HOUSE BILL REPORT
HB 1034

As Reported by House Committee On:
Technology, Telecommunications & Energy

Title: An act relating to technology product development incentives.

Brief Description: Providing technology product development tax incentives.

Sponsors: Representative Morris.

Brief History:
Committee Activity:
Technology, Telecommunications & Energy: 1/15/03, 2/25/03 [DPS].

Brief Summary of Substitute Bill

- Extends the business and occupation tax and sales and use tax incentive programs for high technology businesses for certain expenditures associated with research and development and pilot scale manufacturing indefinitely.
- Requires that the recipient of a credit or a deferral/exemption certificate submit to the Department of Revenue an annual report that includes employment and wage goals, performance data, and other information.
- Requires the Department of Revenue to conduct an annual assessment of the research and development incentive programs.
- Provides that a recipient of a credit or a deferral/exemption certificate that fails to submit a complete annual report loses eligibility for the incentives on a prospective basis.

HOUSE COMMITTEE ON TECHNOLOGY, TELECOMMUNICATIONS & ENERGY

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 17 members: Representatives Morris, Chair; Ruderman, Vice Chair; Sullivan, Vice Chair; Crouse, Ranking Minority Member; Nixon, Assistant Ranking Minority Member; Anderson, Blake, Bush, DeBolt, Delvin, Hudgins, Kirby, McMahan, Romero, Tom, Wallace and Wood.

Staff: Mark Matteson (786-7145).

Background:

Business and Occupation, Retail Sales, and Use Taxes

The business and occupation (B&O) tax is Washington State's major business tax. The tax is imposed on the gross receipts of business activities conducted within the state. Revenues are deposited to the State General Fund. A business may have more than one B&O tax rate, depending on the types of activities conducted. Examples of some of the B&O tax rates that apply to Washington businesses include:

Retailing	0.471 percent
Manufacturing and wholesaling	0.484 percent
Services	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.

The retail sales tax applies to the selling price of tangible personal property and of certain services purchased at retail. The tax base includes goods and certain services purchased at retail. The tax is levied at a 6.5 percent rate by the state. Cities and counties may levy a local tax at a rate up to a maximum of 3.1 percent; currently, local rates levied range from 0.5 percent to 2.4 percent. Sales tax is paid by the purchaser and collected by the seller.

The use tax is imposed on items used in the state which were not subject to the retail sales tax, and includes purchases made in other states and purchases from sellers who do not collect Washington sales tax. The state and local rates are the same as those imposed under the retail sales tax. Use tax is paid directly to the Department of Revenue (Department).

Research and Development Tax Incentives

In 1994 the Legislature enacted several tax incentives to encourage additional research and development (R&D) in the high-technology sector. The legislation allows businesses that conduct R&D or pilot scale manufacturing activities in advanced computing, advanced materials, biotechnology, electronic device technology, or environmental technology and that make certain expenditures, to be eligible for a credit against the B&O tax and for an exemption from state and local retail sales and use taxes.

To qualify for the high technology B&O tax credit for R&D, a firm's annual expenditure for research and development must exceed 0.92 percent of the firm's B&O taxable receipts. For for-profit firms, the amount of tax credit is equal to 1.5 percent of the firm's expenditure for R&D, excluding capital improvement costs. For nonprofit organizations conducting R&D, the credit is equal to 0.484 percent of the R&D expenditures. A maximum of $2 million in credit is available each year to an eligible firm. The statute is set to expire on December 31, 2004.

To claim the B&O credit, the applicant must provide certain information to the Department. The applicant must file an affidavit that includes the amount of credit claimed, an estimate of anticipated R&D expenditures for the year for which the credit is claimed, an estimate of taxable income for the year, and other information that the Department deems necessary to administer the credit. In addition, the applicant is also required to supply the Department with information necessary to measure the results of the tax credit program.

Under the 1994 legislation, the same high-technology businesses eligible for the B&O, R&D, tax credit could receive a deferral from retail sales and use taxes for qualified expenditures. Purchases and acquisitions that qualify include those on construction and equipment related to R&D and pilot scale manufacturing. As originally enacted, the program required deferred sales and use taxes to be repaid starting the third year after which the project was put into operation. In 1995 the Legislature modified the incentive, making it an outright exemption if the firms taking the deferral continued to use the facilities or equipment for a qualified use for at least eight years. No new deferral/exemption certificates may be issued under the program after June 30, 2004.

Similarly to the B&O credit, an applicant must provide certain information to the Department under the deferral/exemption program. The applicant is required to submit an application before beginning construction or equipment purchases. The application must include the location of the project, current employment, new employment estimates, estimated wages related to the project, estimated or actual cost data, time schedules for completion and operation, and other information required by the Department. In addition to the application, the applicant must supply the Department with nonproprietary information necessary to measure the results of the program. If the information supplied to the Department indicates that the investment project is used for a purpose other than qualified R&D or pilot scale manufacturing within the first eight years of operation, a portion of deferred taxes is immediately due.

Under the R&D tax incentives program, the Department is required to do an assessment of the program in 1997, 2000, and 2003. The Department has estimated that about 500 firms utilize the B&O credit for R&D expenditures, resulting in savings of over $30 million annually. About 60 businesses each year take the deferral/exemption from sales and use taxes, resulting in annual savings of about $75 million.

Summary of Substitute Bill:

The tax incentives for high technology R&D and pilot scale manufacturing are extended indefinitely.

The business that has taken the credit or that has received a sales and use tax deferral/exemption certificate must file an annual report to the Department. The report must contain certain information, including the value of the incentive taken, job creation or retention goals, hourly wage goals, the actual number of jobs created, actual wages paid, performance data, an indication as to whether the goals are being met, and certain other information. If the business fails to file a complete report, the eligibility to continue the incentive is lost, and, in the case of a business that has received a sales and use tax deferral certificate, one-eighth of all deferred taxes is immediately due. Eligibility may be restored if a complete form is filed the following year.

The Department is required to report on the effectiveness of the incentive programs annually.

Substitute Bill Compared to Original Bill:

Removes changes to the criteria for the existing credit and deferral/exemption programs. Removes changes to the existing intent language for the incentives programs. Removes the requirement that a taxpayer claiming the credit or applying for a deferral/exemption certificate also submit a proposal that outlines the development of the product. Removes the requirement that the Joint Legislative Audit and Review Committee conduct a sunset review of the incentive programs in 2013. Removes provisions that repeal the incentives in 2014.

Extends the incentive programs permanently. Adds a new provision that requires persons that take the credit or that have received a sales and use tax deferral/exemption certificate file an annual report to the Department. Provides that the report must contain various information, including value of the incentive taken, job creation or retention goals, hourly wage goals, actual number of jobs created, actual wages paid, performance data, whether the goals are being met, and other information. Provides that if the person taking the incentive fails to file a complete report, the eligibility to continue the incentive is lost and, in the case of the sales and use tax deferral/exemption, a portion of all taxes deferred is due. Provides that eligibility may be restored if a complete form is filed the following year. Requires the Department to report on the effectiveness of the incentive programs annually.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill takes effect 90 days after adjournment of session in which bill is passed.

Testimony For: This is the only sector of the economy that seems likely to grow in the near future. The reality is that we rely on the technology community for value and for job growth. There are three principal goals underlying this bill: to extend the incentive so as to continue the relationship with the technology community; to link the research and development aspects of the incentive with manufacturing requirements, to enable the state to leverage its equity position in the research and development (R&D) investment; and to include benchmarks in the law, so as to make this a true tax incentive with performance requirements, and not just corporate welfare.

Testimony Against: The number one priority of the American Electronics Association is to have the current R&D incentives made permanent. We can't support the current proposal because it would make the incentive too restrictive. The administrative burden would be much greater. In addition, the information that would be requested in proposals for the incentives is, in some cases, proprietary, which would discourage applications. The proposal appears to require that all product development work occur in-state, but there is a lot of front-end work, such as clinical trials, that by necessity may be required out-of-state. It is not practical for a company to move 100 percent of its manufacturing to Washington for a relatively small tax credit. In addition, there are some entities that might be left out. For example, third party research firms that license the further development of their products to others might not be covered under this proposal.

The biotechnology industry is also in support of extending the current incentives, but against the current proposal. By virtue of its nature, biotechnology product development may be as long as 15 to 20 years. For that kind of cycle, the requirements of this bill would be too onerous for our firms.

The Washington Software Alliance's concern in this proposal is not the extension of the current incentives, but the substitution of one kind of credit for another

Testified: (In support) Representative Morris, prime sponsor.

(Opposed) Terry Byington, American Electronics Association; Linda Hull, Washington Biotechnology and Biomedical Association; and Ron Main, Washington Software Alliance.