Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Finance Committee

HB 3245

Brief Description: Concerning the excise taxation of the aerospace industry.

Sponsors: Representatives Liias, Orcutt, Ericks, Sells, Loomis, Ormsby, Grant, Condotta, Barlow, McIntire, Dunn, Conway, Kelley and Kenney.

Brief Summary of Bill

- Expands tax incentives for the aerospace industry.

Hearing Date: 2/5/08

Staff: Don Taylor (786-7388).

Background:

Washington's principal tax on businesses is the state business and occupation (B&O) tax. The B&O tax applies to the gross receipts derived from engaging in business. Although the tax does not reflect the cost of doing business, there are a variety of exemptions, deductions and other tax incentives permitted by law. Major tax rates are 0.484 percent for manufacturing and wholesaling; 0.471 percent for retailing, and 1.5 percent for services; several lower rates also apply to specific business activities. The B&O tax generates about 16 percent of all state tax collections; most of the receipts are deposited in the state general fund.

In 2003 several B&O tax incentives were enacted which target the aerospace industry. These included the following:

1. A preferential B&O tax rate of 0.2904 percent for manufacturing of commercial airplanes and their components, compared with the general manufacturing rate of 0.484 percent.
2. A preferential B&O tax rate was established for firms that are certified by the Federal Aviation Administration which perform a limited range of repair activities for commercial aircraft. Initially, the tax rate dropped to 0.275 percent but in 2006 it was increased slightly to 0.2904 to correspond with other specialized B&O tax rates.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

3. A B&O tax credit for research and development expenditures incurred by manufacturers of commercial airplanes and components prior to commencement of actual production. In 2006 the credit was broadened to include pre-production expenditures of aerospace firms that are not actually manufacturers or processors for hire.

4. A B&O tax credit for property or leasehold excise taxes paid on new or expanded structures and machinery and equipment devoted to manufacturing commercial airplanes and components.

<u>Retail Sales & Use Tax</u>

Washington's major tax is the state retail sales tax and it's companion use tax. Together, these comprise approximately 47 percent of all state tax receipts. In addition, local sales/use taxes are a major source of revenue for cities, counties and other types of local taxing districts.

The sales tax applies to purchases for which the buyer actually uses the item or service (i.e., not for direct resale); use tax applies to items upon which the retail sales tax was not paid (e.g., items purchased out of state or from nonretail vendors). Most purchases of tangible personal property, including items used by businesses, are subject to the tax. Some services, such as contract construction or repair of tangible personal property, are subject to the tax; however, the majority of personal and profession services are not taxable. A variety of exemptions apply to certain types of goods - e.g., manufacturing machinery and motor vehicle fuel - or to specific types of purchasers.

The state levies a sales/use tax rate of 6.5 percent; local sales/use tax rates range from 0.5 to 2.4 percent. Starting in April 2008 the highest combined rate in the state will be 9.0 percent.

In 2003 a sales/use tax exemption was enacted for computer hardware and software used in developing commercial airplanes by manufacturers. The exemption was expanded in 2006 to firms engaged in related aerospace work but which were not actually manufacturers of commercial airplanes or components.

Summary of Bill:

A variety of tax incentives pertaining to the aerospace industry are amended by the bill. These are summarized below:

1. Sales/use tax exemption for computer hardware and software used by manufacturers in developing commercial airplanes is broadened to include:

   - Computer hardware and software used by firms involved in maintenance, repair, overhaul or refurbishing of commercial airplanes, if they are certified by the Federal Aviation Administration (FAA) under regulation Part 145, or
   - Computer hardware and software used in the design of machinery and tooling by aerospace manufacturers.

2. The preferential B&O tax rate of 0.2904 percent for manufacturing of commercial airplanes and their components is broadened to include tooling which is used in manufacturing commercial airplanes.

3. The preferential B&O tax rate of 0.2904 for repair of commercial aircraft is broadened to include <u>any</u> repair activities which are performed pursuant to certification of the FAA under regulation Part 145, as long as the repair is restricted to items used in interstate or foreign commerce. Currently, only repair stations which have specified ratings under the FAA regulation (e.g., for airframe and instruments, or limited ratings for nondestructive testing, radio, Class three Accessory, and specialized services), qualify for the lower B&O tax rate.

4. A new preferential B&O tax rate is established under the service classification. Instead of the regular 1.5 percent rate, firms engaged in aerospace product development are provided a lower rate of 0.9 percent. In addition to commercial airplanes and their components, aerospace products include machinery used in maintaining, repairing, overhauls or refurbishing airplanes and components by certified repair stations and tooling designed for use in manufacturing of airplanes and components.

5. The B&O tax credit for pre-production R&D expenditures by manufacturers of commercial airplanes and components is broadened to include expenditures in developing aerospace products. This includes the activities noted in the previous paragraph, i.e. machinery for maintaining, repair, etc. of commercial airplanes and tooling equipment.

6. The B&O tax credit for property or leasehold excise taxes paid on new or expanded structures and machinery and equipment devoted to manufacturing commercial airplanes and components is expanded to facilities for development of aerospace products as discussed above.

The bill extends annual reporting requirements to new firms covered by these incentives.

Because of the broader incentives provided by the bill in other statutes, the bill repeals two of the existing tax incentive statutes - the B&O tax credit for pre-production expenditures and a sales tax exemption for computer equipment for firms that perform aerospace services but do not actually manufacture commercial airplanes.

Appropriation: None.

Fiscal Note: Requested on January 28, 2008.

Effective Date: The bill takes effect 90 days after adjournment of session in which bill is passed.