

# HOUSE BILL REPORT

## HB 1445

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### As Reported By House Committee On:

Trade & Economic Development

**Title:** An act relating to sales and use tax deferrals for high technology businesses.

**Brief Description:** Extending sales and use tax deferrals for high technology businesses.

**Sponsors:** Representatives Thompson, Dyer, Morris, Pennington, Linville, D. Schmidt, Ogden and Sherstad.

### Brief History:

#### Committee Activity:

Trade & Economic Development: 2/13/97, 2/17/97 [DPS].

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## HOUSE COMMITTEE ON TRADE & ECONOMIC DEVELOPMENT

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 9 members: Representatives Van Luven, Chairman; Dunn, Vice Chairman; Veloria, Ranking Minority Member; Sheldon, Assistant Ranking Minority Member; Alexander; Ballasiotes; Mason; McDonald and Morris.

**Staff:** Kenny Pittman (786-7392).

**Background:** The sales tax is imposed on retail sales of most items of tangible personal property and some services. The state rate is 6.5 percent and is applied to the selling price of the article or service. In addition, local sales taxes apply. The total rate is between 7 percent and 8.2 percent, depending on the location.

Sales tax applies when items are purchased at retail in the state. Sales tax is paid by the purchaser and collected by the seller. Use tax is imposed on the use of an item in this state, when the acquisition of the item has not been subject to sales tax. Use tax applies to items purchased from sellers who do not collect sales tax, items acquired from out of state, and items produced by the person using the item. Use tax is equal to the sales tax rate multiplied by the value of the property used.

Items which become an ingredient or component of a new article or property for sale are exempt from sales and use taxes. However, sales of machinery and equipment used in manufacturing were subject to taxation until 1995. Sales tax also applies to labor and services for construction, installation, and repair of property.

In 1994, the Legislature created a tax deferral program for high-technology businesses. High-technology firms initiating new operations, or expanding, renovating or equipping existing facilities, for research and development or pilot manufacturing purposes were eligible for deferral of sales and use taxes due for up to three years after project completion. Biotechnology companies could defer taxes for up to five years after project completion.

In 1995, a statewide sales and use tax exemption was provided for machinery and equipment used directly in a manufacturing operation or research and development operation, including necessary installation labor and services. As part of the statewide sales and use tax exemption in 1995, the tax deferral for high technology businesses programs was revised to give firms a total exemption of deferred sales and use taxes on new construction, and expansion or renovation of existing structures, if specific program requirements are met for an eight-year period after completion of the project. Any firm found in noncompliance, during the eight-year period, is required to repay a pro-rata share of the deferred taxes. The repayment is based on the number of years the project is in compliance plus interest, but not penalties.

In 1996, the statewide sales and use tax exemption was expanded to include installing, repairing, cleaning, altering, or improving the machinery and equipment. It was later found that research and development firms that do not manufacture a product or license a product to be manufactured by others were not eligible for the tax exemption on machinery and equipment and replacement parts.

**Summary of Substitute Bill:** The high technology statewide sales and use tax deferral/exemption on machinery and equipment is expanded. The tax exemption applies to: (1) labor and services in respect to installing, repairing, cleaning, altering, or improving the machinery and equipment; and (2) replacement parts for the machinery and equipment that has a useful life of one year or more.

The total exemption of deferred sales and use taxes on new construction, and expansion or renovation of existing structures, including necessary labor and services, is extended from an eight-year period to a ten-year period after completion of the project. The amount of deferred taxes that must be repaid for noncompliance by the firm, based on a prorata share, has been revised to reflect the longer compliance period.

**Substitute Bill Compared to Original Bill:** The substitute bill restores original language that was removed that defines research and development to include inventions or software.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date of Substitute Bill:** The bill contains an emergency clause and takes effect on July 1, 1997.

**Testimony For:** The tax exemption for manufacturing businesses has been a gain for the state. The nature of the bio-technology and medical-technology industry is that you incur huge costs before the product is available to the public. This exemption is important in that some of those up-front development costs will be reduced. The bill also completes a piece of tax legislation that everyone thought was included in the 1996 manufacturing sales and use tax exemption.

**Testimony Against:** It has not been proven that these incentives have been effective in luring businesses to locate in the state. Tax incentives are not high on the businesses' list when making determinations to locate in an area. These tax incentives are another hit to local government revenue at a time of increased demand for services. The committee should hold off passing this bill until the Department of Revenue has time to complete a study on the effectiveness of state tax incentive programs.

**Testified:** Representative Thompson, prime sponsor (pro); Len McComb (pro); Tom Rankin, Washington Biotechnology and Biomedical Association (pro); Mike Ryherd, Fred Hutchinson Cancer Research Center (pro); Todd Fedorenko, Institute for Washington's Future (con); and Doug Levy, city of Everett (con).