

HOUSE BILL REPORT

HB 3188

As Reported by House Committee On: Finance

Title: An act relating to modifying the definitions of "manufacturing" and "research and development" for tax incentive programs for businesses in rural counties.

Brief Description: Modifying the definitions of "manufacturing" and "research and development" for tax incentive programs for businesses in rural counties.

Sponsors: Representative Hunter.

Brief History:

Committee Activity:

Finance: 2/19/10 [DP].

Brief Summary of Bill

- Modifies the definitions of "manufacturing" and "research and development" for the purposes of the rural county tax incentive programs.

HOUSE COMMITTEE ON FINANCE

Majority Report: Do pass. Signed by 5 members: Representatives Hunter, Chair; Hasegawa, Vice Chair; Conway, Ericks and Springer.

Minority Report: Do not pass. Signed by 4 members: Representatives Orcutt, Ranking Minority Member; Parker, Assistant Ranking Minority Member; Condotta and Santos.

Staff: Jeff Mitchell (786-7139).

Background:

State law provides a state and local retail sales and use tax deferral program for the purchase of labor and materials used in the construction of new or remodeled buildings or equipment where the buildings or equipment will be used for manufacturing or research and development. (Since July 1, 1994, the repayment requirement has been waived as long as program requirements are maintained making the program an outright exemption.) For

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purposes of the deferral program, the definition of manufacturing, in addition to its regular definition relating to the production of a new, different, or useful substance or article of tangible personal property, specifically includes computer programming, the production of computer software, and other computer-related services. To qualify, a project must be located in a county with an average population density of no more than 100 persons per square mile or in a designated community empowerment zone. The sales and use tax deferral program is currently scheduled to expire on July 1, 2010.

State law provides a credit against business and occupation tax liability for gross income derived from manufacturing or research and development activities in rural counties or designated community empowerment zones. For purposes of the credit program, the definition of manufacturing, in addition to its regular definition relating to the production of a new, different, or useful substance or article of tangible personal property, specifically includes computer programming, the production of computer software, and other computer-related services. Rural counties are defined as those with an average population density of less than 100 persons. The amount of the credit is \$2,000 for each new job created, unless the new position is paid wages and benefits of more than \$40,000 annually, in which case the credit is \$4,000. To qualify, the firm must increase its total jobs in an eligible area by at least 15 percent. The total amount of credit is capped at \$7.5 million.

On January 29, 2010, the Thurston County Superior Court, in an oral ruling, partially granted a motion for summary judgment in a suit brought by Yahoo against the Department of Revenue (DOR). The Court found that Yahoo's data center in Quincy qualified for the rural county sales and use tax deferral program. The DOR's position has been that state law allows a deferral for computer-related services or programming only when those activities lead to a finished tangible product for sale or potential sale.

Summary of Bill:

For purposes of the rural county sales and use tax deferral program and the rural county business and occupation tax credit, the following changes are made to the definitions of "manufacturing" and "research and development:"

1. Until July 1, 2010, the definition of "manufacturing" is changed to include only computer programming, production of computer software, and other computer-related services that contribute to the production of a new, different, or useful substance or article of tangible personal property. Beginning July 1, 2010, activities related to computer programming, production of computer software, and other computer-related services are excluded from the definition of "manufacturing."
2. The definition of "research and development" is modified to apply only to activities that are intended to ultimately result in the production of a new, different, or useful substance or article of tangible personal property.

The provisions of the bill are made retroactive, as well as prospective.

Appropriation: None.

Fiscal Note: Preliminary fiscal note available.

Effective Date: The bill takes effect on July 1, 2010.

Staff Summary of Public Testimony:

(In support) If the decision by the Thurston County Superior Court is upheld, then it will have a negative fiscal impact on the state. The range of the possible impacts is broad, but if the court's opinion is widely interpreted, it could have a \$600-\$900 million fiscal impact. This bill would prevent that from happening.

(Opposed) Yahoo! put their Quincy data center in Washington because of the tax incentives modified in this bill. The bill is essentially a bait and switch that takes away a tax incentive that Yahoo! relied on. There will be litigation should the bill be signed into law.

Persons Testifying: (In support) Drew Shirk, Department of Revenue.

(Opposed) Scott Hazelgrove, Yahoo!.

Persons Signed In To Testify But Not Testifying: None.