

Introduction and Summary of Findings

INTRODUCTION

The Tax Exemption Study lists exemptions for the major state and local taxes in Washington and is authorized by the Revised Code of Washington (RCW) 43.06.400 [Appendix A].

Tax exemptions:

The term *tax exemption* includes a variety of preferences that reduce tax liability for taxpayers. Tax exemptions include:

- Exclusions,
- Deductions,
- Credits,
- Deferrals,
- Preferential tax rates, and
- Exemptions.

Department of Revenue (Department) staff estimated the impact of each exemption. Sales and use tax exemptions for the same product or activity are included as a single estimate. In other cases, there are multiple estimates for a single statute to better illustrate the impacts.

The summary of each exemption includes:

- A brief description,
- The purpose of the exemption,
- Taxpayer savings,
- Potential revenue gains from a full repeal of the exemption, and
- Additional information.

Taxpayer savings versus potential revenue gains:

Savings to taxpayers does not indicate the potential revenue that governmental jurisdictions would accrue if the exemption did not exist. For example, some exemptions will not increase state revenues by the same amount as the taxpayer savings due to:

- Constitutional prohibitions against taxing certain activities,
- Property tax exemptions that result in tax shifts among remaining property owners,
- Possible changes in taxpayer reporting behavior, or
- Actual cash receipts lower as a result of compliance factors.

In all cases, it is assumed that a full repeal would be effective July 1, 2016 resulting in no revenue gain in Fiscal Year 2016 and only 11 months of revenue gain for Fiscal Year 2017. This is the first study that includes estimates of potential revenue gains for a full repeal of the exemption in addition to the taxpayer savings amounts.

The Tax Exemption Study does not include:

- Locally administered taxes such as the municipal business taxes,
- Discussion regarding tax policy related to the exemption, or
- Recommendations to keep or terminate existing exemptions.

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Forecast:

All estimates use the February 2015 Economic and Revenue Forecast Council forecast unless otherwise noted.

Revised Code of Washington (RCW) Citation:

The full RCW citation is included if it was available at the time that the exemption was analyzed. Some exemptions that passed during the 2015 session were not yet codified.

SUMMARY OF FINDINGS

The current study analyzes 694 tax exemptions. The state and local impacts of the 694 tax exemptions combine for an estimated taxpayer savings of \$105.9 billion for the 2015-17 Biennium. Approximately 48 percent of the total, or \$50.4 billion, is exemptions from state taxes. Exemptions from local government taxes amount to \$55.5 billion.

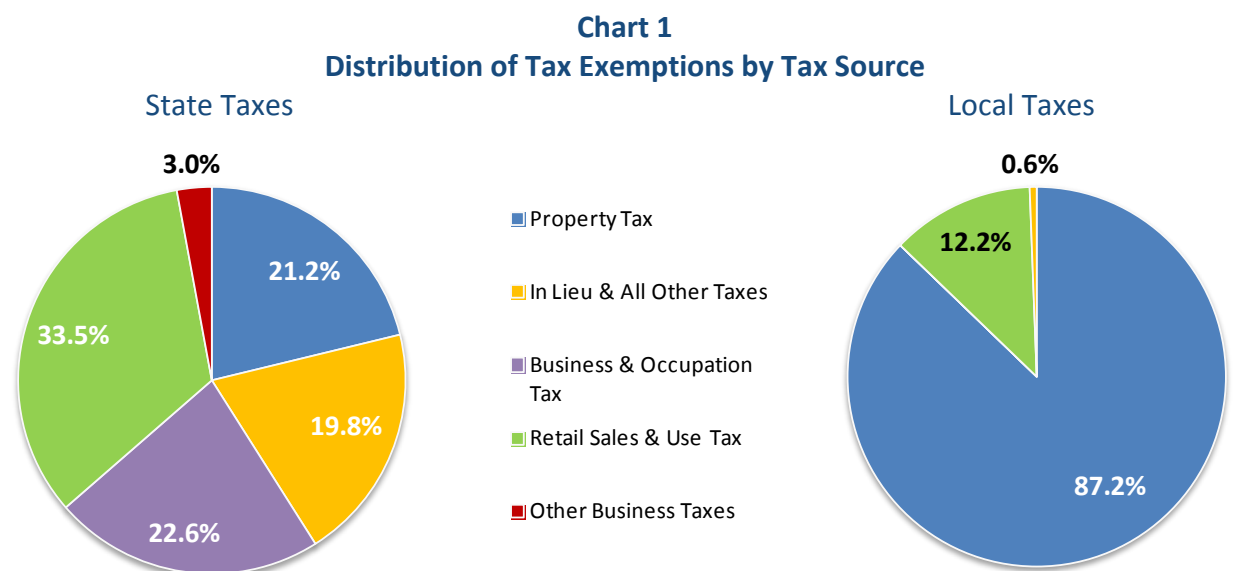
Table 1 summarizes the number of exemptions and the distribution of state and local impacts for the various types of taxes considered in this study.

Table 1
Summary of Tax Exemption Impacts by Tax Source
Estimated Taxpayer Savings
2015-17 Biennium (\$ millions)

Tax Source	Number of Exemptions	State Tax Savings	Local Tax Savings	Total Savings for Biennium
Property Tax	114	\$10,678.427	\$48,441.605	\$59,120.032
In Lieu Excise Taxes	45	68.410	57.190	125.600
Business & Occupation Tax	190	11,365.038	2.522	11,367.560
Retail Sales & Use Tax	193	16,873.246	6,772.499	23,645.745
Other Business Taxes	89	1,462.343	0.000	1,462.343
All Other Taxes	63	9,911.180	273.500	10,184.680
Total	694	\$50,358.644	\$55,547.316	\$105,905.960

Almost one-third of the state impact is from retail sales and use tax exemptions. Property and business and occupation (B&O) tax exemptions also account for a large share of the state impact. Almost 90 percent of the local exemption impacts relate to property tax. The remainder is mostly attributable to local sales tax exemptions.

Chart 1 on the following page provides a breakdown of the state and local taxes by tax source, showing that retail sales and use taxes comprise nearly 34 percent of states taxes and more than 87 percent of local taxes are from property tax.



Taxpayer savings versus potential revenue gains from a full repeal:

Savings to taxpayers do not indicate the potential revenue that governmental jurisdictions would accrue if the exemption did not exist. For this reason each exemption provides the estimated taxpayer savings plus the potential revenue gains from a full repeal of the exemption.

- For many excise taxes there is a one-to-one relationship between the amount that taxpayers save and the amount that government gives up in potential revenues.
- Other exemptions may cause possible changes in taxpayer reporting behavior, which could restrict the potential revenues realized.
- Several exemptions exist because of constitutional reasons, and are not a reliable source of potential new governmental revenue.
- Repealing a property tax exemption does not increase state revenues. Removing a property tax exemption broadens the tax base, and at the same time reduces the tax rates. This reduces the property taxes for existing taxpayers, and shifts property tax to currently exempt taxpayers. It does not generate additional revenue for the state and many local taxing districts. However, a lower local tax rate for a taxing district at their statutory maximum allows the district to collect money they would not have otherwise been able to collect. So local taxing districts at their statutory maximum may experience a revenue increase.

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Table 2a shows the taxpayer savings for the 2015-17 Biennium, and the amount of potential revenue gains with a full repeal of the exemptions as of July 1, 2016. The potential gains reflect no collections in Fiscal Year 2016 and eleven months of collections in Fiscal Year 2017, the second year of the biennium.

Table 2a
Taxpayer Savings versus Potential Revenue Gains by Tax Source
2015-17 Biennium (\$ millions)

Tax Source	State Tax Savings	State Potential Revenue Gains	Difference	Local Tax Savings	Local Potential Revenue Gains	Difference
Property Tax	10,678.427	(18.079)	10,696.506	48,441.605	474.134	47,967.471
In Lieu Excise Taxes	68.410	30.181	38.229	57.190	27.912	29.278
Business & Occupation Tax	11,365.038	3,785.928	7,579.110	2.522	1.156	1.366
Retail Sales & Use Tax	16,873.246	6,279.870	10,593.376	6,772.499	2,503.220	4,269.279
Other Business Taxes	1,462.343	609.492	852.851	0.000	0.000	0.000
All Other Taxes	9,911.180	576.739	9,334.441	273.500	124.063	149.437
Total	50,358.644	11,264.131	39,094.513	55,547.316	3,130.485	52,416.831

Table 2b shows the taxpayer savings and potential revenue gains from a full repeal of the exemptions for the 2017-19 Biennium in order to include a full 24 month impact for both the savings and gains.

Table 2b
Taxpayer Savings versus Potential Revenue Gains by Tax Source
2017-19 Biennium (\$ millions)

Tax Source	State Tax Savings	State Potential Revenue Gains	Difference	Local Tax Savings	Local Potential Revenue Gains	Difference
Property Tax	10,698.841	(38.096)	10,736.937	50,901.252	1,579.970	49,321.282
In Lieu Excise Taxes	72.162	72.160	0.002	61.004	61.004	0.000
Business & Occupation Tax	12,483.757	9,156.226	3,327.531	2.522	2.522	0.000
Retail Sales & Use Tax	18,162.214	14,999.332	3,162.882	7,307.505	5,979.618	1,327.887
Other Business Taxes	1,684.790	1,606.639	78.151	0.000	0.000	0.000
All Other Taxes	11,016.374	4,258.803	6,757.571	296.833	285.996	10.837
Total	54,118.138	30,055.064	24,063.074	58,569.116	7,909.110	50,660.006

Taxpayer savings versus forecasted revenue collections:

Table 3 and Chart 2 compare the estimated taxpayer savings from exemptions for selected state taxes with the Economic and Revenue Forecast Council forecasted revenues for those same tax sources.

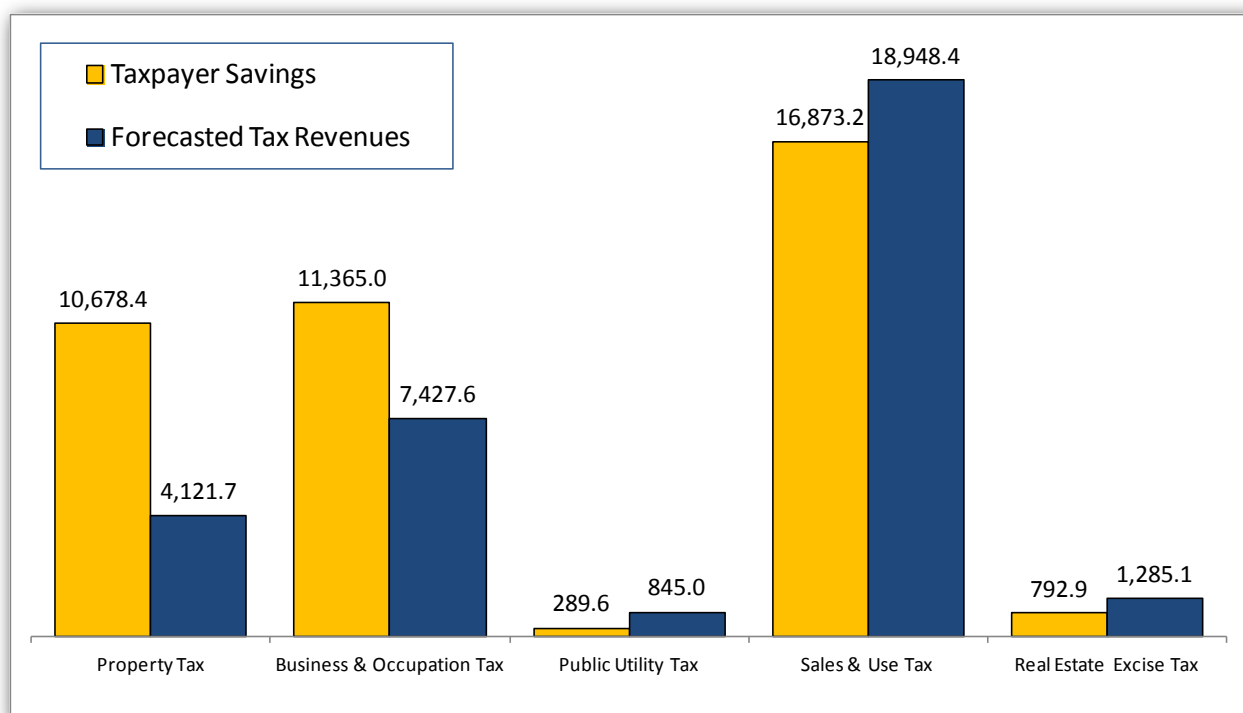
The total taxpayer savings for these state taxes is nearly \$40 billion for the 2015-17 Biennium, which is over \$7 billion more than the forecasted revenues of \$32.6 billion.

Table 3
Comparison between Taxpayer Savings and Revenues
Selected Major State Tax Sources
2015-17 Biennium (\$ millions)

State Tax Source	Taxpayer Savings from Exemptions	Forecasted Tax Revenues ¹	Exemptions as a Percent of Revenue
State Property Tax Levy	10,678.427	4,121.731	259.1%
State Business & Occupation Tax	11,365.038	7,427.610	153.0%
Public Utility Tax	289.628	844.961	34.3%
Retail Sales & Use Tax	16,873.246	18,948.367	89.0%
Real Estate Excise Tax	792.863	1,285.149	61.7%
Total	39,999.202	32,627.818	122.6%

¹Economic and Revenue Forecast Council (February 2015 Forecast)

Chart 2
Comparison between Taxpayer Savings and Revenues
Selected Major State Tax Sources
2015-17 Biennium (\$ millions)



As noted in the chart above, taxpayer savings for both property tax and the business and occupation tax is significantly higher than the forecasted revenues for these tax sources in the 2015-17 Biennium.

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Categorical Analysis:

Tax exemptions are established for a variety of reasons. In an attempt to present more meaningful data for the various types of exemptions, 8 categories were developed with each exemption assigned to the category that most closely represents its general purpose or type of beneficiary (recognizing that many exemptions serve multiple purposes).

A brief description of the exemption categories appears below:

Category	Number of Exemptions	Brief Description of Category
Agriculture	64	There are a variety of property, B&O and sales tax, and other exemptions for agricultural businesses.
Business	233	These exemptions generally benefit business entities.
Government	82	Governmental jurisdictions include the federal government, the state of Washington, local governments and foreign countries.
Individuals	53	These exemptions generally benefit people, as opposed to businesses or other entities.
Interstate Commerce	21	The United States Constitution prohibits direct taxation of interstate commerce. The Legislature has enacted exemptions to assure that Washington does not violate this requirement.
Nonprofit	91	There are a variety of property, B&O and sales tax exemptions allowed for nonprofit organizations.
Tax Base	73	This category includes activities the Legislature purposefully excluded in the original tax base. For example, there is an exemption to assure employees are not subject to B&O tax, even though it was never the intent for tax to apply to salaries and wages.
Other	77	Some exemptions do not fit easily into one category. These are included in the "Other" category. As an example, the exemption for intangibles benefits the agricultural industry, businesses, and individuals.

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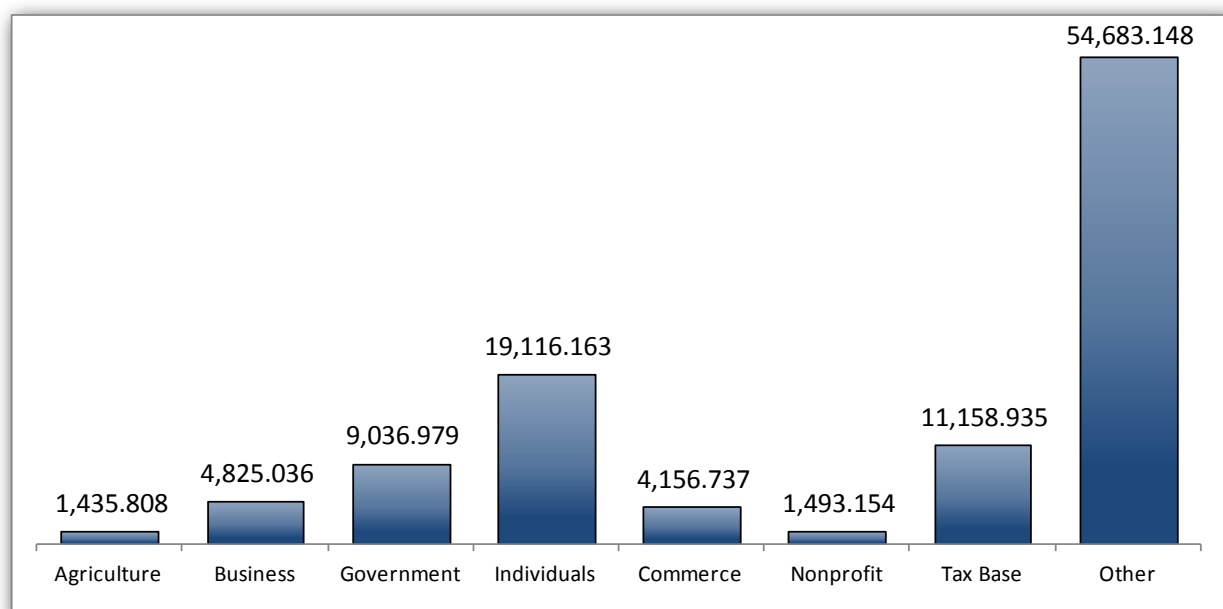
Table 4 summarizes the results of the categorical analysis. The other category represents over 50 percent of the total taxpayer savings, the majority of which are local tax savings. Of the \$54.7 million taxpayer savings in the other category, \$50.7 million comes from the following two exemptions:

- The property tax exemption on intangibles, and
- Sales and use tax exemption on personal and professional services.

Table 4
Tax Exemptions by Category
2015-17 Biennium (\$ millions)

Category	Number of Exemptions	State Tax Savings	Local Tax Savings	Total Tax Savings	Percent of Total
Agriculture	64	869.258	566.550	1,435.808	1.4%
Business	233	3,073.844	1,751.192	4,825.036	4.6%
Government	82	2,770.343	6,266.636	9,036.979	8.5%
Individuals	53	15,202.558	3,913.605	19,116.163	18.1%
Interstate Commerce	21	3,612.414	544.323	4,156.737	3.9%
Nonprofit	91	868.798	624.356	1,493.154	1.4%
Tax Base	77	9,804.780	1,354.155	11,158.935	10.5%
Other	73	14,156.649	40,526.499	54,683.148	51.6%
Total	694	50,358.644	55,547.316	105,905.960	100.0%

Chart 3
Tax Exemptions by Category
2015-17 Biennium (\$ millions)



Exemption History

Tax exemptions enacted by year:

Until 1935, no more than a half dozen new exemptions appeared in any single year. With the adoption of Revenue Act of 1935 came 44 new exemption statutes. These were associated with:

- Retail sales and use taxes,
- B&O tax, and
- Various other new state excise taxes.

State policy-makers have enacted over 340 new tax exemptions since 1990, an average of 13 per year. In 2003, 32 new exemptions were added - the largest number of new exemption statutes established since 1935.

Table 5 traces the growth of current tax exemption statutes over time, starting in Washington's territorial days.

Table 5
Current Tax Exemptions by Year of Enactment

Year Adopted	Number	Year Adopted	Number	Year Adopted	Number	Year Adopted	Number
1854	4	1947	4	1979	14	1999	7
1871	1	1949	13	1980	12	2000	8
1886	1	1951	9	1981	10	2001	21
1889	5	1953	2	1982	4	2002	5
1890	3	1955	7	1983	13	2003	32
1891	2	1957	1	1984	6	2004	19
1911	1	1959	4	1985	9	2005	24
1915	3	1961	5	1986	6	2006	16
1923	3	1963	4	1987	14	2007	18
1925	2	1965	9	1988	3	2008	17
1929	1	1967	19	1989	29	2009	13
1931	4	1970	12	1991	9	2010	9
1933	4	1971	16	1992	4	2011	10
1935	44	1972	1	1993	13	2012	8
1937	3	1973	5	1994	4	2013	17
1940	2	1974	5	1995	16	2014	3
1941	1	1975	10	1996	11	2015	19
1943	3	1976	11	1997	18		
1945	5	1977	4	1998	20	TOTAL	694

Since 1970, there are only two years where the Legislature did not pass any exemptions, 1978 and 1990.

Exemption History

The following two charts show current tax exemptions:

- Enacted by year, and
- The cumulative number by decade.

Chart 4
Current Tax Exemptions by Year of Enactment

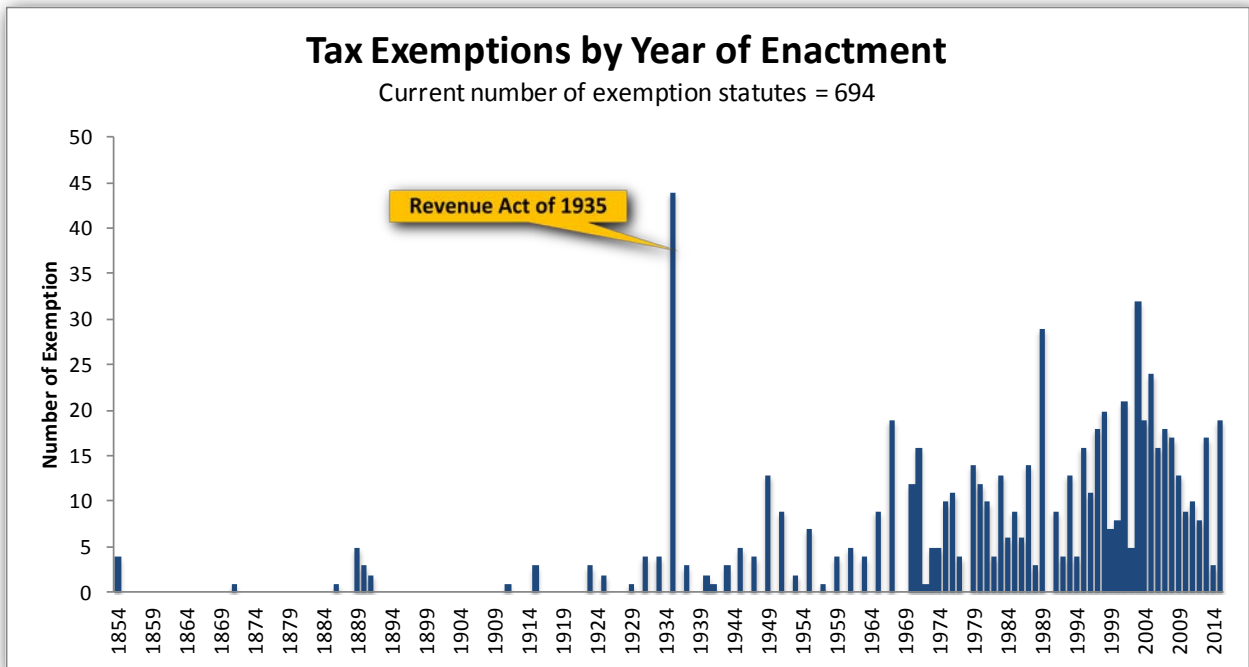


Chart 5
Cumulative Number of Tax Exemption Enacted by Decade

