
Finance Committee

HB 1454

Brief Description: Eliminating the expiration date on certain business and occupation tax credits and deferrals.

Sponsors: Representatives Morris, Cairnes, Gombosky, Bush, O'Brien, Linville, Anderson, Kirby, Tom, Grant, Kessler, Sullivan, Roach, Benson, Newhouse, Chandler, Orcutt, Nixon, Woods, Rockefeller, McMahan, Campbell, Pflug, Upthegrove and Ruderman.

Brief Summary of Bill

- Extends the business and occupation (B&O) tax credit allowed to high technology businesses for certain expenditures associated with research and development (R&D) indefinitely.
- Extends the sales and use tax deferral/exemption for certain expenditures associated with R&D and pilot scale manufacturing indefinitely.

Hearing Date: 2/4/03

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. The rate at which gross receipts derived from research and development activities are taxed depends on whether the business is for-profit or nonprofit. For-profit firms pay at a rate of 1.5 percent; nonprofits pay at a rate of 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.

The retail sales tax applies to the selling price of tangible personal property and of certain services purchased at retail. The tax base includes construction and equipment purchase costs, as well as costs for labor and services associated with the construction. 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 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.

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 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. 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. If the firm's annual expenditure for R&D fails to exceed 0.92 percent of taxable receipts, the firm is liable for an amount equal to the amount of credit taken, plus interest. 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 tax credit for R&D spending were made eligible to 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 or to 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 firm 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.

The Department of Revenue is required under the 1994 legislation 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 \$60 million.

Summary of Bill:

The provisions that terminate the business and occupation tax credit and the sales and use tax deferral/exemption provided to high-technology firms for operational and capital expenditures relating to research and development and to pilot-scale manufacturing are removed, making the incentives permanent.

Appropriation: None.

Fiscal Note: Available.

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