

HOUSE BILL REPORT

HB 1751

As Reported by House Committee On:
Trade & Economic Development
Finance

Title: An act relating to providing tax incentives to support the semiconductor cluster in Washington state.

Brief Description: Providing tax incentives to support the state's semiconductor cluster.

Sponsors: Representatives Fromhold, Boldt, Veloria, Cairnes, Gombosky, Roach, Orcutt, Mielke, Grant, Sullivan, Wallace, Moeller, Rockefeller, Chase, Nixon and Skinner.

Brief History:

Committee Activity:

Trade & Economic Development: 2/18/03, 2/28/03 [DP];
Finance: 3/7/03, 3/10/03 [DPS].

Brief Summary of Substitute Bill

- Creates a preferential business & occupation (B&O) tax rate for manufacturers or processors for hire engaged in the manufacturing of semiconductor materials.
- Creates a retail sales and use tax exemption for construction and construction materials and installation services related to new buildings, to be used for the manufacturing of semiconductor materials.
- Creates a retail sales and use tax exemption for gases and chemicals used by a manufacturer or processor for hire, in the manufacturing of semiconductor materials.
- Creates a B&O tax job credit of \$3,000 for each employment position in manufacturing production that takes place in a new building exempt from the sales and use tax.
- Creates a property tax exemption for manufacturing machinery and equipment used in manufacturing semiconductor materials at a building exempt from the sales and use tax.
- Provides for accountability reporting and a review of the rates, credits and exemptions.

HOUSE COMMITTEE ON TRADE & ECONOMIC DEVELOPMENT

Majority Report: Do pass. Signed by 8 members: Representatives Veloria, Chair; Eickmeyer, Vice Chair; Skinner, Ranking Minority Member; McDonald, Assistant Ranking Minority Member; Blake, McCoy, Pettigrew and Priest.

Minority Report: Do not pass. Signed by 3 members: Representatives Chase, Condotta and Kristiansen.

Staff: Tracey Taylor (786-7196).

Background:

Business and Occupation Tax

Washington's business and occupation (B&O) tax is the second largest tax source for the state. In Fiscal Year 2001, B&O tax collection totaled \$2 billion which represented approximately 17.3 percent of state revenue sources within the State General Fund. Almost all businesses located or doing business in Washington are subject to the state B&O tax, including corporations, partnerships, sole proprietors and nonprofit organizations.

There are six different tax rates that apply to various classifications of business activities. A business may have more than one B&O tax rate, depending on the types of activities conducted. The current B&O tax rates are:

- Manufacturing, wholesaling, and other activities: 0.484 percent
- Retailing, environmental cleanup and radioactive cleanup for the United States: 0.471 percent
- Travel agents, stevedoring, & freight brokers, international investment management services: 0.275 percent
- Processing meat (at wholesale); processing soybeans, canola & dry peas; manufacturing wheat into flour; manufacturing raw seafood; warehousing/reselling of prescription drugs; and manufacturing fresh fruit, vegetables & dairy products: 0.138 percent
- Disposal of low-level radioactive waste: and 3.3 percent
- All services, public/nonprofit hospitals, and all other activities: 1.5 percent

In Fiscal Year 2000, manufacturing was responsible for 17.8 percent of the B&O tax liability; wholesaling contributed 10.1 percent; retailing accounted for 15.1 percent; and services produced 34.1 percent of the total B&O tax collected in Washington.

Washington's B&O tax is calculated on gross income from business activities in the state. There are no deductions from the B&O tax for labor, materials, taxes or other costs of doing business. However, some businesses may qualify for certain exemptions, deductions or credits.

An exempted activity is not subject to the B&O tax and is not reported on the Combined Excise Tax Return (CETR). Exempted activities include raising and selling plantation Christmas trees at wholesale; sales for fund-raising of certain nonprofit organizations; international banking facilities; and growing, raising or producing agricultural products.

Deductions must first be reported on a business's CETR as part of the business's gross income, then taken as a deduction. Allowable deductions include bad debts; freight and delivery costs incurred by a Washington manufacturer for out-of-state shipments; and sales made in Washington by an out-of-state seller without activities in Washington that establish, maintain, or facilitate a market for its products or services.

Credits are amounts that have been paid to the Department of Revenue (DOR) which are either not due or are granted by the Legislature for a specific purpose. Credits are subtracted from the B&O tax due on the CETR and include the multiple activities tax credit, the high technology B&O tax credit and the small business B&O tax credit.

The Retail Sales and Use Tax

The retail sales tax is by far the largest revenue source for the state. Together, the revenue for the retail sales tax and its companion use tax account for slightly more than 50 percent of state revenues supporting the State General Fund.

The retail sales tax applies to the selling price of tangible personal property and certain services purchased at retail. In general, the tax applies to goods, construction including labor, repair of tangible personal property, lodging for less than 30 days, telephone service, and participatory recreational activities. The tax is levied at 6.5 percent by the state. Cities and counties may levy a local tax at a rate up to a maximum of 3.1 percent. Sales tax is paid by the purchaser and is collected by the seller.

The use tax is imposed on items used in this state, the acquisition of which was not subject to Washington retail sales tax. This includes purchases made from out-of-state sellers, purchases from sellers who are not required to collect Washington sales tax, items produced for use by the producer, and gifts and prizes. The tax is measured by the value of the item at the time of the first use within the state, excluding any delivery charges. The state and local rates are the same as those imposed under the retail sales tax. However, the use tax is paid directly to the DOR.

Property Taxes

Property taxes apply to the assessed value of all taxable property, which includes all real and personal property located within the state, unless specifically exempted. Real property includes land, structures and certain equipment that is affixed to the structure. Personal property includes machinery, supplies, certain utility property and items which are generally moveable.

The property tax rates consist of the annual levy rates applied to the assessed value of taxable property by the taxing districts, including the state. The state levy rate is set by statute at \$3.60 per \$1,000 of fair market value. There are exemptions for certain properties, including property owned by federal, state and local governments, churches, farm machinery, and business inventory.

Summary of Bill:

B&O Tax Rate for the Manufacturing of Semiconductor Materials

The B&O tax levied on manufacturers of semiconductor materials shall be equal to the value of the product manufactured multiplied by a rate of 0.138 percent instead of the usual manufacturing rate of 0.484 percent. If the business is a processor for hire in the semiconductor industry, the B&O tax shall be equal to the gross income of the business multiplied by the rate of 0.138 percent. Semiconductor materials— means silicon crystals, silicon ingots, raw polished semiconductor wafers, integrated circuits and microchips. This tax rate shall expire July 1, 2017.

B&O Tax Job Credit

A B&O tax credit is authorized for manufacturers of semiconductor materials for each employment position used in manufacturing productions that takes place in a new building exempt from the sale and use tax under this act. The job credit is \$3,000 per employment position and is earned for the calendar year in which a person fills the position. In addition, a credit is earned for each year the position is maintained, up to eight years. If a position is not filled for an entire year, but more than six months, a full credit is still earned. If the position is filled for less than six months, the manufacturer is eligible for 50 percent of the credit.

When a production building in existence on July 1, 2005, is being phased out of operation, during which time employment at the new building at the same site is increased, the manufacturer is eligible for the employment credit at the existing building and the new building, with the limitation that the combined eligible employment does not exceed full employment at the new building, as set by the DOR.

If the DOR finds that a manufacturer is not eligible for a tax credit, the amount of taxes for which the credit has been claimed shall be immediately due, including interest. No penalties shall be assessed.

This credit expires July 1, 2017. However, credits may be taken after July 1, 2017, for those buildings at which commercial production began before July 1, 2017.

Retail Sales and Use Tax Exemptions for Construction, Construction Materials and Installation Services

The retail sales and use taxes shall not apply to: charges made for labor and services related to the construction of new buildings to be used to manufacture semiconductor materials; sales of tangible personal property that will be incorporated as an ingredient or component of such a new building during the course of construction; or the labor and services related to the installation of building fixtures not otherwise eligible for a retail sales exemption. In order to obtain an exemption, the buyer must provide the seller with an exemption certificate from the DOR.

The requirements to qualify for this retail sales and use tax exemption, are:

- (1) The manufacturer or processor-for-hire must maintain at least 75 percent of full employment at the new building for which the exemption is claimed;
- (2) Before commencing the commercial production at the new facility, the manufacturer or processor-for-hire must meet with the DOR to review projected employment levels in the new building(s) and the DOR will determine the number of positions that would be filled at full employment; and
- (3) Where a production building in existence on July 1, 2005, will be phased out of operation during which time employment at the new building at the same site is increased, the manufacturer or processor for hire must maintain 75 percent of the full employment at the manufacturing site overall.

These requirements must be met for an eight-year period, commencing the day the new building begins commercial production. If the manufacturer or processor-for-hire fails to meet the requirements for any one calendar year, one-eighth of the exempt sales and use taxes shall be due and payable by April 1 the following year, plus interest. No penalties shall be assessed.

No exemptions may be claimed after July 1, 2017.

Property Tax Exemption for Manufacturing Machinery & Equipment

Manufacturing machinery and equipment exempt from the retail sales and use taxes that are used in manufacturing semiconductor materials at buildings exempted from the retail sales and use taxes are exempt from property taxes. In order to qualify for this exemption, the manufacturer must also be in compliance with the employment requirements of the retail sales and use tax exemptions.

An application must be made to the county assessor to be granted this exemption.

This exemption applies for taxes levied for collection in 2006 through 2018. The

exemption expires December 31, 2017.

Accountability

A manufacturer or processor-for-hire who reports B&O taxes or who claims an exemption under this act must make an annual report to the DOR detailing the employment and wages at the manufacturing site. The report is due by March 31 following any year in which a tax exemption or credit is taken. This information shall not be confidential and may be disclosed to the public upon request.

Failure to submit an annual report revokes the preferential rate, exemption or credit and the amount of taxes exempted or credited for that year are immediately due and payable. Excise taxes are subject to interest.

By November 1, 2016, the fiscal committees of the House of Representatives and the Senate, in consultation with the DOR, shall report to the Legislature on the effectiveness of this act. The report shall measure the effect of the act on job retention, net jobs created for Washington residents, company growth, diversification of the state's economy, cluster dynamics, and other related factors. The report shall also include a discussion of principles to apply in evaluating whether the Legislature should reenact any or all of the tax preferences in this act.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect on July 1, 2005.

Testimony For: The semiconductor industry is important to Washington State, especially southwestern Washington. This bill is critical to the health and continuing growth of this global industry here. Washington is in competition on an international scale to retain our current semiconductor manufacturers. This is because the industry is capital intensive and the technology has a limited life. Therefore, many of these companies are looking to build new state-of-the-art facilities. Washington has a skilled workforce, but is unable to compete with the incentive packages being offered elsewhere. This bill would allow Washington to compete for siting of these new facilities. In fact, at least one of Washington's current semiconductor manufacturers is looking to build a new facility and, should we retain their presence here, it would be one of the largest private construction jobs in this state. Thus, there would be the immediate positive economic impact from the creation of new construction jobs, as well as the retention and expansion of the semiconductor manufacturer jobs. Both are important for Washington's economic recovery. Moreover, the accountability provisions in this bill are unique and one of the strongest in any economic development program of this nature.

Testimony Against: None.

Testified: Representative Fromhold, prime sponsor; Martha Choe, Department of Community, Trade and Economic Development; Ron Newbry, Washington Economic Development Association; David Michener and Joseph Kalinowski, Wafer Tech; Victor Liang, Linear Technology; Scott Keeney, NLIGHT; Dave Seburn, Solar Grade Silicon; Bart Phillips, Columbia River EDC; Mark Brown, City of Vancouver; Dean Dossett, Mayor, City of Camas; and Rick Wickman, Clark County.

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 8 members: Representatives Gombosky, Chair; Cairnes, Ranking Minority Member; Orcutt, Assistant Ranking Minority Member; Ahern, Conway, Morris, Roach and Santos.

Minority Report: Do not pass. Signed by 1 member: Representative McIntire, Vice Chair.

Staff: Rick Peterson (786-7150).

Summary of Recommendation of Committee On Finance Compared to Recommendation of Committee On Trade & Economic Development:

The substitute contains all the provision of the original bill and also permits public disclosure of the full employment numbers used for determining continuing eligibility for the sales tax exemption on new building construction. The substitute also permits public disclosure of the amount of taxes that must be repaid when a taxpayer has failed to file an annual report on employment and wages to the department of revenue.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill takes effect on July 1, 2005.

Testimony For: Washington is home to a robust semiconductor industry. This a very capital intensive industry. Their location depends on infrastructure and incentives. The bill takes a cluster approach to economic development. Tax incentives are created for manufacturers in the semiconductor industry. This will benefit existing businesses and surrounding suppliers. If Washington is to remain home to this industry we must offer the same competitive advantage offered elsewhere. These companies will grow somewhere we want this to occur in Washington. The bill includes disclosure provisions. Information will be available to evaluate the program. If the company fails to meet the

standard they will lose the exemption. We are no longer competitive in Washington and these firms will locate elsewhere. The cost of production is compared for each facility. Lower taxes will lower costs. The bill will increase competitiveness of Washington sites. The bill is an important step in supporting the existing industry and the future of the industry in Washington.

Testimony Against: None.

Testified: Representative Fromhold, prime sponsor; and Wendy Holden, Department of Community, Trade, and Economic Development.