HOUSE BILL REPORT

HB 2663

As Reported By House Committee On:
Revenue

Title: An act relating to the taxation of high-technology businesses.

Brief Description: Providing tax credits and deferrals for high-technology businesses.

Sponsors: Representatives Finkbeiner, Foreman, Cothern, G. Fisher, Forner, Patterson, Shin, Dorn, Bray, R. Meyers, Basich, Johanson, Pruitt, Ogden, Wolfe, Quall, Jones, Moak, H. Myers, Kessler, Springer, King, Morris, Cooke, Backlund and L. Johnson; by request of Governor Lowry.

Brief History:
Reported by House Committee on:
Revenue, February 5, 1994, DPS.

HOUSE COMMITTEE ON REVENUE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 11 members: Representatives G. Fisher, Chair; Holm, Vice Chair; Foreman, Ranking Minority Member; Anderson; Caver; Leonard; Romero; Silver; Talcott; Thibaudeau and Wang.

Minority Report: Do not pass. Signed by 1 member: Representative Rust.

Staff: Rick Peterson (786-7150).

Background: Washington's major business tax is the business and occupation (B&O) tax. This tax is imposed on the gross receipts of business activities conducted within the state. Although there are several different rates, the principal rates are:

retailing activities	0.471 percent
manufacturing, wholesaling, & extracting	0.515 percent
miscellaneous services	2.13 percent
selected business services	2.5 percent

Businesses engaged in computer and data processing, information services, engineering services and others pay the selected services rate of 2.5 percent. Nonprofit corporations engaged in research and development activities pay a tax rate of 0.515 percent.

Since the B&O tax is a gross receipts tax, deductions for the costs of doing business are not permitted. Some other deductions are allowed, but most of these are really exemptions of certain types of gross income or business activities.

Deferral of sales and tax is permitted on purchases on plant and equipment investments by manufacturing firms and research and development firms in distressed counties, and by new manufacturers and aluminum firms statewide. These firms are allowed to defer sales and use tax for three years after completion of the project followed by repayment over five years. Sales tax on labor in distressed areas is not repaid. Also, a $1,000 business and occupation tax credit is available for each new job created above a 15 percent growth rate by manufacturing firms and research and development firms in distressed areas.

Summary of Substitute Bill: A B&O tax credit is allowed equal to 2.5 percent of the amount of qualified high-tech research and development expenditures. For firms hired to perform research and development services for others the credit is calculated on 80 percent of the payment for such services. For nonprofit research and development entities the credit is equal to 0.515 percent of qualified research and development expenditures.

To qualify for the credit a business must spend at least 0.92 percent of the firm’s gross income on qualified research and development. Qualified research and development must take place in the fields of advanced computing, advanced materials, biotechnology, electronic device technology or environmental technology.

The credit for any one firm is limited to no more than $1 million in 1994 and no more than $2 million per year in 1995 and after. A firm hired to do research and development for another firm may assign the B&O credit to the hiring firm. The credit may be used to reduce taxes only for same year as the research and development expenditures. Unused credits may not be "carried forward" and used to offset future tax liability.

The B&O credit provisions sunset on December 31, 2004.

A new sales tax deferral program is created for investments in pilot scale manufacturing or qualifying research and development. The pilot scale manufacturing and research and development must be in the fields listed above for the B&O

credit program. Pilot scale manufacturing is the design, construction and testing of preproduction prototypes and models other than for commercial sale.

Expenditures for buildings, machinery and equipment are eligible for the deferral. Deferred sales taxes are repaid beginning three years after completion of the investment project. Repayments are made over a five-year period. If the investment project is for a product requiring licensing by the Federal Food and Drug Administration then taxes are paid back over a six-year period starting five years after the project is complete.

The Department of Revenue may not approve new applications for the deferral program after July 1, 2004.

The Department of Revenue is required to evaluate the new credit and deferral programs in 1997, 2000 and 2003. Also the Department must study the effectiveness of the current sales tax deferral and B&O credit programs and report by September 1, 1996. Reports to the Legislature must measure the effect on job creation, company growth, the introduction of new products, the diversification of the state's economy, growth in research and development and the movement of firms or the consolidation of firms' operations in Washington.

Substitute Bill Compared to Original Bill: The substitute bill adds the provision allowing assignment of the tax credit to the firm contracting for research and development services. The substitute also limits the amount of credit available to any one firm. The original bill did not contain this limitation. The substitute also adds the requirement for the Department of Revenue studies on effectiveness.

Fiscal Note: Available. New fiscal note requested on substitute bill February 7, 1994.

Effective Date of Substitute Bill: The bill contains an emergency clause and takes effect immediately.

Testimony For: The Governor wants to encourage economic diversification. Government does not create jobs but must work in a partnership with the private sector. Growth in high-technology companies have offset job losses in other sectors of the Washington's economy. These are high-wage high-skill jobs. Growth in technology leads to industrial development. Washington's tax structure taxes investments in buildings and equipment. Since capital development money is limited, the sales tax on laboratory construction and other facilities takes away from hiring more research staff. In order to leverage limited state resources, any tax program must be targeted to those activities expected to provide the best return in terms of high-wage high-skill jobs in Washington.

Many high tech products have very long development cycles. The high up front taxes in Washington discourage location here. Washington needs a state environmental policy. This proposal is an important element of such a policy. The expansion of these high tech industries in Washington will have an important spill-over effect on other technology industries.

Testimony Against: Jobs in every industry are portable, not just high tech jobs. We should look at the total tax structure to see how it affects these high tech companies. Washington is an attractive state for high wage workers because there is no personal income tax. Also, the lack of personal income tax is a great advantage in attracting entrepreneurs. These entrepreneurs will take much of their earnings as a return on capital. Washington is attractive to them because it has no tax on capital gains.

Witnesses: (All pro) Representative Bill Finkbeiner, prime sponsor; Len McComb, Department of Revenue; Michael Kranda, and Tom Rankin, Immunex; Howard Mendelsonno, ICOS Corporation; Karen Lane, Fred Hutchinson Cancer Research Center; Jerry Smeds, Washington Environment Association; Charlie LaNasa, O’Sullivan O’Mega; Don Guthrie, McCaw Cellular; Barbara Kommer, American Electronics Association and Hewlitt-Packard Company; Tom Taylor, Battelle; and Bill Grinstein.

(Con) Dick Ducharme, Building Industry Association of Washington.