

---

**Finance Committee**

---

**HB 2689**

**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 Summary of 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 sales and use tax deferral program for manufacturing, computer programming, or research and development businesses that construct or expand plants or acquire equipment is extended to July 1, 2010.

**Hearing Date:** 1/27/04

**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.

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 of Revenue 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 of Revenue 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.

To receive the deferral, a firm must apply to the Department of Revenue 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.

### **Summary of 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 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 was not available to businesses that took 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 of Revenue 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.

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

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill contains an emergency clause and becomes effective April 1, 2004.