SENATE BILL REPORT
SB 6430

As Reported by Senate Committee On:
Trade & Economic Development, February 4, 2014
Ways & Means, February 11, 2014

Title: An act relating to extending tax preferences for high-technology research and development.

Brief Description: Extending tax preferences for high-technology research and development.

Sponsors: Senators Liias, Fain, Hobbs, Litzow, Eide, Dammeier, McAuliffe, Baumgartner, Cleveland, Angel and Ericksen.

Brief History:
Committee Activity: Trade & Economic Development: 1/30/14, 2/04/14 [DP-WM, DNP].
Ways & Means: 1/27/14 [w/oRec-TRED]; 2/10/14, 2/11/14 [DPS, DNP, w/oRec].

SENATE COMMITTEE ON TRADE & ECONOMIC DEVELOPMENT

Majority Report: Do pass and be referred to Committee on Ways & Means.
Signed by Senators Braun, Chair; Angel, Vice Chair; Holmquist Newbry and Liias.

Minority Report: Do not pass.
Signed by Senators Chase, Ranking Member; Pedersen.

Staff: Jeff Olsen (786-7428)

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: That Substitute Senate Bill No. 6430 be substituted therefor, and the substitute bill do pass.
Signed by Senators Hill, Chair; Baumgartner, Vice Chair; Honeyford, Capital Budget Chair; Bailey, Becker, Dammeier, Hatfield, Hewitt, Padden, Parlette, Rivers, Schoesler and Tom.

Minority Report: Do not pass.
Signed by Senators Hargrove, Ranking Member; Keiser, Assistant Ranking Member on the Capital Budget; Ranker, Assistant Ranking Member on the Operating Budget; Billig, Conway, Fraser and Hasegawa.

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.

Minority Report: That it be referred without recommendation.
Signed by Senators Braun, Frockt and Kohl-Welles.

Staff: Juliana Roe (786-7438)

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.

In 1994 the Legislature created tax incentives to encourage additional research and development (R&D) in the high technology sector. The high technology B&O tax credit and sales tax deferral are allowed for qualified R&D spending through January 1, 2015. The B&O tax credit is allowed for R&D expenditures in excess of 0.92 percent of the taxpayer's taxable income. The sales tax deferral allows for a deferral and waiver of sales and use taxes on the construction of R&D facilities and pilot scale manufacturing plants and purchases of related machinery and equipment. To qualify, a firm must be engaged in the fields of advanced computing, advanced materials, biotechnology, electronic device technology, or environmental technology.

Summary of Bill (Recommended Substitute): The high technology B&O tax credit and sales and use tax deferral are extended until January 1, 2040.

It is clarified that when manufacturing software, persons can be provided with a digital copy rather than tangible storage media.

EFFECT OF CHANGES MADE BY WAYS & MEANS COMMITTEE (Recommended Substitute): A tax preference statement is included.

It is clarified that when manufacturing software, persons can be provided with a digital copy rather than tangible storage media.

Appropriation: None.

Fiscal Note: Available.

Committee/Commission/Task Force Created: No.

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

Staff Summary of Public Testimony on Original Bill (Trade & Economic Development): PRO: Washington has a diverse high technology and life sciences industry that we need to foster. The innovation economy is critical to the success of the state. Washington needs to retain and recruit new companies, and by extending the research and development (R&D) tax credits, we stay competitive with other states and other parts of the world for very limited R&D investments. Long-term certainty is required for attracting new R&D investments. Texas previously repealed their R&D tax credit and later restored it after determining the loss of the credit negatively impacted investments in Texas. The Joint Legislative Audit and Review Committee (JLARC) report does not have adequate data, and they did not recommend to repeal, only to clarify the goals of the tax incentive. The Citizen's Commission recommendation to sunset the incentive is based on flawed data.

CON: JLARC has reviewed the credit and reported that it is not effective. Less than 1 percent of job growth in the sector is due to the tax incentive, and $45,000 is spent for every job created. The Citizen's Commission on Tax Reform recommended that the incentive should sunset. The Department of Revenue (DOR) has also reviewed the tax credit and documented less job growth from companies using the tax credit. If allowed to sunset, revenues could be invested in other areas. There should be the same level of scrutiny on tax incentives as there are on spending of public funds.

Persons Testifying (Trade & Economic Development): PRO: Senator Liias, prime sponsor; John Drescher, NW Executive Director, TechNet; Tom Ranken, WA Clean Technology Alliance; Chris Rivera, WA Biotechnology and Biomedical Assn.; Michael Schutzler, Lew McMurran, WA Technology Industry Assn.; Neil Strege, WA Roundtable; Amber Carter, Assn. of WA Business; Doug Levy, City of Redmond, WA Tech Cities Coalition.

CON: Nick Federici, Our Economic Future Coalition.

Staff Summary of Public Testimony on Substitute (Ways & Means): PRO: It is important that we extend the incentives that are scheduled to sunset. We want long-term certainty for our industry and want to let the industry know that we care about them and want them to remain in Washington State. We want them to grow here.

This area is highly competitive. If we let the incentives expire, we would be only one of eight states that do not have tax incentives for high technology R&D. We do not want to be at a competitive disadvantage. We want a level playing field with other states.

The state has invested about $24 million per year in B&O tax credits and received about $2.1 billion in state and local tax benefits. That is a return of 4.86. For the deferral the state has provided $693 million for $8.2 billion of return. That is a return of 11.8. These credits will allow our state to pay for things like education.

R&D is the lifeblood of our industry. There are over 10,000 companies in 24 of 39 counties. We employ one of every four workers in Washington. This industry generates over $3 billion in taxes every year. There is good evidence that the current incentives work. There has been a fourfold growth in patent generation in Washington alone. It is one of richest in the country. There are more than 15,000 R&D projects launched in Washington alone. About 325,000 jobs have been created in last 20 years by this industry, most of which have been in Washington.

The high technology sector has been a phenomenal job creator. It has helped us bear and come out of the recession. Look at Digipen, they supply people going into the very competitive gaming industry. Without incentives, we will lose companies like this to other states.

In this industry we have to find capital for new startups. Capital investors go where they can get the best return, and this is generally in states in which there are incentives. Capital investors need to see that these incentives will be in effect for many years, not for a small limited time.

The incentives are key component in attracting and retaining companies. About 86 percent of 2012 new high technology sector employees were Washington residents. This sector makes up about 28 percent of employment in Washington State. This sector drives the rest of the economy and having a healthy sector is important to the economy as a whole. We have very few tools to incentivize these types of investments, so we should maintain what we have. Elimination of these incentives will increase costs in Washington.

CON: While we are all committed to improving Washington's economy, there is no proof that these incentives help us with that objective. When studying the high technology sector, JLARC found that there was ambiguous data and asked for additional analysis. It was found that less than 1 percent of growth in that sector was attributable to the incentives. The Tax Preference Commission, in its report, recommended ending the incentives. When DOR studied this sector, it found that those companies that used the incentives increased jobs at a lower rate than those that did not use the incentives. Maybe we should narrow the incentives to those companies that are true entrepreneurial companies. Microsoft gets a large amount of money from the incentive and does not likely need the extra help.

Persons Testifying (Ways & Means): PRO: Doug Levy, city of Redmond, WA Tech Cities Coalition; Brad Harlow, Cardiac Insight; Maud Daudon, Seattle Metropolitan Chamber of Commerce; Michael Schutzler, WA Tech Industry Assn., President; Neil Strege, WA Roundtable; Tom McBride, TechAmerica.

CON: Nick Federici, Our Economic Future Coalition.