

HOUSE BILL REPORT

HB 2762

As Reported by House Committee On: Ways & Means

Title: An act relating to tax expenditure reform to provide transparency and accountability in fiscal matters.

Brief Description: Concerning tax expenditure reform to provide transparency and accountability in fiscal matters.

Sponsors: Representatives Carlyle, Anderson, Kagi, Orwall, Springer, Seaquist, Dickerson, Sells, Appleton, Fitzgibbon, Reykdal, Ormsby, Wylie, Ryu, Pollet, Sullivan, Hasegawa, Roberts, Hansen, Jinkins and Goodman.

Brief History:

Committee Activity:

Ways & Means: 2/29/12, 3/1/12, 3/3/12 [DPS].

Brief Summary of Substitute Bill

- Repeals most sales and use tax preferences and business and occupation tax preferences in five stages, beginning in 2017.
- Consolidates the annual accountability surveys and reports into a single document.
- Refers measure to the voters for their approval at the next general election.
- Requires new, extended, or expanded tax preferences to contain a statement of legislative intent.
- Requires taxpayers claiming the warehouse and grain elevator sales and use tax exemption to file an annual survey.
- Incorporates expiring state tax preference into the budget documents.

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,

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 10 members: Representatives Alexander, Ranking Minority Member; Bailey, Assistant Ranking Minority Member; Dammeier, Assistant Ranking Minority Member; Orcutt, Assistant Ranking Minority Member; Chandler, Haler, Parker, Ross, Schmick and Wilcox.

Staff: Rick Peterson (786-7150).

Background:

Washington imposes two general types of taxes: property and excise. Property taxes consist of annual payments by owners of real property (land and structures), and personal property. Property taxes are measured by the value of the property – i.e., an ad valorem tax determined either by the fair market value of the property or a statutory assessment formula. Property taxes are the oldest form of general taxation in this country and are levied in all states. Excise taxes include virtually every other type of tax. Although there is not a uniform definition of excise taxes, generally, these taxes are imposed on a specific transaction or activity. In Washington, most excise taxes are measured by the selling price or some other measure of sales such as gross receipts. The retail sales tax is the single largest excise tax levied in this state. The major state business tax is the business and occupation (B&O) tax. Other excise taxes include selective sales taxes on specific products (cigarettes, gasoline, etc.) and various taxes which are levied in lieu of the property tax (harvested timber, leaseholds, etc.). The retail sales tax and B&O tax account for approximately 72 percent of State General Fund revenue.

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." The Department of Revenue (DOR) produces a listing of tax preferences every four years. The most recent report was published in 2012. The tax preferences report describes each exemption, the year of enactment, the purpose of the exemption (or the DOR's best estimate of the purpose), an indication of primary beneficiaries, and estimated fiscal impact. Currently, state law authorizes 640 tax preferences. One-third of them have been enacted since 2000. The 2012 Tax Exemption Study estimated the impact of 452 exemptions that would likely increase revenue if eliminated. The tax preferences enacted after 2000 represent about 10 percent of the total taxpayers' saving from the tax preferences included in the 2012 study.

In recent years the Legislature has enacted or extended numerous tax preferences that require the annual reporting of information to the 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.

Washington law provides a sales and use tax exemption for the construction of warehouses, grain elevators, and distribution centers, and the purchase of material-handling and racking equipment and installation and repair services for this equipment. Taxpayers utilizing this preference are not required to file an annual survey.

Legislation enacted in 2006 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 B&O tax, the property tax relief program for retired persons, and tax preferences that the Commission determines are a critical part of the tax structure.

The JLARC prepares a final, yearly report containing its recommendations as to whether tax preferences reviewed that year should be continued without modification, modified, or terminated. The JLARC has reviewed 121 tax preferences since the review process began in 2006.

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.

Summary of Substitute Bill:

A schedule is established to repeal most tax preferences for state and local retail sales and use taxes and the state business and occupation (B&O) tax. The tax preference repeal process will take place over five stages. The first group of tax preferences is repealed on July 1, 2017. This group is comprised of tax preferences that have received a review by the Joint Legislative Audit and Review Committee. The second group is repealed July 1, 2019. This group includes the tax preferences for nonprofit organizations and governmental activities. The third group is repealed on July 1, 2021. This group is comprised of tax preferences for businesses, including farm and agriculture, and exemptions for nonresidents. The fourth group of tax preferences is scheduled for repeal on July 1, 2023. This group provides tax preferences for items typically consumed by households. The fifth and final group of tax preferences is repealed on July 1, 2025. These are tax preferences for health-care related items and services for low-income individuals. Tax preferences that are constitutionally mandated or already scheduled for expiration are not included in the 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 with tax savings less than \$10,000 are not required to file the annual survey. The amount of tax savings will be publically available but the economic information contained in the survey will be confidential.

Legislation that renews an expiring tax preference, expands a tax preference, or creates a new tax preference must include a statement of legislative intent. The intent must state the policy goals and related metrics that provide context or data for use in reviewing the tax preference.

Taxpayers claiming the state sales and use tax exemption for warehouses and grain elevators are required to submit an annual survey.

The measure is referred to the voters for their approval at the next general election. The concise description on the ballot title is specified: "This bill would provide transparency and accountability to the tax code by periodically expiring tax preferences and using revenue from expired tax preferences to fund education and health services."

The Governor's budget proposal and supporting documents must include a list of tax preferences expiring budget documents. The Department of Revenue tax preferences report is produced every two years and is included in the supporting documents for the Governor's biennial budget.

Substitute Bill Compared to Original Bill:

The substitute bill adds the following items: modifies the intent section; incorporates expiring tax preferences into the state budget documents; consolidates the annual accountability surveys and reports into a single document; exempts a taxpayer claiming less than \$10,000 in tax savings from the annual survey requirement; requires taxpayers claiming the state sales and use tax exemption for warehouses and grain elevators to submit an annual survey; requires new, extended, or expanded tax preferences to contain legislative intent; increases frequency of tax preferences report to once every two years; requires list of expiring tax preferences in budget documents; and adds a referendum clause.

Appropriation: None.

Fiscal Note: Available. New fiscal note requested on March 3, 2012.

Effective Date of Substitute Bill: Upon voter approval at the next general election, the bill takes effect 30 days after the election.

Staff Summary of Public Testimony:

(In support) This bill is about consistency. Virtually every bill discussed in the Legislature mentions transparency and accountability. The core driver is to make the default one of expiration and renewal so that each tax preference can be evaluated to see it works. Is there a return on investment for taxpayers? This is about the process of creating preferences in the state tax system. There needs to be a feedback loop between the policy enacted and its impact on the real economy. Creating expiration dates in the future allows a level of certainty for taxpayers and also allows the Legislature to renew or not after reviewing the evidence. The state economy needs to be flexible. To lock in an exemption in perpetuity is not economically competitive. The bill is a long-term structural change. Narrow tax preferences are similar to spending programs and should be reviewed like program expenditures. Most tax preferences will be renewed but they need to be reviewed. The metrics of why certain tax preferences are put into law need to be looked at. Tax preferences, like agencies and programs, need to be transparent and accountable. Many tax preferences are outdated and made obsolete by technology and economic progress. Some employers have benefited from tax preferences but have closed facilities and left the state. There should be claw-backs of these tax preferences. Washington's tax system is arcane and changes are in order. What is the goal of these tax preferences? The Legislature needs make it clear.

(Opposed) The bill creates an uncertain tax code caused by a sunset of all these tax preferences. Tax preferences are an integral part of the tax code to address competitive tax issues and high tax rates. This is a simplistic approach. Individually, each tax preference is worthy of review and many have been reviewed by the Joint Legislative Audit and Review Committee (JLARC), and the JLARC has recommended continuation. This bill ignores the review process established by the Legislature. The bill goes against what the voters intended when they approved Initiative 1053.

Persons Testifying: (In support) Representative Carlyle, prime sponsor; Representative Anderson; Andy Nicholas, Budget and Policy Center; Nick Federici, Our Economic Future Coalition; Dennis Eagle, Washington Federation of State Employees; Jean Squires, Parents Organizing for Welfare and Economic Rights; Bob Cooper, National Association of Social Workers Washington Chapter; Larry Shannon, Washington State Association for Justice; Sean O'Sullivan, Association of Western Pulp and Paper Workers; Robert Whitlock, Olympia Fellowship of Reconciliation; and Pat Holm, Fuse Washington.

(Opposed) Amber Carter, Association of Washington Business; Tim Eyman; and Denny Eliason, Washington Bankers Association.

Persons Signed In To Testify But Not Testifying: None.