

# SENATE BILL REPORT

## SB 5513

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As of February 8, 2018

**Title:** An act relating to increasing tax exemption transparency and accountability.

**Brief Description:** Increasing tax exemption transparency and accountability.

**Sponsors:** Senators Frockt, Hasegawa, Miloscia, Rolfes, Saldaña, Keiser, Wellman, Conway, Chase, Billig, Kuderer, Hunt, McCoy and Darneille.

**Brief History:**

**Committee Activity:** Ways & Means: 1/18/18.

<p><b>Brief Summary of Bill</b></p> <ul style="list-style-type: none"><li>• Creates a tax expenditure budget in the biennial state budget process.</li></ul>
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### SENATE COMMITTEE ON WAYS & MEANS

**Staff:** Jeffrey Mitchell (786-7438)

**Background:** State Operating Budget. The state government operates on a fiscal biennium that begins on July 1 of each odd-numbered year. A two-year biennial operating budget is adopted every odd-numbered year. Appropriations are made in the biennial budgets for the operation of state government and its various agencies and institutions, including higher education and the funding of K-12 public schools.

Governor's Budget Proposal. The Budget and Accounting Act establishes various requirements for the budget documents that the Governor must submit to the Legislature before each regular session. The required documents include the Governor's budget message, which explains the budget and outlines proposed fiscal policies for the period covered by the budget, the budget bill, and other supporting information.

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.

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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.*

Annual Surveys and Reports. Over the last ten 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.

Exemption Study. The Department of Revenue (DOR) must produce and submit a tax exemption report to the Legislature every four years. The report includes a listing of the estimated revenue lost from the exemption and the beneficiary of the exemption. The report also includes the estimated revenue lost for other tax preferences including preferential rates, deductions, and credits. The next report is due in January 2020.

The Citizen Commission for Performance Measurement of Tax Preferences and Joint Legislative Audit and Review Committee: Tax Incentive Reports. The 2006 Legislature established the Citizen Commission for Performance Measurement of Tax Preferences (Commission). The Commission develops a schedule to review nearly all tax preferences at least once every ten years. The Commission also schedules preferences with expiration dates for reviews two years before the tax preference expires. Tax preference reviews are conducted by the Joint Legislative Audit and Review Committee (JLARC) according to the schedule established by the Commission. For each tax preference, the JLARC provides recommendations to continue, modify, schedule for future review, or terminate the preference. The Commission reviews and comments on the JLARC report.

**Summary of Bill:** Washington is required to enact a biennial budget for all discretionary tax expenditures. A framework is established for authorizing, reviewing, and terminating discretionary tax expenditures. A discretionary tax expenditure means an exemption, a deduction, an exclusion from the base of the state tax, a credit against state tax owed, or a preferential tax rate that is not required by the federal or state Constitution or federal law.

The Budget Development Process for the Executive Branch. Previous requirements pertaining to the DOR exemption report are modified.

The DOR is required to prepare a biennial tax expenditure budget. This budget must detail the amount for the current and next biennium in state or local revenues as the result of tax expenditures. This budget will also be updated as part of the supplemental budget process.

The tax expenditure budget must include:

- an estimate of revenue lost from each tax expenditure;
- the purpose of the tax expenditure;
- the persons, organizations, and parts of the population that benefit from the tax expenditure;
- whether or not the tax expenditure conflicts with another state program;
- a ranking of each tax expenditure as high, medium, or low in meeting the state's priorities of government;
- the expiration date of the tax expenditure; and
- the purpose of the tax expenditure along with the results of any review by the JLARC and the Commission.

This tax expenditure budget must be submitted by the DOR to the Governor as part of its biennial budget request. The Governor must review and submit it to the Legislature as part of the required biennial budget documents.

The fiscal committees of the House of Representatives or the Senate, along with the appropriate standing committees, must hold a public hearing of the tax expenditure budget submitted by the Governor and the DOR.

The Governor, the DOR, the JLARC, and the Commission must identify each expenditure that will be set to expire in the next biennium and make a recommendation as to whether the expenditure should be allowed to expire, continue, or continue with modification.

The Legislature and the Biennial State Operating Budget. As part of the biennial Operating Budget, the Legislature must include a tax expenditure budget. The tax expenditure budget must detail all discretionary state tax expenditures with an estimate of the state revenue impact associated with each expenditure. It must also state the purpose of the tax expenditure and the effectiveness of tax expenditure. In addition, there must be a section with the total estimated revenue impact from all discretionary tax the expenditures, total appropriations, and total state expenditures representing the sum of all discretionary tax expenditures and appropriates. Another section must outline the total state revenue impacts from all nondiscretionary tax expenditures. Finally, the Legislature must include the purpose of the exemption or preference and the criteria by which its continuation is going to be evaluated.

The tax expenditure budget must be adopted as part of the Omnibus Appropriations Act. Any tax expenditure not included in the tax expenditure budget in the adopted Omnibus Appropriations Act expires at the end of the calendar year in which the budget was adopted. If adopted as part of the Omnibus Appropriations Act, a tax expenditure expires at the end of that biennium and must be reauthorized with each biennial budget.

The Legislature may expire a tax expenditure earlier than its authorized expiration date by a majority vote, or as part of the budget process in the same manner as any other expenditure is approved or denied.

New Tax Expenditures. No new or existing tax expenditure may be approved or reauthorized by the Legislature for more than ten years. Any new tax expenditures authorized as part of the Omnibus Appropriations Act are subject to the same audit and review procedures and must meet the state's priorities of government.

Citizen Commission for Performance Measurement of Tax Expenditures and The JLARC. The Citizen Commission for Performance Measurement of Tax Preferences becomes the Citizen Commission for Performance Measurement of Tax Expenditures (Citizen Commission). In determining their schedule, the Citizen Commission must include the timely review of any tax expenditure that has a statutory expiration date. The Citizen Commission must allow public comments to be submitted and posted online.

The review criteria for tax expenditures is updated. The JLARC must consider the classes and number of individuals, organizations, and industries whose state tax liabilities are

directly affected by the tax expenditure. In addition, the JLARC must consider the public policy objectives that provide justification for the tax expenditure, including the legislative history and intent, the priorities of government, and the extent of the preference or exemption. The committee must consider, but not be limited to, the following factors:

- any increase in overall state revenues above the tax reduction as the result of the preference increasing economic activity;
- any increase in family wage jobs, the value of which exceeds the subsidy to the beneficiary;
- evidence that the tax expenditure has contributed to any of the public policy objectives and priorities of government;
- the extent to which the continuation of the tax expenditure would contribute to any of the public policy objectives or priorities of government;
- the extent to which the tax expenditure may provide unintended benefits to an individual, organization, or industry other than those the Legislature intended;
- the extent to which terminating the tax exemption may have negative impacts on the category of taxpayer that currently benefit from the tax expenditure, the extent to which there may be negative or positive effects on employment, the economy, the state budget, and other taxpayers;
- the feasibility of modifying or terminating the tax expenditure to provide for the adjustment or recapture of the tax benefits of the tax expenditure if economic benefits, jobs, or other objectives are not fulfilled;
- the fiscal impacts, both past and expected, if the tax expenditure is continued;
- the extent to which termination of the tax expenditure would affect the distribution of state tax liability payments;
- the economic impact of the tax expenditure as compared to the economic impact of government activities that could have been funded by the tax for which the tax expenditure is taken, utilizing the Washington input-output model or other economic models accepted by OFM;
- the extent that the tax expenditure promotes a sustainable nonpolluting economy and contributes to protecting the environment and our quality of life;
- a ranking of high, medium, or low priority as to the tax expenditure meeting the most recent Priorities of Government developed by OFM;
- the extent to which the tax expenditure contributes to tax fairness and a reduction in the regressive impacts of the current tax system in Washington;
- the opportunities and feasibility to use direct budget expenditures, instead of tax expenditures, to accomplish economic goals more efficiently, effectively and within a set time frame; and
- whether the tax expenditure is necessary to accomplish its stated goal or if finances, funds or other resources, or other opportunities are available to the recipient to accomplish the same result.

For each tax expenditure, the JLARC must provide a recommendation as to whether the tax expenditure should be continued without modification, modified, scheduled for sunset review at a future date, or terminated immediately.

The JLARC's review must include whether the expenditure has a purpose identified in the tax expenditure budget. If the purpose is to generate additional state or local revenue by generating additional gross sales for the B&O tax, retail sales, or other taxes exceeding the

estimated revenue lost, the review must include how much additional revenue has been generated in comparison to the reduction in revenue attributable to the tax expenditure. If the purpose is to create or preserve jobs, the JLARC must include a comparison of the projected total earnings per job for each job created or preserved to the estimated amount of lost revenue from the tax expenditure. It must also indicate if the jobs are family wage jobs and whether the industry or business would likely move the jobs to another state or country, taking into consideration comparative tax structures and access to an educated and trained workforce. A family wage job is defined as a job that provides health and other benefits and earnings of at least 50 percent of the median wage for the local economic region where the jobs were created or preserved.

If the review by the JLARC does not demonstrate that the net earnings of the jobs created or preserved are attributable to the tax expenditure, or exceed the amount of lost revenue from the tax expenditure, the JLARC must recommend the tax expenditure be terminated.

The report timing for the JLARC and the Commission are updated, as is the timing of the final report to the Legislature.

**Exempt Tax Expenditures.**

If a tax expenditure is required under the Washington Constitution, the United States Constitution, or federal law, then it does not need to be included in the biennial tax expenditure budget.

**Appropriation:** None.

**Fiscal Note:** Available. New fiscal note requested on January 14, 2018.

**Creates Committee/Commission/Task Force that includes Legislative members:** No.

**Effective Date:** The bill contains an emergency clause and takes effect immediately, except Section 3, referring to requiring a biennial tax exemption study by the Department of Revenue, which takes effect July 1, 2018.

**Staff Summary of Public Testimony:** PRO: There are a lot of things going on in the bill and all of these issues should be open for consideration. At the core, this bill is about having a little more transparency by having a formal tax expenditure budget. It is time to take a real look at tax expenditure accountability, especially in light of the reduced federal corporate tax rate. We need to think about tax reform holistically and this would be a tool to help us with that. This bill would help create a more transparent, rationale, and comprehensive budget process in which the cost and benefits of tax exemptions would be balanced with other budget needs. Under this bill, tax breaks that are truly needed would be reauthorized whereas tax breaks that are outdated or obsolete would provide funds for other high priority needs such as the opioid crisis. Things are a little out of whack where a person receiving state funds for basic needs has to constantly establish that they are using the money appropriately whereas a business receiving a large tax break does not have to prove it is creating jobs. State lawmakers should create a tax structure that is as rationale, comprehensive, and transparent as possible because of the many challenges the state faces. There is very little evidence to support the idea that renewing tax breaks every couple of

years will cause uncertainty and hurt the economy. Washington gives away more in tax breaks than it collects in tax revenues. This is a broken system. We have tax breaks that take away \$30 billion. For far too long, Washington has prioritized keeping taxes low on the 1 percent while everyone else pays. Washington has over 700 tax breaks and little or no data as to whether these tax breaks work.

CON: The section of the bill that would require reauthorization for tax expenditures would create great uncertainty. There are 64 tax expenditures for the agricultural industry, which is a \$49 billion industry employing 145,000 in Washington with \$15 billion exported. There is a question about whether it is wise to upset the business planning of this industry every couple of years. The name change of the commission concerns us. The business community does not agree that a tax exemption is necessarily equivalent to foregone government expenditures. Many tax exemptions make necessary adjustments to our tax code.

**Persons Testifying:** PRO: Senator David Frockt, Prime Sponsor; Steve Zemke, Director, Tax Sanity; Nick Federici, All In For Action; Andy Nicholas, Washington Budget & Policy Center; Melissa Taylor, citizen; Jon Culver, Washington's Paramount Duty; Max Culver, Lake Forest Park Elementary; Steve Clagett, Faith Action Network.

CON: Clay Hill, Association of Washington Business.

**Persons Signed In To Testify But Not Testifying:** No one.