

# HOUSE BILL REPORT

## HB 1347

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### As Reported by House Committee On: Ways & Means

**Title:** An act relating to sales and use tax exemptions for certain property and services used in manufacturing, research and development, or testing operations, not including changes to RCW 82.08.02565 and 82.12.02565 that reduce state revenue

**Brief Description:** Concerning sales and use tax exemptions for certain property and services used in manufacturing, research and development, or testing operations, not including changes to RCW 82.08.02565 and 82.12.02565 that reduce state revenue.

**Sponsors:** Representatives Hunter and Orcutt; by request of Department of Revenue.

#### **Brief History:**

##### **Committee Activity:**

Ways & Means: 1/25/11, 2/25/11 [DPS].

#### **Brief Summary of Substitute Bill**

- Clarifies that the sales and use tax exemption for machinery and equipment (M&E) does not apply if the M&E is used in connection with utility-related activities.
- Clarifies that the sales and use tax exemption for M&E does not apply to research and development activities of the state or its public institutions.
- Provides a five year stand-alone sales and use tax exemption for M&E used by public research institutions as part of a research and development operation.

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#### **HOUSE COMMITTEE ON WAYS & MEANS**

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 27 members: Representatives Hunter, Chair; Darneille, Vice Chair; Hasegawa, Vice Chair; Alexander, Ranking Minority Member; Bailey, Assistant Ranking Minority Member; Dammeier, Assistant Ranking Minority Member; Orcutt, Assistant Ranking Minority Member; Carlyle, Chandler, Cody, Dickerson, Haigh, Haler, Hinkle, Hudgins, Hunt,

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*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.*

Kagi, Kenney, Ormsby, Parker, Pettigrew, Ross, Schmick, Seaquist, Springer, Sullivan and Wilcox.

**Staff:** Jeffrey Mitchell (786-7139).

**Background:**

Retail sales and use taxes are imposed by the state, most cities, and all counties. Retail sales taxes are imposed on retail sales of most articles of tangible personal property and digital products and some services. A retail sale is a sale to the final consumer or end user of the property, digital product, or service. If retail sales taxes were not collected when the property, digital products, or services were acquired by the user, then use taxes apply to the value of most tangible personal property and digital products and some services when used in this state. The state sales and use tax rate is 6.5 percent. Local tax rates vary from 0.5 percent to 3.0 percent, depending on the location. The average local tax rate is 2 percent, for an average combined state and local tax rate of 8.5 percent.

A retail sales and use tax exemption applies to new or replacement machinery and equipment (M&E) used in a manufacturing or research and development operation by a manufacturer or processor for hire. The exemption also applies to services, such as installation or repair services, rendered with respect to the M&E. The exemption applies to industrial fixtures and devices as well as pollution control equipment that is used in the manufacturing operation. The exemption does not apply to short-lived tools, hand tools, and consumable supplies.

King County is constructing a new regional wastewater treatment plant, called Brightwater. Construction started in 2006. The treatment plant is anticipated to begin operations in 2012. Brightwater will serve portions of King and Snohomish counties. The new facilities will include a treatment plant, conveyance (pipes and pumps taking wastewater to and from the plant), and a marine outfall. King County filed a refund lawsuit claiming it is entitled to the M&E exemption for the M&E installed at Brightwater. The amount of the refund request is approximately \$23 million, not including interest.

As part of the wastewater treatment process, many treatment plants produce exceptional quality biosolids that contain almost no pathogens. These exceptional grade biosolids can be used as commercial fertilizer.

Two state universities are claiming the exemption for M&E used as part of a technological research and development operation.

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**Summary of Substitute Bill:**

The sales and use tax exemption for machinery and equipment (M&E) is clarified to only apply with respect to businesses that are taxed under the manufacturing category for business and occupation tax. The exemption does not apply to M&E used for activities within the purview of a utility business, i.e., distributing electricity, providing water and sewer services, distributing natural gas, etc. However, M&E used by a wastewater treatment facility to

process class B biosolids into biosolids meeting class A or exceptional quality standards would qualify for the exemption. It is also clarified that the M&E exemption does not apply to the state and its departments and institutions.

A stand-alone sales and use tax exemption for M&E is provided for public research institutions using the M&E as part of a research and development operation. The exemption also applies to installation, repair, and other services related to the M&E. The following institutions would be eligible for the exemption: University of Washington, Washington State University, Western Washington University, Central Washington University, Eastern Washington University, and The Evergreen State College. Any public research institution claiming the exemption is required to file an annual survey with the Department of Revenue providing employment-related information for the prior calendar year, the general areas of research and development where exempt M&E is used, and the amount of the tax exemption claimed in the prior calendar year. The exemption expires July 1, 2016.

The bill applies retroactively to open assessment periods as well as prospectively.

**Substitute Bill Compared to Original Bill:**

A July 1, 2016, expiration date is added to the stand-alone sales and use tax exemption for public research institutions.

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**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date of Substitute Bill:** The bill contains an emergency clause and takes effect immediately.

**Staff Summary of Public Testimony:**

(In support) This comes out of recent litigation over the Brightwater treatment plant in King County. This bill preserves the tax exemption for the processes that create exceptional biosolid products. However, the bill would disallow the exemption for traditional utility-type activities. All public universities would get a separate exemption for machinery and equipment (M&E) used in their research and development operations.

(With concerns) New technologies to treat water and produce biosolids sometimes do not pencil out initially so we need every option available. We support the sales tax exemption for public university research and development operations. It is certainly the right of the Legislature to establish prospective policy, but the retroactive component makes it more of a budget issue than a policy issue. Extending this type of incentive to capital intensive activities can lead to a net positive for the state.

(Opposed) Protecting public health and enhancing the environment are primary objectives of the King County waste water division. This is achieved by creating resources from waste

water. We treat over 300 million gallons of reclaimed water. The M&E exemption has been an important tool for us in promoting our investment and creating green jobs. The exemption has been granted for existing facilities. The state has encouraged the production of reclaimed water and biosolids for years. We are asking that the bill be amended so it applies only prospectively and not retroactively.

**Persons Testifying:** (In support) Drew Shirk, Department of Revenue.

(With concerns) Amber Carter, Association of Washington Business; and Ed Thorpe, Coalition for Clean Water.

(Opposed) Pam Elardo, King County Wastewater Treatment Division.

**Persons Signed In To Testify But Not Testifying:** None.