Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Technology, Telecommunications & Energy Committee

HB 1034

Brief Description: Providing technology product development tax incentives.

Sponsors: Representative Morris.

Brief Summary of Bill

- Extends the business and occupation (B&O) tax and sales and use tax incentive programs for high technology businesses for certain expenditures associated with research and development (R&D) and pilot scale manufacturing to 2014.
- Modifies the incentives so that they pertain to product development as a whole, rather than just R&D, and requires applicants to include a proposal outlining the technological development of anticipated products through the manufacturing stage.

Hearing Date: 1/15/03

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.

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 state business and occupation (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 to1.5 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. To claim the credit, an applicant must file an affidavit with the department 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. A maximum of $2.0 million in credit is available each year to an eligible firm. The statute is set to expire on December 31, 2004.

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. To receive the deferral, an applicant is required to submit an application to the department 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.

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.

Under the R&D tax incentives program, the Department of Revenue 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.

Sunset Review

The Legislature may schedule a program or agency to be terminated under the sunset review process. The Joint Legislative Audit and Review Committee (JLARC) must conduct a program and fiscal review of the program or entity scheduled for termination and prepare a preliminary report of its review by June 30, of the year prior to the termination date. The JLARC reports on the results of its review to the Legislature, the Governor, the affected agency, and the Secretary of State. Subsequent to receipt of the final report, the appropriate standing committees of the House and Senate must hold hearings to consider the final report and may propose legislation reestablishing, modifying, or transferring the functions of the program or agency.

Summary of Bill:

The tax incentives for high technology research and development (R&D) and pilot scale manufacturing are extended to the year 2014 and modified to limit the incentives to those firms that develop products through the manufacturing stage within Washington State.

The business and occupation (B&O) tax credit for qualified R&D expenditures, and the associated sales and use tax deferral/exemption program for capital or equipment expenditures, are extended and modified to pertain to product development through the manufacturing stage. In addition to the existing criteria, only those firms that conduct within the state product development associated with the qualified R&D expenditures, with the exception of federally mandated field testing, may qualify for the B&O credit. Similarly, only those firms that conduct within the state product development associated with the qualified expenditures on construction or equipment for R&D or pilot scale manufacturing may qualify for the sales and use tax deferral/exemption. Firms that apply for either of the incentives must include a proposal that outlines the planned development of the product, including all research and development activities, as well as manufacturing activities. The proposal must describe the anticipated product, activity location, and employment. The Department of Revenue is required to do an additional assessment of the credit and the deferral/exemption program in 2008.

The Joint Legislative Audit and Review Committee is required to do a sunset review of the incentives by July 1, 2013. The incentives are repealed, effective July 1, 2014.

Appropriation: None.

Fiscal Note: Requested January 10, 2003.

Effective Date: Ninety days after adjournment of session in which bill is passed.