
Finance Committee

HB 1693

Brief Description: Changing provisions relating to the high technology business and occupation tax credit.

Sponsors: Representatives McIntire and Orcutt; by request of Department of Revenue.

Brief Summary of Bill

- Modifies the definition of "average tax rate" for the purposes of the high technology research and development business & occupation tax credit such that the rate is based on the total taxable amount, and not just total taxable income.
- Authorizes an extension to file the annual survey required of businesses that take the high tech B&O tax credit if the delay was for reasons beyond the business' control.
- Requires businesses that take the high tech B&O tax credit to file the annual survey and other information electronically unless the tax relief from exemptions taken by the firm are \$1,000 or less.

Hearing Date: 2/11/05

Staff: Mark Matteson (786-7145).

Background:

Business and Occupation Tax. Washington's major business tax is the business and occupation (B&O) tax. The B&O tax is imposed on the gross receipts of business activities conducted within the state, without any deduction for the costs of doing business. The tax is imposed on the gross receipts from all business activities conducted within the state. Revenues are deposited in the state General Fund. A business may have more than one B&O tax rate, depending on the types of activities conducted. The tax rate for most types of businesses that provide services is 1.5 percent.

The B&O tax does not permit deductions for the costs of doing business, such as payments for raw materials and wages of employees. Nonetheless, there are many exemptions for specific types of business activities and certain deductions and credits permitted under the B&O tax statutes, including a credit under the B&O tax for certain operational research and development (R&D) expenditures. The credit is provided to businesses, including qualifying nonprofit organizations, that make R&D expenditures in excess of 0.92 percent of taxable income.

Changes to the High Technology Research and Development B&O Tax Credit. In the 2004 session, the Legislature modified the high technology R&D B&O tax credit. The amount of credit that may be taken pursuant to the changes is based on amounts spent on R&D in excess of 0.92 percent of a business' total taxable amount for the year; previously, the basis for the credit was the entire amount of R&D spending. In addition, calculation of the credit by for-profit firms must be based on the average tax rate of the firm for the tax reporting period, rather than 1.5 percent, the requirement prior to the 2004 changes. The credit is equal to the average tax rate multiplied by the amount spent on R&D in excess of 0.92 percent of the business total taxable amount.

The 2004 changes to the high tech R&D B&O tax credit provided a definition of "average tax rate" based on a business' taxable income. However, for the purposes of the B&O tax, the measure of tax for some firms includes more than taxable income. Specifically, for firms that manufacture products, the measure of tax is based on the value of the products manufactured. (If the manufacturing firm then wholesales the product in-state, the income from the sale is subject to a separate B&O tax classification, wholesaling, and the firm is allowed a credit for any tax paid under the manufacturing classification with respect to the same product. For products sold out-of-state, however, the state has no nexus on the transaction, and so the firm is just subject to the B&O tax on the value of the products under the manufacturing classification.)

The manner in which "average tax rate" is defined means that the amount of credit that may be taken by firms that engage in manufacturing activities is higher than if the calculation were based on the entire measure of tax for B&O purposes..

High Technology Research and Development Tax Incentives - Administrative Requirements. In the 2004 changes, businesses that take the high tech B&O tax credit for R&D spending must submit an annual survey. Program participants must provide information on the amount of B&O tax credit or sales tax exemption; number of new products, trademarks, patents, and copyrights; number of jobs and the percent of full-time, part-time and temporary jobs; wages by salary band; and number of jobs with employer provided health and retirement benefits. The survey is in addition to an annual report that must be submitted regarding the amount of credit claimed, the amount of qualified R&D expenditures made during the year, and the taxable amount during the year. Both the survey and report are due by March 31 of the year following the year the credits were taken. If the survey is not completed by the due date, the business is not eligible to take or assign the credit. No exceptions are allowed for failure to file even if the failure was for reasons beyond the taxpayer's control.

Tax Incentives and Reporting Requirements. In the past few years, the Legislature has required business that take tax incentives to provide surveys and reports to the Department of Revenue for accountability and other purposes. Such incentives include the high tech B&O tax credit for R&D spending, the rural county software programming/computer manufacturing B&O tax credit, the rural county information technology help desk services B&O tax credit, the high tech sales tax deferral for R&D building construction, the rural county manufacturers sales tax deferral, and the various tax incentives provided to semiconductor, aluminum, electrolytic chemical, and airplane manufacturers.

Waiver or Cancellation of Penalties. The Department of Revenue is authorized to waive or cancel penalties under certain circumstances if the failure to pay any excise tax was the result of

circumstances beyond the control of the taxpayer. Pursuant to departmental rule, such circumstances include delinquency resulting from erroneous information provided to the taxpayer by a department employee; from the death of the taxpayer or a member of the taxpayer's family, and a number of others.

Summary of Bill:

For the purposes of calculating the high technology B&O tax credit for R&D spending, the average tax rate is defined to be based on a business' total annual taxable amount, including both taxable income and the value of the products manufactured. The average tax rate may be based on projected activity for the calendar year if the business' reporting requirement is more frequent than annually, but the business must make an adjustment in the final reporting period for the year if the actual tax and taxable amounts were different than the estimates.

The changes to the high tech R&D B&O credit are retroactive to June 10, 2004. Persons who owe additional tax as a result of the changes are liable for interest, but not penalties, if the additional taxes are paid by January 1, 2006. For payments after that, persons are also subject to penalties.

A business that fails to submit a survey for the high tech B&O tax credit as a result of circumstances beyond the control of the taxpayer may receive an extension to file of up to 30 days from the date that the Department of Revenue notifies the taxpayer of such extension. The department is allowed to use existing rule provisions concerning the waiver or cancellations of penalties as a guide in determining whether the failure to file was indeed the result of circumstances beyond the taxpayer's control.

A business claiming the high tech R&D credit must submit the survey electronically, unless cumulative tax relief to the taxpayer from taking any of the tax incentives requiring surveys or reports is \$1,000 or less.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains an emergency clause and takes effect immediately except for section 2 which takes effect January 1, 2006.