

SENATE BILL REPORT

ESHB 2546

As of February 6, 2004

Title: An act relating to high technology and research and development tax incentives.

Brief Description: Modifying high technology and research and development tax incentive provisions.

Sponsors: House Committee on Finance (originally sponsored by Representatives McIntire, Morris, Hunter, Ruderman, Kessler, Lovick, Hunt, Grant, Hatfield, Fromhold, Clibborn and Clements; by request of Governor Locke).

Brief History:

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Background: In 1994 the Legislature enacted tax incentives to encourage additional research and development (R&D) in the high-technology sector. The legislation allows businesses that conduct activities in advanced computing, advanced materials, biotechnology, electronic device technology, or environmental technology to take a credit against the business and occupation (B&O) tax and an exemption from sales and use taxes on construction of R&D and pilot scale manufacturing facilities.

A firm qualifies for the high technology B&O tax credit for R&D spending if the firm's spending on research and development exceeds 0.92 percent of B&O taxable income. For-profit firms may take a credit equal to 1.5 percent of R&D spending. The credit is equal to 0.484 percent of the R&D expenditures for nonprofit organizations. A maximum of \$2 million in credit is available each year to an eligible firm. The tax credit program expires on December 31, 2004.

Firms taking the B&O tax credit file an affidavit 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.

Firms that create a new operation or expand or diversify a current operation in R&D or pilot scale manufacturing are eligible for a sales and use tax exemption on the project. The exemption includes sales and use tax on building construction and purchases of equipment. If the investment project is used for a purpose other than qualified R&D or pilot scale manufacturing within the first eight years of operation, a proportionate share of exempted taxes must be paid.

Firms apply for the exemption before starting 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. Applications for the program are not confidential and may be disclosed to the public. No new projects will be approved for exemption after June 30, 2004.

Participants in both tax incentives are required to supply the Department of Revenue with information necessary to measure the results of the tax credit program. The department was required to do assessments of the programs in 1997, 2000, and 2003. The department has estimated that about 600 firms utilize the B&O credit for R&D expenditures each year, resulting in tax savings of about \$25 million annually. About 50 to 60 businesses use the sales and use tax exemption each year with annual tax savings of about \$40 million. Firms in the advanced computing and biotechnology sectors have used the majority of the incentives. The majority of the incentives have been used in King County.

Under the federal small business innovation research program, grants are made to small businesses for research and development. Under the federal small business technology transfer program, grants are made for research and development to small business partnering with nonprofit research institutions. To be eligible for the programs, a business must be American owned, independently operated, for profit, employ the principal researcher, and have not more than 500 employees. Amounts received by a small business under these programs are subject to the B&O tax.

Sales tax is imposed on all sales to state and local governments other than sales for resale. The federal government is immune from direct taxation by the states unless Congress has specifically waived that immunity. States may impose indirect taxes on the federal government as long as the economic burden borne by the federal government is not greater than that borne by a similarly situated entity. Under current law, contractors on federal construction projects are considered the consumer of tangible personal property purchased or used by them. Therefore, the federal government is indirectly subject to the sales and use tax on the materials. The U.S. Supreme Court upheld this tax treatment in *Washington v. United States*, 460 US 536 (1983) explaining that as long as the burden on the federal government was not greater than the burden on other contractors for other governmental or private activities, the tax would be valid.

Summary of Bill: The business and occupation tax credit for research and development spending is extended from December 31, 2004 to January 1, 2015. The R&D credit is calculated on the amount of R&D expenditures in excess of 0.92 percent of taxable income. For taxpayers other than nonprofit institutions, the credit is computed using the taxpayer's average tax rate rather than 1.5 percent. The affidavit that previously was filed with each tax return is changed to an annual report that is filed in the year following use of the credit.

The sales and use tax exemption for new, expanded, or diversified operations in R&D or pilot scale manufacturing is extended from July 1, 2004 to January 1, 2015. State universities (UW and WSU) may take the exemption. An exemption from sales and use tax is provided for federal contractors on materials purchased for an investment project that would be eligible for the deferral program if undertaken by a private entity.

Participants in both programs are required to complete an annual survey and provide information on the amount of B&O tax credit or sales tax exemption; 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 of Revenue may request additional information necessary to measure the results of the programs. Information reported in the survey is confidential except the amount of B&O credit and the amount of sales tax exemption taken is not confidential. Businesses taking less than \$10,000 in B&O credit may request the credit amount be treated as confidential.

The survey is due by March 31. B&O tax credit participants may not take credits in any year they fail to complete the survey. Sales and use tax exemption participants must pay 12.5 percent of the tax exempted for each year they fail to complete the survey.

Each year by September 1, the Department of Revenue 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 of Revenue is required to study the B&O tax credit program and the sales and use tax exemption program and report back to the Legislature by December 1, 2009 and December 1, 2013.

Amounts received by businesses from the federal small business programs for innovation research and technology transfers are exempt from B&O tax.

Appropriation: None.

Fiscal Note: Available. New fiscal note requested on January 24, 2004.

Effective Date: Ninety days after adjournment of session in which bill is passed, except for sections 9 and 10 relating to the B&O exemptions for amounts received from the federal small business programs for innovation research and technology transfers, which takes effect on July 1, 2004.