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DEPARTMENT OF REVENUE
OFFICE OF THE DIRECTOR

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December 31, 2013

TO: Hunter Goodman, Secretary
Washington State Senate

Barbara Baker, Chief Clerk
Washington State House of Representatives

FROM: Carol K. Nelson, Director
Department of Revenue

SUBJECT: **REPORT ON ANNUAL SURVEY AND ANNUAL REPORT**

This report provides recommendations for improvements to certain annual filings required of taxpayers in order to claim a variety of existing tax preferences. The filings are the annual survey identified in RCW 82.32.585 and the annual report identified in RCW 82.32.534.

These recommendations should provide more meaningful data, reduce the administrative burden on taxpayers, and improve transparency. The recommendations include:

- Combining the annual report and annual survey into a single tax preference accountability document;
- Requiring reporting of certain employment and tax information and eliminate reporting of unnecessary information;
- For certain preferences, requiring taxpayers to file earlier than required under current law;
- Allowing taxpayers to qualify for a preference through amended returns; and
- Creating consistent confidential and public information disclosure standards.

If you have any questions on the report, please contact Drew Shirk, Assistant Director of the Legislation and Policy Division, at (360) 534-1547.

cc: Members, Senate Ways and Means Committee
Members, House Appropriations Committee
Members, House Finance Committee
David Schumacher, Director, Office of Financial Management
Keenan Konopaski, Legislative Auditor, Joint Legislative Audit and Review Committee



Recommendations to Update and Improve Annual Surveys and Reports

ESSB 5882 §1801, Laws 2013

December 31, 2013
Report to the Legislature
Carol Nelson, Director

Purpose

In the 2013 session, the Legislature directed the Department of Revenue, in consultation with the Joint Legislative Audit and Review Committee (JLARC), to recommend improvements for two different supplemental annual filings required of taxpayers in order to qualify for certain existing tax preferences.¹ The supplemental filings are the annual survey identified in RCW 82.32.585 (the “Annual Survey”) and the annual report identified in RCW 82.32.534 (the “Annual Report”).

In the same legislation, the Legislative Auditor was tasked with recommending ways to improve information collected for evaluating tax preferences.² The following report contains recommendations on improving information with respect to existing tax preferences where the statute requires the taxpayer to submit a tax preference report or survey. A similar but different challenge is addressed in the Legislative Auditor’s report: ways to improve the information to evaluate new preferences, suggesting statutory language and approaches for the Legislature to use for new preferences established in the future.

Although the specific areas of focus are different, our two offices have worked together to ensure the reports complement each other. Please refer to the Legislative Auditor’s report if you are interested in their recommendations for ways to improve the information to evaluate new preferences.

The Annual Report and Annual Survey: Background and Content

Over the last 10 years, the Legislature has required taxpayers to file the Annual Survey or the Annual Report in order to qualify for a variety of new tax preferences, or in some cases, when extending existing preferences. There are currently more than two dozen preferences that require one of these supplemental filings.

The Annual Report was first introduced as part of the original aerospace preference package passed by the Legislature and signed into law in December 2003. The Report requires information on the salaries and benefits provided to taxpayers’ employees in Washington State, as well as information on the quantity of incentivized products produced in Washington. Most

¹ ESSB 5882, 2013 2nd sp.s. c 13 § 1801. The full text of this section of the legislation is included in Appendix A.

² ESSB 5882, 2013 2nd sp.s. c 13 § 1703. The full text of this section of the legislation is also included in Appendix A.

of the information in the Annual Report is specifically identified as public information (not confidential taxpayer information).

The Annual Survey was first required for the high technology B&O tax credit and high technology deferral when those preferences were extended in 2004. The Annual Survey requires taxpayers to provide the amount of any tax preference claimed each year, in addition to information on employment and other items specific to the particular incentive claimed. Except for the tax preference amount, which is public, information reported under the Annual Survey is confidential taxpayer information. A chart comparing the information required on the Annual Report and the Annual Survey is included in Appendix B.

Prior to 2010, the Department of Revenue was required to prepare an annual summary of descriptive statistics for the Legislature from the data collected on the Annual Survey. The Department also provided periodic reports, using data from both the Annual Survey and Annual Report, on job growth, company growth, and other measures of economic development. These periodic reports and the annual summary of descriptive statistics have been eliminated because the same type of analysis is now provided under JLARC's annual report to the legislature on tax preferences.³

General Concerns

Taxpayers have expressed concerns that both the Annual Survey and Annual Report are complex and time-consuming. One particular issue is the complexity of completing a form that requires significant input from a business's tax or accounting department as well as its human resources department.

Another taxpayer concern relates to the strict filing date requirements for the Annual Report and Annual Survey. Both the Annual Report and Annual Survey must be filed by April 30th of the year following the calendar year in which a taxpayer claims the preference. Under current law, a taxpayer cannot claim the preference for a prior tax period if it has not already filed the required Annual Report or Annual Survey.

³ In 2006, the legislature enacted Chapter 43.136 RCW charging JLARC with reviewing all "tax preferences" in an orderly manner, providing a report to the legislature, and making recommendations on whether the tax preference should be continued. The term "tax preferences" is defined broadly and encompasses hundreds of exemptions, deductions, preferential rates, etc., including those requiring an Annual Survey or Annual Report.

Another area of concern is that the Annual Report and Annual Survey contain sensitive business information, and that similar or identical employment information is treated inconsistently in the two filings (for example, treated as public information in the Annual Report, but as confidential information in the Annual Survey).

But most significantly, JLARC staff confirm that often the information collected under the Annual Report and Annual Survey is not of significant analytical value for the purposes of performing a comprehensive review or providing the Legislature with recommendations on a tax preference. The information and data currently gathered on both filings are not adequate, and are in some cases, unnecessary. For example, some current preference-specific questions, such as the number of patents applied for or tons of product produced, cannot be utilized to provide reliable conclusions on the economic effect of the preferences.

Recommendations

After consultation with the Legislative Auditor, the Department of Revenue makes the following recommendations for improvement of the Annual Survey and Annual Report. These recommendations should provide JLARC staff and the Legislature with more meaningful data, reduce the administrative burden on taxpayers, and improve transparency.

It should be noted that these recommendations apply to the reporting requirements for tax preferences currently required to file an Annual Survey or Annual Report, or tax preferences intended to create jobs or improve industry competitiveness.

I. Combine the Report and Survey into a single tax preference accountability document for all job creation and competitiveness preferences that currently utilize one of these reporting mechanisms.

The Annual Report and Annual Survey can be combined into a single tax preference accountability document, eliminating the public disclosure inconsistencies and simplifying the statutory scheme. This would also resolve duplicate filing requirements where, as a result of the transparency provisions of recent legislation, taxpayers claiming certain tax preferences must file both an Annual Report as well as an Annual Survey.⁴

⁴ For a tax preference expanded or extended after August 1, 2013, a taxpayer claiming the preference must file an Annual Survey even if the statute that originally created the tax preference already requires the taxpayer to file an Annual Report. See ESSB 5882, 2013 2nd sp.s. c 13 § 1702(5). The text of this section of the legislation is included in Appendix A.

2. Eliminate reporting of information that does not help the Legislative Auditor provide meaningful recommendations on the legislation's effectiveness in creating jobs or improving competitiveness.

Preference-specific questions, such as number of patents applied for or tons of product produced, can be eliminated from the report without impacting JLARC staff's analysis or the Legislative Auditor's recommendations to the Legislature. Instead, the filing could capture specific employment-related and tax benefit data, identified in Recommendation #3, below, to allow meaningful analysis of a tax preference's impact on family wage jobs or industry competitiveness.

3. Require useable tax data accessible from tax returns and employment data.

While some useable employment data can be obtained from reports that taxpayers file with the Employment Security Department (ESD), additional information may be needed for some preferences when the Legislature is interested in examining the quality of Washington jobs at businesses that claim a tax preference. JLARC staff indicated that wage bands and detailed breakdowns of job types currently required on the Annual Survey and Annual Report are of limited analytical value for that purpose.

JLARC staff have suggested that more useful information would include:

- Average wage for all positions within four or five basic job categories (e.g. management, production, clerical);
- The percent within those basic categories covered by health insurance;
- The percent within those basic categories covered by retirement plans.

Also, JLARC staff have indicated they may not be able to disclose the results of analysis of ESD data for some preferences due to ESD disclosure limitations.

4. For sales and use tax deferrals, require taxpayers to file for the calendar year in which they first purchase tax exempt goods and services.

The deferral programs provide a contingent exemption from sales and use tax on the construction or refurbishment of a facility that will be used for a qualifying activity. Taxpayers participating in current programs are not required to file an Annual 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 received by the taxpayer. This delay is inconsistent with other tax preference benefit reporting, which requires taxpayers to complete an Annual Survey or Annual Report in any year after

they claim a preference (receive the benefit of the preference). The reporting delay also impacts the timeliness of JLARC staff's analysis of these preferences.

5. 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 Annual Report and Annual Survey can prevent taxpayers from fully utilizing tax preferences. However, there is no substantive reason beyond the current statutory language for this to be the case. The information necessary to evaluate a preference could still be captured if the taxpayer submits accountability information when it files an amended return. Analysis of the preference is not unduly impacted if the necessary information is filed along with the amended return within the four-plus-current-year non-claim period. This is an important issue to the business community.

6. Disclosure of taxpayer information and disclosure waivers should be consistent.

The Department has no specific recommendation regarding whether taxpayer information provided for an annual accountability filing should be subject to public disclosure. However, the Department strongly recommends that all tax incentives requiring an annual accountability filing, and all "new tax preferences" under RCW 82.32.805, have consistent disclosure requirements. Under current law, information obtained under some preferences can be disclosed while similar information under other preferences cannot be disclosed, or may only be disclosed after a period of two years. This inconsistency creates administrative difficulties and concerns for the Department and potentially, confusion and concerns for taxpayers as well.

Conclusion

This concludes the Department's report to the Legislature. The Department is available to answer questions related to any of its recommendations or assist legislative staff if desired.

Appendix A

ESSB 5882, 2013 2nd sp.s. c 13 § 1801, § 1703, & 1702(6)(a)

§ 1801

By December 1, 2013, the department of revenue, in consultation with the joint legislative audit and review committee, must make recommendations to the appropriate fiscal committees of the legislature on ways to update and improve the annual report and annual survey. The recommendations must include suggested revisions to the report and survey that would make the data more relevant and reduce the administrative burden on the taxpayer.

§ 1703

(1) The legislative auditor, with the assistance of a task force, must make recommendations on the appropriate data and metrics that should be included in tax preference performance statements to evaluate new tax preferences, as provided under [RCW 82.32.808].

(2)(a) The task force is comprised of five members: (i) one person from the department of revenue; (ii) one person from an association representing Washington businesses; (iii) one person from the office of financial management; (iv) the legislative auditor or a designee of the legislative auditor; and (v) an economist with substantial experience in state taxes.

(b) The task force must choose its chair from among its membership.

(3) By January 1, 2014, and in compliance with RCW 43.01.036, the legislative auditor must submit a report to the appropriate fiscal committees of the legislature the findings and recommendations of the task force.

§ 1702(5)

If the tax preference performance statement for a new tax preference indicates a legislative purpose [to improve industry competitiveness or to create or retain jobs], any taxpayer claiming the new tax preference must file an annual survey in accordance with RCW [82.32.585].

Appendix B

Contents of Annual Survey and Annual Report – compared

Contents	Annual Survey	Annual Report
DOR registration number	X	X
UBI number	X	X
Name of business	X	X
Survey contact	X	X
Phone number	X	X
Total number of employees statewide		X
Employment Security reference number	X	X
Name of tax incentives taken (check boxes)	X	X
Amount of incentives taken	X	
% of activities reflected in this report supported by tax incentives		X
If and how many business sites in WA		X
How many sites supported by tax preference		X
Address of all business sites in WA		X
Contact for each business site in WA		X
Date of first business activity at site in WA		X
Business site moved, sold or closed		X
Is the credit assigned	X	
Who is the assignor	X	
Are you a lessee	X	
Who is your lessor	X	
Taxable amount reported on excise return	X	
How many employees	X	
Medical, dental, retirement plans offered		X
Provide description of medical/dental plan offered		X
% of employees eligible for medical/dental plan		X
Average monthly contribution paid by employer for medical/dental plan		X
Average premium paid by employee for medical/dental plan		X
% of employees enrolled in medical/dental plan		X

Contents	Annual Survey	Annual Report
Plan offered to spouse and dependents		X
Medical/dental plan specifics		X
What is annual maximum dental benefit		X
Occupation type and number		X
% of full time	X	
% of part time	X	
% of temporary	X	
Wage bands	X	
How many are hired through temp staffing firms	X	X
Of the temps, top 3 occupations hired	X	X
Average length of temporary employment	X	X
% of employees engaged in R&D in WA	X	
% of employees engaged in R&D globally	X	
How many new positions in WA	X	
Of new positions, how many were residents of WA	X	
% of new positions filled by WA residents	X	
Any business expansion in or into WA	X	
# of employees moved in to WA	X	
# of employees added due to expansion	X	
# of employees due to newly created business activity	X	
% of employees from newly created that were WA residents	X	
Any business activities moved out of WA	X	
How many employees moved out of WA	X	
# of employees at a deferral eligible site by certificate number	X	
Average hourly wage paid to seasonal or temporary employees	X	

Contents	Annual Survey	Annual Report
How many US patents granted to your business for which you received a tax preference	X	
How many US trademarks registered	X	
How many US copyrights registered	X	
What type of federal classification of copyrights	X	
What category of copyrights	X	
What type of retirement benefits are offered - defined benefit/defined contribution		X
% of employees eligible for retirement benefits		X
% of employees enrolled in retirement benefits		X
Maximum contribution to enrolled employees		X
% of R&D performed in WA	X	
What type of products are manufactured or stored at an eligible deferral site	X	
What type of B&O tax exempt products were sold (certain taxpayers)	X	
Did any R&D preference result in a new product, service, process or project	X	
What % of those new things were produced or distributed by WA employees	X	
What % of your new products were produced or distributed by other firms in WA	X	
What % of materials/inputs related to WA R&D were provided by other WA firms	X	
Have you purchased exempt products under the M&E	X	
Estimate value of M&E products purchased	X	
What % of purchased M&E was used for R&D purposes more than half the time	X	
How many tons of chlor-alkali electrolytic/sodium chlorate electrolytic product was manufactured at the site		X
How many metric tons of aluminum was smelted (for aluminum smelters) at the site		X
Estimate the retail value of all sales made during year that resulted from taking the high tech credit or deferral	X	
Has your firm merged with another company or reorganized	X	
If your firm merged or reorganized provide name and registration number	X	
For aluminum smelters and chlor-alkali electrolytic processors - what is your actual total employment at the manufacturing site		X
For aluminum smelters and chlor-alkali electrolytic processors - how many positions will be affected by employment reductions publicly announced during the sixty-day period preceding the date of the report		X