SENATE BILL REPORT
ESSB 6239

As Passed Senate, January 28, 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: Senate Committee on Ways & Means (originally sponsored by Senators Zarelli, Benton, Carlson, Hale, McAuliffe, Prentice, Rasmussen, Murray, Haugen and Poulsen; by request of Governor Locke).

Brief History:
Committee Activity: Ways & Means: 1/20/04, 1/21/04 [DPS, DNP].
Passed Senate: 1/28/04, 35-13.

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: That Substitute Senate Bill No. 6239 be substituted therefor, and the substitute bill do pass.
Signed by Senators Zarelli, Chair; Hewitt, Vice Chair; Parlette, Vice Chair; Carlson, Doumit, Hale, Honeyford, Johnson, Rasmussen, Roach, Sheahan and Winsley.

Minority Report: Do not pass.
Signed by Senators Fairley, Fraser and Regala.

Staff: Terry Wilson (786-7433)

Background: The sales tax is paid on each retail sale of most articles of tangible personal property and certain services. Taxable services include construction, repair, telephone, lodging of less than 30 days, physical fitness, and some recreation and amusement services. The use tax is imposed on the use of articles of tangible personal property when the sale or acquisition has not been subject to the sales tax. The use tax commonly applies to purchases made from out-of-state firms.

The business and occupation (B&O) tax is levied for the privilege of doing business in Washington. The tax is levied on the gross receipts of all business activities conducted within the state. There are no deductions for the costs of doing business.

A B&O tax credit for high technology research and development is available for research and development expenditures by high technology firms that spend 0.92 percent of their gross income on research and development. The amount of the credit is 0.484 percent of eligible research expenditures for nonprofit institutions and 1.5 percent for other firms, with a $2.0 million maximum annual credit per firm. The credits expire December 31, 2004.

The high technology sales and use tax deferral program is available statewide to businesses involved in "high-tech" research and development and pilot scale manufacturing. The business must be involved in biotechnology, advanced computing, electronic device technology, advanced materials, or environmental technology. These businesses may defer sales and use taxes on buildings, machinery and equipment, and installation labor. An expansion or renovation must increase the floor space or production capacity of an existing structure to qualify. These taxes need not be repaid unless the project is used for a non-qualifying purpose during the eight years after the project is operationally complete. If used for a non-qualifying purpose, a pro-rata share of the taxes are due. However, no repayment is required on new and replacement machinery and equipment used by a manufacturer in a manufacturing or research and development operation, including installation labor and services.

A report on the effectiveness of the high technology B&O tax credit for research and development and the high technology sales tax deferral program was completed by the Department of Revenue in October 2003.

Under the federal small business innovation research program, grants are made to small business 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 B&O tax credit for high technology research and development is extended ten years to January 1, 2015. For persons other than nonprofit institutions, the credit is computed using the person's average tax rate rather than 1.5 percent.

The high technology sales and use tax deferral program is extended ten years to January 1, 2015, and expanded to include the state universities.

A person claiming the credit must supply the Department of Revenue with information on research and development spending, and product development. Applicants for deferral must complete an annual survey, supplying the department with nonproprietary information necessary to measure the results of the tax deferral program. The survey may include questions pertaining to job creation, job retention, the number of full-time equivalent positions created, overall industry wage levels, company growth, introduction of new products, growth in research and development investment, and movement or consolidation of firms' operations into the state. The Joint Legislative Audit and Review Committee uses the information and information from other state agency sources to study the tax credit and deferral programs and report to the Legislature by December 1, 2013. The credit study must measure the effect of the program on company growth, the introduction of new products, the diversification of the state's economy, growth in research and development investment, and the movement or consolidation of firms' operations into the state. The deferral study must measure the effect of the program on job creation, the number of jobs created, company growth, the introduction of new products, the diversification of the state's economy, growth in research and development investment, and the movement or consolidation of firms' operations into the state.

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.

The B&O tax does not apply to amounts received by a small business for research and development under the federal small business innovation research program or the federal small business technology transfer program.

Appropriation: None.

Fiscal Note: Available.

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

Testimony For: These incentives are important tools for economic development and are critical to the economy. They lower the cost on new businesses. They create high-paying jobs and are needed to compete in the global economy. R&D has an immediate payoff in the local economy but the companies take years before becoming profitable. They further business investment and job creation. R&D investment and employment growth in Washington have outpaced the rest of the nation because of these incentives. They are working.

Testimony Against: The report says there was strong job growth in the 1990's in the United States. You cannot say these programs have helped. The money would be better spent on government services which also help business. Tax expenditures are public spending just like any other but there is no accountability or means testing like other programs. There is no accounting of who gets them or how they use the money. Most other states require much greater disclosure than Washington. This is a tax give away. They need to be capped. These tax breaks are unaffordable if it means cutting services. They benefit established businesses that do not need them. The programs are not cost effective.

Testified: PRO: Bart Phillips, Columbia River EDC; Ron Newbry, WA Econ. Dev. Assn.; Dave McFadden, Yakima County Econ. Dev. Council; Bruce Kendal, Pierce County Econ. Dev. Council; Jim Gore, Seattle Biomedical Research Institute; Jim Hedrick, Governor's Office; Randy Hodgins, University of Washington; Larry Ganders, WSU; Linda Hull, WBBA; Greg Weaver, NASTECK; Tom Clements, Pathway; Len McComb, Amgen; Nancy Atwood, ACA; Rachel LeMieux, Moss Adams; Lew McMurran, WSA; CON: Jeff Johnson, WSLC; Ellie Menzies, SEIU; Marily Watkins, EOI; Kristen Rodgers, WA Assoc. of Churches; Julie Watts, Poverty Action Network; Sarajane Siegfreidt, citizen; Kevin Glackin Coley, Children's Alliance; Bob Cooper, WA Citizen's Action; Chris Burks; SEIU 775; Sandra Schroeder; AFT; Alan Mountjoy-Venning, Friends Committee on Was State Public Policy.