

HOUSE BILL REPORT

ESHB 1869

As Passed House:

February 2, 2004

Title: An act relating to performance audits of tax preferences.

Brief Description: Requiring performance audits for tax preferences.

Sponsors: By House Committee on Finance (originally sponsored by Representatives McIntire, Gombosky, Morris, Conway, Santos, Haigh, Kagi, Hunt, Linville, Dunshee, Chase, Simpson, G., Moeller, Lovick, Cody, Murray, Upthegrove, Veloria and Wood).

Brief History:

Committee Activity:

Finance: 2/21/03, 3/10/03 [DPS].

Floor Activity:

Passed House: 3/18/03, 59-38.

Floor Activity:

Passed House: 2/2/04, 58-40.

Brief Summary of Engrossed Substitute Bill

- Creates a citizen commission to develop a schedule for review tax preferences such as exemptions, exclusions, deductions, credits, deferrals, and preferential rates.
- Requires review of all tax preferences except those required by constitutional law or determined be a critical part of the structure of the tax system.
- Requires the Joint Audit and Review Committee to conduct the actual reviews of tax preferences, according to criteria set in the bill.
- Requires annual reports to the Legislature on reviewed tax preferences.

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 5 members: Representatives Gombosky, Chair; McIntire, Vice Chair; Conway, Morris and Santos.

Minority Report: Do not pass. Signed by 4 members: Representatives Cairnes, Ranking Minority Member; Orcutt, Assistant Ranking Minority Member; Ahern and Roach.

Staff: Bob Longman (786-7139).

Background:

Tax exemptions, exclusions, deductions, credits, deferrals, and preferential rates are known as tax preferences. The Department of Revenue publishes a report on tax preferences every four years. The report covers more than 400 tax preferences and describes each preference, the year of enactment, the purpose of the preference (or the department's best guess), an indication of primary beneficiaries, and estimated fiscal impact.

In 1982 the Legislature enacted legislation that initiated a sunset review of tax preferences. The legislation directed the Joint Select Committee on Sunset to prepare a bill that would terminate all tax preferences over a period of four years. If this termination bill had been subsequently enacted, the Legislative Budget Committee (LBC) (now known as the Joint Legislative Audit and Review Committee (JLARC)) would have been required to review each preference before its termination date and report back to the Legislature. The termination and review bill was not enacted, and the LBC did not conduct tax preference reviews.

Summary of Engrossed Substitute Bill:

The citizen commission for performance measurement of tax preferences (commission) is created, with two nonvoting members and five voting members. The state auditor and the chair of the joint legislative audit and review committee are nonvoting members. The chair of each of the two largest caucuses of the senate and the two largest caucuses of the house of representatives shall each appoint a voting member. None of these appointees may be members of the legislature. The governor shall select the seventh member.

The commission must develop a schedule for review of tax preferences at least once every 10 years. The commission is to schedule all tax preferences for review, except those required by constitutional law and those the commission determines are a critical part of the structure of the tax system. An expedited review may be provided for tax preferences with an estimated biennial fiscal impact of \$10 million or less. The commission must provide a process for effective citizen input during its deliberations. A special report on a shorter time line is required for tax preferences that expire before January 1, 2005.

The JLARC must review tax preference according to the 10-year schedule developed by the commission. The JLARC is to consider, but not be limited to, the following factors in the review:

- (a) The classes of individuals, types of organizations, or types of industries whose state tax liabilities are directly affected by the tax preference;

- (b) Public policy objectives that might provide a justification for the tax preference, including the extent to which the preference encourages business growth or relocation into this state, promotes growth or retention of high wage jobs, or helps stabilize communities;
- (c) Evidence that the existence of the tax preference has contributed to the achievement of any of the public policy objectives;
- (d) The extent to which continuation of the tax preference might contribute to any of the public policy objectives;
- (e) The feasibility of modifying the preference to provide for adjustment or recapture of the tax benefits of the preference if the objectives are not fulfilled;
- (f) Fiscal impacts of the tax preference, including past impacts and expected future impacts if it is continued;
- (g) The extent to which termination of the tax preference would affect the distribution of liability for payment of state taxes; and
- (h) Consideration of similar tax preferences adopted in other states, and potential public policy benefits that might be gained by incorporating corresponding provisions in Washington

For each tax preference, the JLARC must provide a recommendation as to whether the tax preference should be continued without modification, modified, scheduled for sunset review at a future date, or terminated immediately. The committee may recommend accountability standards for the future review of a tax preference.

The JLARC will submit a report to the citizen commission by August 30 of each year. The citizen commission will submit a report to the House Finance and Senate Ways & Means committees by December 30th of each year. The legislative committees are to hold a joint hearing on the report.

Staff support to the commission is provided by the JLARC, and the Department of Revenue and Employment Security Department are directed to provide information needed by the citizen commission or JLARC.

Statutes relating to the unimplemented 1982 tax preference review are repealed.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect 90 days after adjournment of session in which bill is passed.

Testimony For: This bill requires a regular review of tax exemptions to see if the objectives are being met. The bill does not sunset any tax preferences. It provides an opportunity to

fine-tune exemptions over time. Just as government should prioritize government expenditures, it should prioritize tax exemptions. Taxpayers deserve to know exemption dollars are spent wisely. Tax exemptions are expenditures of public money, the same as a budget appropriation, and should get the same scrutiny. Tax exemptions are hidden government spending. Unlike the budget, tax exemptions never end. However, existing sunset clauses should be taken off of important existing exemptions. Accountability studies must respect the important goals of tax incentives and be fair. The world is rapidly changing, especially technology. Washington's tax incentives must keep up with changes to be effective in the world economy. We must get past "loophole" thinking and provide incentives that work. It is important to have public participation in the review process. The commission should be able to set the length of time between reviews. Administration of tax laws would benefit from reviews that help determine the legislative intent behind tax incentives. Some other states have done some really good work in disclosure of taxpayer information that helps determine whether tax incentives are working. We should be concerned about the impact on revenue and living wage jobs that add to the health and well being of the state and its citizens.

Testimony Against: These tax preferences are all really expenditures and should be listed in the Governor's budget. To regain the public's trust, we should talk about these hidden expenditures. If trends continue, corporations won't be paying any taxes at all. Intangibles need to be examined; they are the fast growing element of the economy.

Testified: (In support) Representative McIntire, prime sponsor; Bev Hermanson, Washington Federation of State Employees; Scott Noble, Washington State Association of County Assessors; Scott Taylor, Washington Public Ports Association; Ron Newbry, Washington Economic Development Association; Ellie Menzies, Service Employees International Union, State Council; Randy Parr, Washington Education Association; Jeff Johnson, Washington State Labor Council, AFL-CIO; and Reverend Paul Benz, Lutheran Public Policy of Washington State and Washington Association of Churches.

(Comments) Tom Sykes, Joint Legislative Audit and Review Committee; and Julie Sexton, Department of Revenue.

(Opposed) Maria Cain, Asia Pacific Environmental Exchange.