



STATE OF WASHINGTON

September 26, 2016

TO: Keenan Konopaski, Legislative Auditor
Joint Legislative Audit and Review Committee

FROM: Vikki Smith, Director
Department of Revenue

David Schumacher, Director
Office of Financial Management

SUBJECT: JLARC PRELIMINARY REPORT ON 2016 TAX PREFERENCE PERFORMANCE REVIEWS

The Washington State Department of Revenue (DOR) and the Office of Financial Management (OFM) appreciate the opportunity to review and comment on the Joint Legislative Audit and Review Committee's (JLARC) preliminary report on the 2016 tax preference performance reviews.

We believe that continuous review of state tax preferences is important to help the state of Washington maintain a fair and equitable tax system. We appreciate the thorough analysis that has once again been done by JLARC and the Citizen Commission for Performance Measurement of Tax Preferences (Commission).

While we have no specific concerns with the 2016 report, we want to provide comment in four specific areas:

1. The recommendation to repeal both the syrup tax and the associated business and occupation (B&O) tax credit,
2. Incomplete or inaccurate data provided on the Buyer Addendum,
3. Availability of the most recent year's annual survey data, and
4. The tax incentive review and enforcement process.

Recommendation to Repeal Syrup Tax and Associated B&O Tax Credit

Businesses that sell soft drinks they make using carbonated beverage syrup may take a credit against their B&O tax liability for the amount of syrup tax they have paid on their purchases of carbonated beverage syrup.

The Legislative Auditor is recommending that both the syrup tax and associated B&O tax credit be repealed because (1) they are not providing all of the intended relief for businesses that buy syrup and (2) the Legislature made the policy decision that syrup tax revenues no longer would be dedicated to the Violence Reduction and Drug Enforcement (VRDE) account (which was subsequently eliminated).

Comments:

- While the B&O tax credit associated with the syrup tax clearly is a tax preference, DOR notes that the syrup tax itself is not a tax preference.
- DOR also notes that most of the other new or additional taxes that were imposed in 1989 along with the syrup tax are still in existence despite elimination of the VRDE account.

Incomplete or Inaccurate Data Provided on Buyer Addendum

Buyers using any sales and use tax exemptions enacted after August 2013 must complete a Buyer Addendum for their tax exemption purchases if:

- they are required to register with DOR;
- they are required to electronically file monthly or quarterly tax returns with DOR; and
- the tax benefit to the buyer is \$1,000 or more per calendar year.

JLARC staff reviewed Buyer Addendum data for several of the tax preferences reviewed this year for items purchased in fiscal years 2014 and 2015 and have reached the following conclusions:

- Many businesses have inaccurately reported data on the Buyer Addendum.
- Many businesses have failed to properly file a Buyer Addendum.
- Many businesses that benefit from these preferences may not have a registration or tax return filing responsibility and may not be required to file a Buyer Addendum.

DOR agrees with the conclusions reached by JLARC staff and experiences the same challenges when asked to estimate the impact of incentive programs that require a Buyer Addendum. The statute that requires this reporting does not provide DOR with enforcement tools, such as penalties for failure to file. DOR will continue to work with JLARC staff to identify ways to improve this data.

Availability of Most Recent Year's Annual Survey Data

Within the review of the data center equipment sales and use tax exemption, a reference is made to annual survey data that was unavailable as of April 30, 2016. The annual survey provides information on the amount of the beneficiary savings for certain tax preferences. The due date for annual survey and report filing this year was April 30. It takes DOR approximately 30 days to receive and validate the data before it is available.

This problem will be magnified for future reviews, as the Legislature has extended the due date for annual survey and report filing to May 31 for future years. Taxpayers with approved extensions will not be required to file until August 31. DOR has created a new process and schedule for publishing this information. However, the first publication will not occur until June 30, and extension data will not be available until September 30.

The annual survey data is published on DOR's website once available. It is available in list format at [Tax Incentive Public Disclosure Reports](#). It also can be viewed interactively at [Tax Incentive Public Disclosure Survey Data](#).

Tax Incentive Review and Enforcement

DOR is in agreement with JLARC staff regarding various existing data reporting issues and the difficulty this creates when trying to analyze incentive programs. DOR experiences these same challenges when completing statutorily required reports, such as the Tax Exemption Study.

DOR has proactively developed the following processes to enforce correct tax incentive use through return and account examination, audits, incentive program oversight, and monitoring of reports as filed:

- Returns are reviewed holistically and include a review of any identified errors or adjustments.
- Taxpayer reporting is checked to ensure it is appropriate for the business description and North American Industry Classification System (NAICS) code.
- Deductions, credits and other incentives are reviewed to ensure those taken are appropriate for the business activity.
- An examination may include contact with the taxpayer or a referral for a field audit depending on circumstances surrounding the account.
- Specific resources are dedicated to review certain tax incentive programs that require more administrative oversight such as applications, monitoring of caps, or an approval process before the incentive can be used.
- Routinely and by special request, reports are generated that identify businesses using certain incentive programs to ensure use is appropriate for the business activity.

We commend the Commission for its practice of developing a 10-year plan for the review of tax preferences. This has allowed us to develop processes to ensure we have the most complete data possible for JLARC staff for their reviews.

Thank you again for the opportunity to review and provide comments on this JLARC report.