exchange Commission reporting is not any more cumbersome than what is being reported to Washington for businesses filing the Surveys and the Reports. Businesses are concerned about the reporting requirements associated with resellers permits.

Persons Testifying: (In support) Andrew Nicholas, Washington State Budget and Policy Center.

(In support with concerns) Drew Shirk, Department of Revenue; Steve Zemke, Tax Sanity; Patrick Connor, National Federation of Independent Business; and Lisa Thatcher, Port of Tacoma.

(Opposed) Amber Carter, Association of Washington Business; Sharon Appelt, Darigold; Darcy Kooiker, Ryan Limited Liability Company; and Mark Johnson, Washington Retailer Association.

Persons Signed In To Testify But Not Testifying: None.