HOUSE BILL REPORT
HB 2689

As Reported by House Committee On:
Finance

Title: An act relating to extending tax incentives in rural counties expiring in 2003 or 2004.

Brief Description: Extending tax incentives in rural counties expiring in 2003 or 2004.

Sponsors: Representatives Eickmeyer, Buck, Miloscia, Schoesler, Hatfield, Armstrong, Haigh, Skinner, Kessler, Orcutt, Grant, Pearson, Ruderman, Campbell, Blake, Fromhold, Kenney, Woods, Linville and Rockefeller; by request of Governor Locke.

Brief History:
Committee Activity:
Finance: 1/27/04, 2/10/04 [DPS].

Brief Summary of Substitute Bill

- A credit against tax liability under the business and occupation (B&O) tax is available to businesses that:
  - Provide information technology help desk services from rural counties; or
  - Develop or manufacture computer software in rural counties.
- The rural county and distressed area sales and use tax deferral program for manufacturing, computer programming, or research and development businesses is modified such that the recipient taxpayer hire one new full-time employee for each $115,000 of investment for which sales and use tax is deferred.
- Extends the sales and use tax deferral program to July 2010.
- Requires recipients of the tax deferral to respond to a survey by the Department of Revenue concerning the tax savings realized, which may be publicly disclosed, as well as employment and wages.

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 9 members: Representatives McIntire, Chair; Hunter, Vice Chair; Cairnes, Ranking Minority Member; Orcutt, Assistant Ranking Minority Member; Ahern, Conway, Morris, Roach and Santos.

Staff: Mark Matteson (786-7145).

Background:

Business and Occupation Tax

Washington's major business tax is the business and occupation (B&O) tax. The B&O tax is imposed on the gross receipts of business activities conducted within the state, without any deduction for the costs of doing business. The tax is imposed on the gross receipts from all business activities conducted within the state. Revenues are deposited in the state General Fund. A business may have more than one B&O tax rate, depending on the types of activities conducted. The tax rate for most types of service businesses is 1.5 percent and manufacturing businesses is 0.484 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.

Retail Sales and Use Taxes

The retail sales tax applies to the selling price of tangible personal property and of certain services purchased at retail. The tax is imposed at a 6.5 percent rate by the state. Cities and counties may impose a local tax at a rate up to a maximum of 3.4 percent. As of December 2003, local rates imposed 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 that 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).

Retail sales and use taxes apply to everything within the tax base that is not specifically exempt. A requirement for some exemptions is that the buyer present the seller with an affidavit or certificate demonstrating proof that the buyer is eligible for the exemption.

Former Business and Occupation Tax Credits for Businesses in Rural Areas

In 1999, the Legislature enacted an omnibus tax relief package for rural counties. Part of the legislation allowed a credit against B&O tax liability for businesses that provide information technology help desk services by telephone or electronically from rural counties, defined to be counties that have population densities of 100 persons per square mile or less. The amount of the credit was equal to the amount of B&O tax due from activities performed at the rural county location. Information technology help desk services were defined to include certain activities related to computer hardware and software, including maintenance, diagnostics and troubleshooting, installation, repair information and training, and upgrades.

Another provision of the 1999 rural county tax relief legislation was a B&O tax credit for businesses that develop or manufacture software in rural counties. Such businesses were allowed a credit for employment positions created after July 1, 1999, equal to $1,000 for each job created before July 1 of any year that the credit was effective. The credit was allowed for the first year the position was created and for four years thereafter. For positions created after July 1, the allowable credit was $500 for the first year and $1,000 per year for four years thereafter. For businesses that transferred locations between rural counties, the credit was only applicable to any new jobs created as a result of the relocation. The credit was not available to businesses that took the information technology help desk services credit.

Under each credit, no application was necessary to receive the credit, but a business was required to keep records to allow the Department to verify eligibility. A business that was found by the Department to be ineligible was required to repay the amount of the credit with interest, but not penalties. A business taking the credit was required to submit an annual report to the Department with information about the business activity, employment data, and how long the business has been located in the county.

The Department program data indicates that, for fiscal year 2003, approximately $330,000 in credit was taken with respect to help desk services and about $28,000 was taken with respect to computer manufacturing/software programming.

Each of the rural county B&O tax credits expired at the end of calendar year 2003.

Rural County/Distressed Area Sales and Use Tax Deferral Program

The rural county and distressed area tax deferral, as originally enacted in 1985, provided a deferral of sales and use taxes due on plant construction and expansion or on acquisition of equipment by firms that engaged in manufacturing, research and development, or computer programming activities in counties with high rates of unemployment. In 1999, the program was changed so that the incentive is available in any rural county, defined as a county with a population density of less than 100 people per square mile, and in counties with community empowerment zones (CEZs). Firms that use the deferral in counties with CEZs must meet certain employment requirements, relating to the level of deferral requested. Employees hired pursuant to the requirements must be residents of the CEZs.

Under the program, a person that owns property and leases to another may receive deferral of taxes on qualifying expenditures, if the owner under written contract agrees to pass the economic benefit of the deferral on to the lessee by reducing the amount of the lease payments.

To receive the deferral, a firm must apply to the Department prior to the initiation of construction or acquisition of equipment. The application must contain information regarding the project location, project costs, employment, wages, and project schedules. If the application is complete, the Department is required to issue a sales and use tax deferral certificate.

Recipients of a deferral under the program are required to submit a report to the Department by the end of the year in which the project is put into operations, and for each of the seven following years. The report must contain information that allows the Department to determine whether the recipient is meeting the eligibility requirements of the program.

Since 1994, repayment of deferred taxes has been waived, as long as the firm continues to meet eligibility requirements, thus converting the program into an outright tax exemption. The program is scheduled to expire on July 1, 2004.

Thirty-one counties are eligible as rural counties under the program, and four additional counties are eligible because they contain CEZs. The Department has estimated that there are approximately 70 projects approved annually. Taxpayer savings are approximately $16 million annually.

Tax Incentives and Accountability

A number of tax incentives include accountability provisions. The principal components of these provisions are disclosure requirements and enforcement mechanisms. Firms that take certain incentives are typically required to provide such information as number of jobs created, wages paid, and location of new investments. Generally, this information at the taxpayer level is not required to be made available to the public upon request and is typically summarized in reports prepared by the Department to the Legislature. Some information, such as certain tax-related data, is protected by confidentiality provisions and may not be disclosed at the taxpayer level unless specifically exempted otherwise.

With respect to enforcement mechanisms, taxpayers that receive the benefits of specific tax incentive programs are typically required to meet certain eligibility requirements. If the requirements are not met, the taxpayer is required to repay the tax savings to the state. An example is the requirement under the rural county and distressed area sales and use tax deferral that for counties with community empowerment zones a certain number of employees be hired from within the zones, depending on level of investment. Firms in such an area that fail to meet these requirements are required to repay the deferred taxes.

Summary of Substitute Bill:

Credits against B&O tax liability are provided for certain business activity in rural counties through calendar year 2010, and the sales and use tax deferral for projects in rural counties is modified and extended through Fiscal Year 2010.

A credit against the B&O tax is provided to businesses that provide information technology help desk services by telephone or electronically from rural counties under terms similar to those enacted in 1999 and as subsequently amended. To qualify, information technology help desk services must be provided from a rural county, defined as a county with 100 or fewer persons per square mile. These services are defined to include services provided by telephone or electronically for the following functions related to software and hardware: maintenance, diagnostics and troubleshooting, installation, repair, information and training, and upgrade. The credit is equal to the full amount of tax due attributable to providing the services from a rural county.

A B&O tax credit is provided to businesses that develop or manufacture software in rural counties under terms that are similar to those enacted in 1999 and as subsequently amended. Such businesses are allowed a credit for employment positions created after January 1, 2004, equal to $1,000 for each job created before July 1 of any year that the credit is effective. The credit is allowed for the first year the position was created and for four years thereafter. For positions created after July 1, the allowable credit is $500 for the first year and $1,000 per year for four years thereafter. Credit may be taken for qualifying positions for which the business was eligible to continue to take under the former credit at the time the former credit expired, for the number of years that remained under the former eligibility requirements. For businesses that transfer locations between rural counties, the credit is only applicable to any new jobs created as a result of the relocation. The credit is not available to businesses that receive the information technology help desk services credit.

For each of the new credits, no application is necessary to be eligible, but the business must keep adequate records for the Department to verify eligibility. If the Department finds that a business that has claimed credit is ineligible, the business must repay the amount of the credit with interest, but not penalties. Credits may not be carried over from year to year.

A business taking the credit must submit an annual report to the Department. The report is to contain various information, including the type of business activity, number of employees in the rural county, how long the business has been located in the county. Failure to submit a report does not disqualify the business from receiving the credit, but the Department must contact the business and collect the information so as to verify the program's effectiveness.

The rural county and distressed area sales and use tax deferral program is modified to include an employment requirement in all areas under the program that qualify. The requirement is that one new full-time employee be hired for each $115,000 of investment for which a sales and use tax deferral is sought. The requirement applies to projects both in rural areas and in counties that are eligible because they contain community empowerment zones.

A person that owns property and leases to another may receive deferral of taxes on qualifying expenditures, under the following conditions:

- The owner agrees to pass the economic benefit of the tax savings on to the lessee through lower rents or through some other means;
- The lessee receiving the benefit agrees in writing with the Department to complete an annual report; and
- The economic benefit that is passed by the owner to the lessee is at least equal to the tax savings to the owner and is evidenced by written documentation of the financial arrangement to pass on the benefit.

Participants in the sales and use tax deferral program are required to complete an annual survey and provide information on the amount of tax deferred; number of new products, trademarks, patents, and copyrights; number of jobs and the percent of full-time, part-time and temporary jobs; wages by salary band; and number of jobs with employer provided health and retirement benefits. The Department may request additional information necessary to measure the results of the program. Information reported in the survey is confidential, except the amount of taxes deferred, which may be disclosed to the public.

The survey is due by March 31 in the year after the Department determines the project is operationally complete and in each of the seven following years. Participants must pay all deferred taxes if they fail to create the required number of new jobs within two years after the project has been deemed to be operationally complete.

Each year by September 1, the Department will prepare summary descriptive statistics by category from the information provided by the survey. No fewer than three taxpayers will be included in any category.

The Department is required to study the sales and use tax deferral program and report back to the Legislature by December 1, 2009.

The termination date for the sales and use tax deferral program is extended to July 1, 2010.

Substitute Bill Compared to Original Bill:

Requires taxpayers that take either the information technology help desk or computer software programming B&O credit to submit a report to the Department. Requires taxpayers that take the deferral on sales and use taxes on eligible investment projects in rural counties and distressed areas hire at least one new full-time position for each $115,000 of investment for which sales and use taxes would be deferred. Deletes the requirement that deferral applicants submit a report, and instead requires applicants to respond to a survey by the Department each year. Provides that the survey include the amount of tax deferred, employment information by wage band, and aggregated information about products and patents. Allows for public disclosure of the amount of deferral taken. Requires lessors of property that receive the deferral must have a written financial arrangement that provides for the tax savings to be passed to the lessee, and that the lessee then submit the required annual report. Requires the Department to submit an annual summary report to the Legislature each year and to evaluate the program by December 2009. Provides that a taxpayer who takes the deferral and then fails to hire the requisite number of positions is liable for all deferred taxes.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill contains an emergency clause and takes effect on April 1, 2004.

Testimony For: These tax incentives have enabled companies to operate at the Satsop Development Park. The Boise Corporation is responsible for $100 million in investment and 100 jobs. Techtel is an information technology help desk services firm that has 35 employees and utilizes the tax credit to pay for internships. The Safe Harbor Technology Corporation now has 200 employees. We urge the Legislature to pass this to keep the incentives in place.

Safe Harbor is an information technology help desk service. Our clients include Washington Mutual, American Airlines, and several state agencies. The B&O tax credit has helped fill a number of our needs. The jobs that have been created have had a big impact, have pumped more than $50 million into the local economy, and have provided career opportunities to people that might not otherwise have them. We have proved that sophisticated technology businesses can locate in rural areas and compete. We provide hope for the future and a stable work force.

While people thought that locating in rural areas would cost less, this has not really proven to be the case. We don’t pay people less. There is not as much available commercial space. The lack of telecommunications infrastructure and providers mean that we pay more for services. In addition, training costs are high.

Living wage jobs are something that every community aspires to have. However, when local economies fall into double digit unemployment, people just want to get steady work.

The Gates Commission Report shows that the proportion of taxes collected from businesses is out of whack. In Washington it is close to 46 percent, while in other states it is more like 30 percent. The burden placed on high volume, low-margin businesses is unreasonable.

We would support an evaluation based on dynamic modeling. In certain counties, unemployment is still too high. These incentives allow rural areas to become and stay competitive. Grays Harbor County is lucky, with seven companies coming to the county in the last few years. All have taken advantage of some of the incentives. For someone who is expanding and has to make a decision about where to locate, these incentives are a very important factor.

The Governor has made economic development in rural areas a priority. These incentives create jobs, diversify the economy, and provide rural areas high technology jobs. The absence of sales tax for manufacturers making capital investments put the rural border counties on equal footing with those in Oregon.

The Washington Public Ports Association supports this. The sales tax deferral has been an economic development priority for our members over the last 20 years. The Port of Kalama is a poster child for the benefits of this incentive. They compete with Oregon locations, and the rate-of-return analysis has shown that this is a net benefit to the state over time. There is a tremendous amount of return. All ports have equal amenities, more or less, and this incentive keeps us ahead. In 1985, if we hadn't had this incentive, we would not have been able to land the mill.

Testimony Against: None.

Persons Testifying: (In support) Representative Eickmeyer, prime sponsor; Jim Hedrick, Office of the Governor; Scott Taylor, Washington Public Ports Association; Lanny Cawley, Port of Kalama; Michael Tracy, Grays Harbor Economic Development Council; Ron Newbry, Phoenix Association; Tami Garrow, Satsop Development Park; Paul Parker, Washington State Association of Counties; and Brian Sterling, Safe Harbor Technical Corporation.

Persons Signed In To Testify But Not Testifying: None.