HOUSE BILL REPORT
HB 1024

As Reported By House Committee On:
Trade & Economic Development

Title: An act relating to providing tax exemptions for manufacturing and processing.

Brief Description: Providing tax exemptions for manufacturing and processing.

Sponsors: House Committee on Trade & Economic Development (originally sponsored by Representatives Van Luven, Foreman, B. Thomas, Lisk, Horn, Chandler, Casada, Dyer, Ballasiotes, Silver, Cooke, Brumsickle, Carlson, Sehlin, Sherstad, Dellwo, Benton, Skinner, Kremen, Hargrove, Costa, Delvin, Schoesler, Buck, Johnson, Thompson, Beeksma, Goldsmith, Radcliff, Hickel, Backlund, Crouse, Cairnes, Elliot, Reams, Pennington, Mastin, Mitchell, Conway, Quall, Ogden, Chappell, Regala, G. Fisher, Basich, Grant, Campbell, Smith, Robertson, Honeyford, Pelesky, Hankins, Koster, Lambert, D. Schmidt, Mulliken, Boldt, McMorris, Clements, Fuhrman, Sheldon, L. Thomas, Huff, Mielke, Talcott, McMahan, Stevens, Morris and Hymes).

Brief History:
Committee Activity:
Trade & Economic Development: 1/10/95, 1/11/95, 1/12/95 [DPS].

HOUSE COMMITTEE ON TRADE & ECONOMIC DEVELOPMENT

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 13 members: Representatives Van Luven, Chair; Radcliff, Vice Chair; D. Schmidt, Vice Chair; Sheldon, Ranking Minority Member; Veloria, Assistant Ranking Minority Member; Backlund; Ballasiotes; Hatfield; Hickel; Mason; Sherstad; Skinner and Valle.

Staff: Kenny Pittman (786-7392).

Background: The state of Washington's tax structure includes a retail sales and use tax on materials and labor used to construct or renovate a manufacturing facility and to the purchase of new and replacement manufacturing or research and development equipment and machinery. The state imposes a tax that is based on 6.5 percent of the price of the taxable event. Local governments may impose an additional tax up to 1.7 percent of the price of the taxable event.

The state has developed several sales and use tax relief programs for business. These programs are designed to encourage manufacturing and research and development firms to either locate or expand their operations in Washington.

Distressed Area Tax Deferral

The program is targeted to areas with unemployment rates 20 percent higher than the state average. Manufacturing, research and development, and computer related businesses are given a deferral of their sales and use tax on buildings, machinery and equipment, and installation labor. The businesses must create one job per $750,000 of investment. The sales tax is forgiven on new buildings, new equipment, and modernization of existing buildings.

New Business Tax Deferral

The program is available state-wide to manufacturing and research and development businesses not doing business in the state before 1985. The sales and use tax on new buildings and equipment is deferred until 3 years after the project is completed. The business is required to repay the deferred taxes over a 5 year period.

High Technology Tax Deferral

The program is available state-wide to research and development and pilot-scale manufacturing businesses. The business must be involved in biotechnology, advanced computing, electronic device technology, advanced materials, environmental technology. The sales and use tax on new or expanded facilities and machinery and equipment is deferred until 3 years after the project is completed. The business is required to repay the deferred taxes over a 5 or 6 year period.

In an effort to encourage the development of high-wage jobs, the 1994 Legislature directed the Department of Revenue to study the current sales tax structure as it applies to manufacturers. The department, through its advisory committee, studied the existing tax structure and the economic and other effects of tax relief.

Summary of Substitute Bill: The state's sales and use tax relief programs are expanded and revised through: (1) The creation of a state-wide tax exemption program for manufacturers; (2) Revisions to the distressed area and high technology deferral programs; and (3) Early termination of the new business deferral program.

State-Wide Tax Exemption

A state-wide sales and use tax exemption program is created. Manufacturing firms are exempt only from the state's portion of the retail sales and use tax on all new and replacement machinery used directly in the manufacturing process or equipment purchases and the labor and services to install the machinery or equipment. The exemption also applies to the purchase and installation of pollution control equipment used to prevent pollution or contamination as a result of the operation of the facility.

The term manufacturing process does not include research and development, the production of electricity, or the preparation of food products on the premise of a person selling food at retail.

Distressed Area Tax Deferral

The distressed area tax deferral requirement that businesses create one job per $750,000 of investment in buildings or machinery and equipment, including labor and services is repealed. The job to investment provision is retained for cogeneration projects. The renovation of an existing facility must increase the floor space or production capacity to qualify for the tax deferral.

New Business Tax Deferral

The tax deferral on new buildings and equipment, including labor and services, for manufacturing and research and development businesses not doing business in the state before 1985 is terminated. The termination date of the program is changed from December 31, 1998, to December 31, 1995.

High Technology Tax Deferral

The high technology tax deferral is extended to the construction of new structures and expansion or renovation of existing structures used for pilot scale manufacturing or qualified research and development. The expansion or renovation costs of the structure must increase the floor space or production capacity of the facility. The requirement that additional purchases of machinery and equipment used in research and development activities exceed the true and fair value of the facility, prior to improvement, by 25 percent is repealed.

A high technology firm is eligible for a total exemption of deferred taxes if specific program requirements are meet for a eight-year period after completion of the project. Any firm found in non-compliance, during the eight-year period, will be required to repay pro-rata share of deferred taxes. The repayment is based on the number of years the project was in compliance plus interest, but not penalties.

The Department of Revenue must conduct a study on the effects of the state-wide tax exemption program. The results are to be reported to the Governor and Legislature by September 1, 1998.

The Department of Revenue is directed to adopt rules to implement the programs.

Substitute Bill Compared to Original Bill: The state-wide tax exemption program was amended to only include the state's portion of the sales and use tax on machinery and equipment and the labor and services to necessary to install it.
Technical corrections were made to clarify, for purposes of the state-wide tax exemption, the terms: (1) Machinery and equipment; (2) Used directly in the manufacturing operation; and (3) Manufacturing operation.

The expansion or renovation requirement for existing structures to qualify for a tax deferral in the distressed area or high technology programs is change to any improvement that increases floor space or production capacity.

The Department of is directed to conduct a study of the effect of the state-wide tax exemption program.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill takes effect July 1, 1995.

Testimony For: (Original Bill) The present state tax system is a disincentive to business investment. The sales and use tax is a liability that must be paid even before the product is made or sold. The goal is to provide an incentive to businesses to invest in machinery and equipment and expand their operations in Washington. Business expansion creates high wage manufacturing jobs in the state. The tax exemption would put Washington on a level playing field with surrounding states that do not charge a tax on machinery and equipment.

Testimony Against: (Original Bill) The loss of revenue hurts local governments at a time when demand for services are increasing. Local governments with a large manufacturing base would be hurt the most. Local governments need the revenue to respond to the impacts of growth on the infrastructure, the criminal justice system, and the social service system.

Testified: Representative Steve Van Luven, Bill Sponsor (Pro); Len McComb, Department of Revenue (Pro); Larry Culver, CellPro (Pro); Joe Holden, HCI Steel Products (Pro); Roy Wiseman, U.S. Oil (Pro); Tom Dooley, Association of Washington Business (Pro); Randy Lewis, city of Tacoma (Pro); Ron Yamamoto, Boeing (Pro); Krista Fichler, Seattle Chamber of Commerce (Pro); Dennis Matson, Thurston County Economic Development Council (Pro); John Lindsay, TRIDEC (Pro); Melinda Kile, Tree Top (Pro); Pat Dunn, Member of Advisory Committee for the Manufacturing Tax Study (Pro); Larry Young, PACCAR (Pro); Nick Muelln, Weyerhauser (Pro); Stan Finkelstein, Association of Washington Cities (Con); and Rosemarie Ives, Mayor of Redmond (Con).