BILL ANALYSIS

Economic Development, Agriculture & Trade Committee

HB 1574

Brief Description: Providing sales and use tax relief for qualifying small businesses constructing manufacturing facilities.

Sponsors: Representatives Morrell, McDonald, Linville, Springer, Flannigan, Campbell, Pettigrew, Conway, P. Sullivan, Holmquist, Ericks, Hinkle, Upthegrove, Williams and Hudgins.

Brief Summary of Bill

- Authorizes the deferral of the state sales and use tax and the local sales and use tax on the construction of qualified investment projects or the acquisition of equipment or machinery by a qualified small business.

Hearing Date: 2/15/05

Staff: Tracey Taylor (786-7196).

Background:

State Sales Tax
Washington levies a sales tax on the selling price of tangible personal property and certain services purchased at retail. This includes goods, construction including labor, repair of tangible personal property, lodging for less than 30 days, and some personal and professional services, such as landscape maintenance and physical fitness. The state retail sales tax is 6.5 percent. There are local taxes credited against the state sales tax, including a two percent hotel/motel tax upon accommodations for cities and counties. There are also exemptions from the state sales tax, including certain farm related products, certain producer goods, and nonresident purchases. In addition, sales tax deferrals have been authorized for certain purposes, including new or expanding manufacturing or research and development firms in rural counties.

The state sales tax is collected from purchasers by retail vendors at the time of sale using the tax rate schedules provided by the Department of Revenue (DOR). Total transactions are reported in the seller's combined excise tax return (CETR) and receipts are forwarded to the DOR on a monthly or quarterly basis. In fiscal year 2004, the state retail sales tax generated $5.791 billion in revenue.

State Use Tax

For items used in Washington, but the acquisition of which was not subject to the Washington retail sales tax, the Washington use tax is applied. This includes purchases made from out-of-state sellers, including catalog and Internet purchases, purchases from sellers who are not required to collect sales tax, items produced for use by the producer, and gifts and prizes. The tax is measured by the value of the item at the time of the first use within Washington, excluding any delivery charges. The state use tax rate is the same as the state retail sales tax -- 6.5 percent.

Tax on equipment bought in other states and on manufactured items used in production is reported by a business on their CETR. Tax on sales from a seller not required to collect retail sales tax, such as a vehicle sale by a private owner, is collected by county auditors and registration agents, at the time of title transfer. Individuals who acquire items not subject to the retail sales tax are obligated to report the tax on the Consumer Use Tax Return. The use tax exemptions are parallel to those authorized for the retail sales tax credit. In addition, items donated to schools and charities are exempt from the state use tax. In 2004, $391 million in state use tax was collected.

Local Sales & Use Tax

Just as the state taxes the sale of tangible personal property and some services purchased at retail, cities and counties may levy a local sales and use tax. State law currently authorizes 17 different types of local sales and use taxes. There is: a basic 0.5 percent tax for cities and counties; an optional tax of up to 0.5 percent for cities and counties; three local taxes for the support of transportation program; a tax of up to one percent to fund high capacity transportation; two taxes for funding criminal justice or public safety programs; taxes of 0.1 percent each for public facilities, juvenile correctional facilities, zoos and emergency communications facilities; two state-credited taxes to finance professional sports stadiums; and two state-credited taxes to support rural counties and regional centers.

Manufacturing Machinery Exemption

In 1995, the Legislature authorized a state and local sales and use tax exemption for new or replacement manufacturing machinery and equipment if it is used in a manufacturing operation. Materials and installation labor are included for machinery, equipment, pollution control equipment, and the internal use portion of cogeneration equipment. The exemption includes repair parts and labor, research and development equipment, testing devices and certain logging and rock-crushing equipment. It is estimated that at least 15,000 manufacturing firms in Washington are potentially eligible. In fiscal year 2004, eligible taxpayers saved $148 million in state sales and use taxes and $43.2 million in local sales and use taxes.

Summary of Bill:

A state and local sales and use tax deferral may be granted for the construction of an investment project or the acquisition of equipment and machinery for qualified small businesses.

A qualified small business is a business that pays all of its employees at least one and one half times the state's minimum wage at the time the project is certified as operationally complete and it offers a health care plan to all full-time employees. In addition, the small business cannot exceed certain employment levels: 50 or fewer employees at the time of the application and at the time the project is certified as operationally complete; 100 or fewer employees at the end of the first calendar year following the year that the project is certified as operationally complete; 200 or fewer employees at the end of the second calendar year following certification that the project is operationally complete; or 400 or fewer employees following the third calendar year that the project is certified as operationally complete.

An application is required prior to the initiation of construction of an investment project or the acquisition of equipment or machinery. The application must contain the location of the project; the applicant's average employment in the state for the prior year; estimated or actual new employment related to the project; estimated or actual costs; time schedules for completion and operation; and other information as required. The department shall rule on the application within 60 days. If the department finds that the project or purchase qualifies, it shall issue a sales and use tax deferral certificate for both the state sales and use tax and the local sales and use tax.

A recipient of the tax deferral shall file an annual report by March 31 in calendar year following the year in which the eligible investment was certified as operationally complete.

Unless a recipient of the tax deferral fails to file an annual report or the DOR finds that the recipient is no longer eligible for the tax deferral, the taxes deferred do not need to be repaid.

If an investment project is used for purposes other than manufacturing or the recipient is no longer a qualified small business at any time during the calendar year in which the investment project is certified as operationally complete, or if at any time during the following calendar years, a portion of the deferred taxes, including interest, shall be immediately due and payable based on a sliding scale. In the first year, the deferred taxes must be paid in full; however, if ineligibility occurs in the fourth year, only 25 percent of the deferred taxes must be repaid.

If an investment project no longer qualifies for deferred taxes under this act, but is eligible for a tax deferral as an investment project in a rural county, then the DOR shall issue a deferral certificate under the rural county program.

Taxes are not eligible for deferral until after July 1, 2005.

Appropriation: None.

Fiscal Note: Requested on January 31, 2005.

Effective Date: The bill contains an emergency clause and takes effect immediately.