

HOUSE BILL REPORT

HB 1695

As Reported by House Committee On:
Finance

Title: An act relating to the business and occupation tax credit for high technology research and development spending.

Brief Description: Restoring the business and occupation tax credit for high technology research and development spending.

Sponsors: Representatives Eddy, Dunn, Wallace, Orcutt, Linville, Ericks and Kelley; by request of Department of Revenue.

Brief History:

Committee Activity:

Finance: 2/6/07, 3/2/07 [DP].

Brief Summary of Bill

- Increases the amount of business and occupation tax credit available for research and development spending.

HOUSE COMMITTEE ON FINANCE

Majority Report: Do pass. Signed by 5 members: Representatives Hunter, Chair; Orcutt, Ranking Minority Member; Ericks, Roach and Santos.

Minority Report: Do not pass. Signed by 4 members: Representatives Hasegawa, Vice Chair; Condotta, Assistant Ranking Minority Member; Conway and McIntire.

Staff: Rick Peterson (786-7150).

Background:

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. 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. There are a number of different rates. The main rates are: 0.471 percent for

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retailing; 0.484 percent for manufacturing, wholesaling, and extracting; and 1.5 percent for professional and personal services, and activities not classified elsewhere.

The B&O tax allows a credit for operational research and development (R&D) expenditures in high-technology businesses. The credit is provided to businesses, including qualifying nonprofit organizations, that make R&D expenditures in excess of 0.92 percent of taxable income. The R&D eligible for the credit is R&D performed within this state in the fields of advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology. No firm may take more than \$2 million a year in credit. The credit program expires on January 1, 2015.

In the 2004 session, the Legislature modified the high technology R&D, B&O tax credit. The amount of credit is based on amounts spent on R&D in excess of 0.92 percent of a business' total taxable amount for the year. In addition, calculation of the credit by for-profit firms is based on the average tax rate of the firm for the tax reporting period, rather than 1.5 percent, the requirement prior to the 2004 changes. Therefore the credit is equal to the average tax rate multiplied by the amount spent on R&D in excess of 0.92 percent of the business' total taxable amount.

In 2005, additional changes were made to the program. For the purposes of calculating the high technology B&O tax credit for R&D spending, the average tax rate is defined to be business' total annual taxable amount, including both taxable income and the value of the products manufactured. Beginning in calendar year 2007, taxpayers claiming the high-tech R&D credit will calculate the credit based on the firm's average tax rate or a specified percentage, whichever is higher. The specified percentage is 0.75 percent in calendar year 2007; 1.0 percent in 2008; 1.25 percent in 2009; and 1.5 percent in 2010 and thereafter.

Summary of Bill:

The R&D, B&O credit is based on the entire amount of R&D spending, not just spending in excess of the 0.92 percent qualification threshold. Taxpayers must still spend at least 0.92 percent of a taxpayer's total taxable amount for the year to qualify for the credit.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect on October 1, 2007.

Staff Summary of Public Testimony:

(In support) High tech is a growth industry. It brings family wage jobs. There are three drawbacks to allowing credit to only the R&D expenditures that exceed 0.92 percent of income. The amount of credit is reduced, especially for firms that are just above the 0.92 percent threshold. It creates another layer of complication. If firms are successful in creating

new products, their underlying income will rise and the 0.92 percent threshold will increase and result in a lower B&O credit. This will simplify and streamline the tax code. About 600 small and medium firms will benefit. The current credit calculation is a problem for smaller firms that are barely above the 0.92 percent threshold. Most of these companies will put the credit back into R&D.

(Opposed) None.

Persons Testifying: (In support) Representative Eddy, prime sponsor; Gil Brewer, Department of Revenue; Amber Carter, Association of Washington Business; and Mike Bernard, Madison Cooke/Association of Washington Business.

Persons Signed In To Testify But Not Testifying: None.