Washington Research Council

Policy Brief

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About That Mythical $8.7 Billion Tax Break . . .

Briefly

A competitive tax policy is not a "subsidy" that costs the state money. It is, rather, a pragmatic response to the marketplace, including the global competition for major industrial projects. Tax policies adopted in 2003 were essential for securing the 787. Extending those policies in 2013 helped to win the 777X.

In November, in an effort to induce The Boeing Company to locate wing production and final assembly of its new 777X commercial airplane in Washington, the Legislature extended tax incentives enacted in 2003. A questionable Department of Revenue (DOR) fiscal note estimated that these incentives will reduce aerospace industry taxes by $8.7 billion. This has led to its being called the biggest corporate tax break of all time (Wilson 2013).

That's a wild overstatement. First, competitive tax policy is not a "subsidy" or "tax break" that costs the state money. It's a pragmatic response to the marketplace, including the global competition for major industrial projects. Second, the DOR forecast spans a 26-year horizon, far longer than is commonly used to cost out tax legislation. Third, the premise is flawed: The state cannot forego revenues it would never have received in the absence of the incentives.

Background

For a number of years Boeing and other private sector enterprises have maintained that the cost of doing business was significantly higher in Washington than in other states. Over time, lawmakers have responded. The cornerstone of the state's bid for the 787 in 2003 was a set of targeted tax incentives (HB 2294). These incentives were intended to bring Boeing's taxes in Washington into line with what they would be in other states.

In addition to HB 2294, four other bills were enacted between 2003 and 2010 that provided tax incentives for various segments of the aerospace industry, all of which were scheduled to expire in 2024. (See Appendix.)

Boeing is not the only company for whom these incentives apply. Firms that take advantage of any of the aerospace tax incentives are required to report annually to DOR the number of jobs that are directly related to the incentives. Statistics compiled by DOR from these reports for calendar year 2012 show that 258 firms with 96,854 employees benefited from the aerospace manufacturing incentives, while 95 firms with 3,792 employees benefitted from the aerospace non-manufacturing incentives. Of the 100,646 employees thus linked to these incentives, 29,786 (30 percent) were at companies other than Boeing, a number of which are Airbus suppliers (DOR 2013b). If the benefits of the tax incentives are proportional to employment, 30 percent of the tax savings thus go to companies other than Boeing.

A recent performance review by the staff of the Joint Legislative Audit and Review Committee (JLARC) concludes that the state is meeting the public policy objectives of the 2003 aerospace incentives as stated in HB 2294. Since 2003, the concentration of aerospace employment in Washington has increased compared to other states, and Washington's share of Boeing Company employment has increased from 37 percent to 49 percent. The average annual wage for aerospace manufacturing in 2012 ($91,318) exceeded the overall average for manufacturing by 32 percent. In that year, 96 percent of aerospace employees were

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offered health insurance and 95 percent were offered health plans (JLARC 2014).

In 2013, Governor Inslee, believing that securing the 777X wing fabrication facility was critical to the long-run future of aerospace in Washington, called for the Legislature to enact a tax incentive package (ESSB 5952). He noted that the cost of these incentives "will be greatly outweighed by the benefits to the state of winning the 777X program." These benefits included an estimated $21.3 billion in tax revenues to the state from 2025 to 2040 due to the direct and indirect economic activity associated with the program (Inslee 2013).

A contract offer was also made to Boeing employees in 2013. When the contract was initially rejected, Boeing began a national search to find a site to build the plane. The company received offers from 22 states (Scott et al. 2014). In early 2014, employees agreed to a revised contract, after which Boeing announced that the plane would be built in Everett.

The incentive bill passed by the Legislature in 2013 extended to 2040 all of the aerospace incentives that were scheduled to sunset in 2024. In addition it broadened the sales tax exemption for the construction of manufacturing facilities for superefficient airplanes to cover all commercial airplanes.

The Department of Revenue analyzed the fiscal impact of the bill in a fiscal note (DOR 2013a). Typically fiscal notes look forward for just six years. Over the standard six-year horizon, the only fiscal impact DOR found was due to the sales and use tax exemption for the construction of a facility for fabrication of the 777X's carbon fiber wing. DOR's midpoint estimates were that taxes foregone by the state would be $9.0 million, while taxes foregone by local governments would be $3.7 million. Over the period 2025–2040, DOR estimated that the total state and local revenue impact of the legislation would be $8.7 billion.

Almost all of the estimated revenue reductions are associated with postponing to 2040 the tax hikes that are currently scheduled to take effect in 2024. In other words, the "new tax break" is simply an extension of current tax policy. And much of the foregone revenues are taxes that would not be collected if the 777X and future new Boeing models were manufactured elsewhere.

Competitive Tax Policy is Not a Subsidy

Our state constitution precludes state subsidies to businesses. This is not the case in other states. For example, the package of incentives that Alabama offered to Airbus to win the A320 included $82 million in state funds for capital investments in the plant (Reiss 2012, Dwoskin 2013).

Still, the tax incentives provided to the aerospace industry by ESSB 5952 are sometimes called a "subsidy." This is a misuse of the word. The bill did not direct any state funds to the industry. It simply brought taxes on aerospace in Washington into line with what the industry pays in other states.

There is clear evidence that the state's tax structure fell heavily on the aerospace industry before 2003. In 1994, DOR's research department conducted an extensive study benchmarking the taxation of manufacturing in Washington against 11 other states. The result: "Washington is usually one of the top three states for tax liability" (DOR 1994). For aerospace taxation, Washington ranked 4th highest for a large established firm and highest for a new firm. Three of the comparison states have significant aerospace sectors: California, Texas and Alabama. While taxes in California were somewhat higher than in Washington, taxes in both Texas and Alabama were lower. In the case of Texas, taxes were 20 percent less than Washington for the new firm and 28 percent less for the established firm.

In part, Washington's poor showing in these rankings reflects the fact that our state and local governments raise a disproportionate share of their revenues

through taxes on business. A recent study by Ernst and Young (E&Y) ranked Washington 9th highest in the share of state and local tax revenue raised through taxes on business and 14th highest in business taxes as a percentage of private sector value added (Phillips et al. 2013). Washington's high place in E&Y's rankings is due primarily to the state's unique business and occupation (B&O) tax, which raises much more money than the corporate income tax (the primary tax on business in most other states).

Prior to the enactment of tax incentives in 2003, the B&O tax was particularly burdensome for aerospace. An analysis prepared in 2002 for the Washington State Tax Structure Study Committee (which was chaired by Bill Gates Sr.) found that the aerospace industry's effective B&O tax rate (calculated as the ratio of taxes paid to value added) was 2.63 percent, third highest among Washington's industries. The average industry's effective B&O tax rate was 1.53 percent, more than 40 percent lower than that for aerospace.

This documented high cost of doing business prompted Boeing, in 2003, to consider assembling the 787 out of state, and the upcoming expiration in 2024 of the aerospace tax incentives prompted them to consider locating the 777X out of state as well. An early extension of the tax incentives to 2040 gave Boeing more certainty about the business climate and made Washington a more attractive location. All told, the 2003 and 2013 tax incentive packages leveled the playing field, making Washington more competitive with other states.

The Inherent Problems with a 26-Year Forecast

Estimating the effects of legislation can be more of an art than a science, but the estimate for ESSB 5952 raises more red flags than most. It's no indictment of DOR to say the estimate is likely to be far off the mark. The department was asked to do the impossible. The fiscal note forecasts that the revenue foregone from this extension would total $3.6 billion between July 1, 2024 and June 30, 2032 and $5.2 billion from July 1, 2032 to June 30, 2040. (See the table below.)

The fiscal note considers a period that is 20 years longer than normal. The longer the timeframe of an estimate, the less robust it is. (To paraphrase Niels Bohr or Yogi Berra, predictions are hard, especially about things far in the future.)

At this point it is impossible to say with confidence what the situation of the aerospace industry in Washington will be 20 years from now. Boeing's most recent market forecast only extends through the year 2032 (Boeing 2013). In making its projection, DOR calculated average annual taxpayer savings in recent years and projected them forward, using IHS Global Insight's 30-year forecast of U.S. aerospace production. The estimate does not account for developments like increasing Boeing production occurring in South Carolina (Hamilton 2013, Wilhelm 2014a), new Airbus pro-

Table: ESSB 5952 State and Local Government Impact

	Fiscal Years, Dollars in Millions		
Major Aerospace Incentives*	**2014-2024**	**2025-2032**	**2033-2040**
B&O Aerospace Tax Rate Reduction, rate of 0.2904%		$1,735.5	$2,513.0
FAR 145 Certified Repair Stations, rate of 0.2904%		$9.6	$13.8
Aerospace Product Development (for others,) rate of 0.9%		$47.6	$68.9
B&O Tax Credit for Aerospace Manufacturers' Preproduction Development		$1,439.9	$2,085.0
B&O Tax Credit for Property Taxes on Land/Buildings		$229.8	$332.8
Sales & Use Tax Exemption for Computers Used in Development & Design		$98.9	$143.1
Sales & Use Tax Exemption for Superefficient Airplane Facilities, as extended	$12.7	Minimal	Minimal
Total	$12.7	$3,561.2	$5,156.7

*There are some other incentives that are not used.

Source: DOR

duction in the U.S. (Wilhelm 2014b), or increasing competition from Chinese and Russian companies (Sinitsky 2013, Govindasamy and Fang 2013). Instead, DOR assumes that Washington will maintain over the next 26 years the share of U.S. aerospace activity that it enjoyed in the recent past.

The many variables associated with the long-term evolution of the aerospace industry make a 26-year forecast an exercise in statistical sleight of hand. The straight lines drawn by forecasters do not reflect competitive reality.

Revenue That Would Not Have Been Collected

Even if forecasters could anticipate competitive reality so far into the future, in this case they failed to do so even in the near future.

DOR's estimate of foregone revenue from the extension of the tax incentives does not account for the possibility that the bill changed taxpayer behavior. If it is the case that the facility in question would not be constructed but for the provision of the tax incentives, the revenues in question are not really foregone, as they would never have been realized.

Indeed, it was clear at the time the tax incentive legislation was being debated that Boeing was prepared to move production elsewhere (as they have done with other production in recent years). Certainly, as noted above, Washington's aerospace tax policy was uncompetitive prior to the original enactment of the incentives.

In the end, after considering the possibility that Washington would not have won the 777X in the absence of the tax incentive extension, along with the impossibility of accurately estimating the impacts of legislation so far into the future, the $8.7 billion of revenue foregone appears extraordinarily unlikely. That Boeing—and the other qualified aerospace firms—will somehow bank $8.7 billion is a misconception: Instead, these incentives will make (and have made) it cost effective for Boeing and other aerospace companies to locate here. Focusing on the $8.7 billion number overestimates the costs of aerospace tax incentives for the state and underestimates the impacts of tax policy on business.

Comment

Unquestionably, tax policy influences business decisions. While not the only critical factor—as the 777X decision made clear, labor relations matter—tax policy is one of the few determinants that can be directly and swiftly addressed by lawmakers. Last November, the Washington Legislature acted to secure policies important to Boeing and the state's strong aerospace cluster.

Essentially, the policies simply extended existing state tax policy. Yet, in the push to quantify the impact of the legislation, a price tag of $8.7 billion was affixed to the package. Because the estimate projects the value of the incentives for 26 years, it is not directly comparable to any other similar legislation. More importantly, the tax policies adopted in 2003 were essential to securing the Boeing 787 here. Not subsidies, these tax adjustments offset extraordinarily high taxes on commercial airplane manufacturing, enabling Washington to prevail in the intense interstate—and international—competition for industries that can transform regional economies. The policy made sense a decade ago and still does.

Appendix: Aerospace Incentives

Reduced B&O Rate for FAR Certificated Repair Stations: ESSB 5071 (2003) temporarily reduced the B&O rate from 0.484 percent to 0.275 percent for repairs made to equipment used in interstate or foreign commerce at certain aircraft repair stations certificated by the Federal Aviation Administration under Federal Aviation Regulations (FAR) Part 145. The rate was initially scheduled to revert to 0.484 percent on July 1, 2006. HB 2466 (2006) raised the B&O rate for these repairs to 0.2908 percent and the postponed the reversion to 0.484 percent until July 1, 2011. HB 6828 (2008) extended the 0.2908 rate to all FAR Part 145 certificated repair stations. SSB 6712 (2010) postponed the reversion to 0.484 until July 1, 2024.

Reduced B&O Rate for Aerospace Manufacturing: HB 2294 (2003) established a 0.2904 percent B&O rate for manufacturing, wholesaling or retailing commercial airplanes and parts. This represented a 40 percent reduction from the standard 0.484 percent rate. The rate was scheduled to revert to 0.484 percent on July 1, 2024. SSB 6828 extended the 0.2908 rate to tooling used in the manufacture of aircraft or parts.

Reduced B&O Rate for Design and Engineering Services: SSB 6828 (2008) reduced the B&O rate from 1.5 percent to 0.9 percent for non-manufacturers that provide design and engineering services with respect to aircraft and parts, tooling used in the manufacture of aircraft and parts, or machinery and equipment used by FAR Part 145 certificated repair stations. The rate was scheduled to revert to 0.484 percent on July 1, 2024.

Preproduction Development B&O Credit: HB 2294 (2003) provided aircraft manufacturers a credit against B&O taxes equal to 1.5 percent of preproduction development expenditures towards new products, product lines, models, or model derivatives. The credit was scheduled to expire on June 30, 2024. HB 2466 (2006) extended the credit to nonmanufacturing firms doing preproduction development in the field of aeronautics.

Computer Hardware and Software Sales and Use Tax Exemption: HB 2294 (2003) exempted from the sales and use taxes purchases by manufacturers of computer equipment and software used in the development, design, and engineering of commercial aircraft. This exemption was scheduled to expire on June 30, 2024. HB 2466 (2006) extended this exemption to nonmanufacturing firms. SSB 6828 (2008) extended this exemption to manufacturers of aerospace tooling, non-manufacturers who provide aerospace design and engineering services, and FAR Part 145 certificated repair stations.

Construction Sales and Use Tax Exemption: HB 2294 (2003) exempted from sales and use taxes labor, materials and fixtures incorporated in buildings constructed for manufacturers of superefficient airplanes. (The Boeing 787 satisfies the definition of superefficient airplane.) This exemption was scheduled to expire on June 30, 2024.

B&O Tax Credits for Property Taxes Paid: HB 2294 (2003) established B&O tax credits to offset property taxes on new privately owned investments in plant and equipment of airplane and component manufacturers. These credits were scheduled to expire on June 30, 2024. HB 2466 (2006) extended the credits to leasehold excise taxes paid. SSB 6828 made these credits available to manufacturers of aerospace tooling, non-manufacturers who provide aerospace design and engineering services, and FAR Part 145 certificated repair stations.

Property Tax Exemption: HB 2294 (2003) provided a property tax exemption for property located on the property of a public port district, owned by a manufacturer, and used exclusively in the production of superefficient airplanes. This exemption was scheduled to expire on June 30, 2024.

Leasehold Excise Tax Exemption: HB 2294 (2003) provided a leasehold excise tax exemption for property leased to a

manufacturer of superefficient airplanes or components by a public port district. This exemption was scheduled to expire on June 30, 2024.

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