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**SUBSTITUTE SENATE BILL 5665**

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**State of Washington 64th Legislature 2015 Regular Session**

**By** Senate Ways & Means (originally sponsored by Senators Hill, Liias, Fain, Brown, and Benton; by request of Office of Financial Management)

AN ACT Relating to reinstating tax preferences for high-technology research and development; amending RCW 82.63.020 and 82.63.045; reenacting and amending RCW 82.63.010; adding a new section to chapter 82.04 RCW; adding a new section to chapter 82.63 RCW; creating a new section; providing an effective date; providing expiration dates; and declaring an emergency.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

NEW SECTION. **Sec.**  (1) This section is the tax preference performance statement for the tax credit contained in section 2 of this act and the tax deferrals contained in sections 3 through 6 of this act. This performance statement is only intended to be used for subsequent evaluation of the tax preferences. It is not intended to create a private right of action by any party or be used to determine eligibility for preferential tax treatment.

(2) The legislature categorizes these tax preferences as intended to improve industry competitiveness and create or retain jobs, as indicated in RCW 82.32.808(2) (b) and (c).

(3) It is the legislature's specific public policy objective to improve industry competitiveness and create or retain more jobs. It is the legislature's intent to provide a business and occupation tax credit for high-technology companies performing research and development and a sales and use tax deferral for certain construction for new and expanding high-technology companies conducting research and development in the fields of advanced computing, advanced materials, biotechnology, electronic device technology, or environmental technology, in order to reduce the business costs of performing research and development and to reduce the cost of certain construction and equipment purchases used for research and development in specified areas, thereby encouraging investments in research and development, thereby increasing the number of firms in the industry performing research and development activities, thereby increasing the number of jobs performing research and development in the high-technology industry.

(4) If a review finds that the number of businesses participating in the credit and deferral programs, and the overall number of jobs for businesses participating in the credit and deferral programs performing research and development, have increased compared to the number at the time of enactment, then the legislature intends to extend the expiration date of the tax preferences.

(5) In order to obtain the data necessary to perform the review in subsection (3) of this section, the joint legislative audit and review committee may refer to: (a) Employment data available from the employment security department; and (b) North American industrial code system (NAICS) from the department of revenue.

NEW SECTION. **Sec.**  A new section is added to chapter 82.04 RCW to read as follows:

(1) In computing the tax imposed under this chapter, a credit is allowed for each person whose research and development spending during the year in which the credit is claimed exceeds 0.92 percent of the person's taxable amount during the same calendar year.

(2) The credit is calculated as follows:

(a) Determine the greater of the amount of qualified research and development expenditures of a person or eighty percent of amounts received by a person other than a public educational or research institution in compensation for the conduct of qualified research and development;

(b) Subtract 0.92 percent of the person's taxable amount from the amount determined under (a) of this subsection;

(c) Multiply the amount determined under (b) of this subsection by 1.50 percent.

(3) Any person entitled to the credit provided in subsection (2) of this section as a result of qualified research and development conducted under contract may assign all or any portion of the credit to the person contracting for the performance of the qualified research and development.

(4) The credit, including any credit assigned to a person under subsection (3) of this section, must be claimed against taxes due for the same calendar year in which the qualified research and development expenditures are incurred. The credit, including any credit assigned to a person under subsection (3) of this section, for each calendar year may not exceed the lesser of five hundred thousand dollars or the amount of tax otherwise due under this chapter for the calendar year.

(5) For any person claiming the credit, including any credit assigned to a person under subsection (3) of this section, whose research and development spending during the calendar year in which the credit is claimed fails to exceed 0.92 percent of the person's taxable amount during the same calendar year or who is otherwise ineligible, the department must declare the taxes against which the credit was claimed to be immediately due and payable. The department must assess interest, but not penalties, on the taxes against which the credit was claimed. Interest must be assessed at the rate provided for delinquent excise taxes under chapter 82.32 RCW, retroactively to the date the credit was claimed, and accrues until the taxes against which the credit was claimed are repaid. Any credit assigned to a person under subsection (3) of this section that is disallowed as a result of this section may be claimed by the person who performed the qualified research and development subject to the limitations set forth in subsection (4) of this section.

(6) A person claiming the credit provided in this section must file a complete annual survey with the department under RCW 82.32.585.

(7) The definitions in this subsection apply throughout this section unless the context clearly requires otherwise.

(a) "Qualified research and development" shall have the same meaning as in RCW 82.63.010.

(b) "Qualified research and development expenditures" means operating expenses, including wages, compensation of a proprietor or a partner in a partnership as determined under rules adopted by the department, benefits, supplies, and computer expenses, directly incurred in qualified research and development by a person claiming the credit provided in this section. The term does not include amounts paid to a person other than a public educational or research institution to conduct qualified research and development. Nor does the term include capital costs and overhead, such as expenses for land, structures, or depreciable property.

(c) "Research and development spending" means qualified research and development expenditures plus eighty percent of amounts paid to a person other than a public educational or research institution to conduct qualified research and development.

(d) "Taxable amount" means the taxable amount subject to the tax imposed in this chapter required to be reported on the person's combined excise tax returns for the calendar year for which the credit is claimed, less any taxable amount for which a credit is allowed under RCW 82.04.440.

(8) This section expires January 1, 2025.

**Sec.**  RCW 82.63.010 and 2009 c 268 s 2 are each reenacted and amended to read as follows:

((~~Unless the context clearly requires otherwise,~~)) The definitions in this section apply throughout this chapter unless the context clearly requires otherwise.

(1) "Advanced computing" means technologies used in the designing and developing of computing hardware and software, including innovations in designing the full spectrum of hardware from hand-held calculators to super computers, and peripheral equipment.

(2) "Advanced materials" means materials with engineered properties created through the development of specialized processing and synthesis technology, including ceramics, high value-added metals, electronic materials, composites, polymers, and biomaterials.

(3) "Applicant" means a person applying for a tax deferral under this chapter.

(4) "Biotechnology" means the application of technologies, such as recombinant DNA techniques, biochemistry, molecular and cellular biology, genetics and genetic engineering, cell fusion techniques, and new bioprocesses, using living organisms, or parts of organisms, to produce or modify products, to improve plants or animals, to develop microorganisms for specific uses, to identify targets for small molecule pharmaceutical development, or to transform biological systems into useful processes and products or to develop microorganisms for specific uses.

(5) "Department" means the department of revenue.

(6) "Electronic device technology" means technologies involving microelectronics; semiconductors; electronic equipment and instrumentation; radio frequency, microwave, and millimeter electronics; optical and optic-electrical devices; and data and digital communications and imaging devices.

(7) "Eligible investment project" means an investment project ((~~which~~)) that either initiates a new operation, or expands or diversifies a current operation by expanding((~~,~~)) or renovating((~~, or equipping~~)) an existing facility. The lessor or owner of the qualified building is not eligible for a deferral unless:

(a) ((~~The underlying ownership of the buildings, machinery, and equipment vests exclusively in the same person; or~~

~~(b)(i)~~)) The lessor by written contract agrees to pass the economic benefit of the deferral to the lessee;

((~~(ii)~~)) (b) The lessee that receives the economic benefit of the deferral agrees in writing with the department to complete the annual survey required under RCW 82.63.020((~~(2)~~)) (4); and

((~~(iii)~~)) (c) The economic benefit of the deferral passed to the lessee is no less than the amount of tax deferred by the lessor and is evidenced by written documentation of any type of payment, credit, or other financial arrangement between the lessor or owner of the qualified building and the lessee.

(8) "Environmental technology" means assessment and prevention of threats or damage to human health or the environment, environmental cleanup, and the development of alternative energy sources.

(9)(a) "Initiation of construction" means the date that a building permit is issued under the building code adopted under RCW 19.27.031 for:

(i) Construction of the qualified building, if the underlying ownership of the building vests exclusively with the person receiving the economic benefit of the deferral;

(ii) Construction of the qualified building, if the economic benefits of the deferral are passed to a lessee as provided in subsection (7) of this section; or

(iii) Tenant improvements for a qualified building, if the economic benefits of the deferral are passed to a lessee as provided in subsection (7) of this section.

(b) "Initiation of construction" does not include soil testing, site clearing and grading, site preparation, or any other related activities that are initiated before the issuance of a building permit for the construction of the foundation of the building.

(c) If the investment project is a phased project, "initiation of construction" ((~~shall apply~~)) applies separately to each phase.

(10) "Investment project" means an investment in qualified buildings or qualified machinery and equipment, including labor and services rendered in the planning, installation, and construction or improvement of the project.

(11) "Meaningful construction" means an active construction site, where excavation of a building site, laying of a building foundation, or other tangible signs of construction are taking place and that clearly shows a progression in the construction process, at the location designated by the taxpayer in the application for deferral. Planning, permitting, or land clearing before excavation of the building site, without more, does not constitute meaningful construction.

(12) "Multiple qualified buildings" means qualified buildings leased to the same person when such structures: (a) Are located within a five-mile radius; and (b) the initiation of construction of each building begins within a sixty-month period.

((~~(12)~~)) (13) "Person" has the meaning given in RCW 82.04.030 and includes state universities as defined in RCW 28B.10.016. Person also includes any affiliate of a person. For purposes of this subsection (13), (a) "affiliate" means a person who controls, is controlled by, or is under common control with another person, and (b) "control" means the possession, directly or indirectly, of more than twenty percent of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting shares, by contract, or otherwise.

((~~(13)~~)) (14) "Pilot scale manufacturing" means design, construction, and testing of preproduction prototypes and models in the fields of biotechnology, advanced computing, electronic device technology, advanced materials, and environmental technology other than for commercial sale. As used in this subsection, "commercial sale" excludes sales of prototypes or sales for market testing if the total gross receipts from such sales of the product, service, or process do not exceed one million dollars.

((~~(14)~~)) (15) "Qualified buildings" means construction of new structures, and expansion or renovation of existing structures for the purpose of increasing floor space or production capacity used for pilot scale manufacturing or qualified research and development, including plant offices and other facilities that are an essential or an integral part of a structure used for pilot scale manufacturing or qualified research and development. Areas used for amusement and recreational activities, physical fitness activities, parking, the selling or furnishing of meals or other food and beverages, or similar commercial and noncommercial activities are not essential or integral to pilot scale manufacturing or qualified research and development. If a building or buildings are used partly for pilot scale manufacturing or qualified research and development, and partly for other purposes, the applicable tax deferral shall be determined by apportionment of the costs of construction under rules adopted by the department. Such rules may include provisions for determining the amount of the deferral based on apportionment of costs of construction of an investment project consisting of a building or multiple buildings, where qualified research and development or pilot scale manufacturing activities are shifted within a building or from one building to another building.

((~~(15)~~)) (16) "Qualified machinery and equipment" means fixtures, equipment, and support facilities that are an integral and necessary part of a pilot scale manufacturing or qualified research and development operation. "Qualified machinery and equipment" includes: Computers; software; data processing equipment; laboratory equipment, instrumentation, and other devices used in a process of experimentation to develop a new or improved pilot model, plant process, product, formula, invention, or similar property; manufacturing components such as belts, pulleys, shafts, and moving parts; molds, tools, and dies; vats, tanks, and fermenters; operating structures; and all other equipment used to control, monitor, or operate the machinery. For purposes of this chapter, qualified machinery and equipment must be either new to the taxing jurisdiction of the state or new to the certificate holder, except that used machinery and equipment may be treated as qualified machinery and equipment if the certificate holder either brings the machinery and equipment into Washington or makes a retail purchase of the machinery and equipment in Washington or elsewhere.

((~~(16)~~)) (17) "Qualified research and development" means research and development performed within this state in the fields of advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology.

((~~(17)~~)) (18) "Recipient" means a person receiving a tax deferral under this chapter.

((~~(18)~~)) (19) "Research and development" means activities performed to discover technological information, and technical and nonroutine activities concerned with translating technological information into new or improved products, processes, techniques, formulas, inventions, or software. The term includes exploration of a new use for an existing drug, device, or biological product if the new use requires separate licensing by the federal food and drug administration under chapter 21, C.F.R., as amended. The term does not include adaptation or duplication of existing products where the products are not substantially improved by application of the technology, nor does the term include surveys and studies, social science and humanities research, market research or testing, quality control, sale promotion and service, computer software developed for internal use, and research in areas such as improved style, taste, and seasonal design.

**Sec.**  RCW 82.63.020 and 2010 c 114 s 140 are each amended to read as follows:

(1)(a) Application for deferral of taxes under this chapter must be made to the department before initiation of construction of, or acquisition of equipment or machinery for, the investment project. In the case of an investment project involving multiple qualified buildings, applications must be made for, and before the initiation of construction of, each qualified building. The application must be made ((~~to the department~~)) in a form and manner prescribed by the department. The application must contain information regarding the location of the investment 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 wages of employees related to the project, estimated or actual costs, time schedules for completion and operation, and other information required by the department. The department must rule on the application within sixty days.

((~~(2)~~)) (b) Nothing in this subsection (1)(b) may be construed to allow a tax deferral for an investment project for which an application for deferral under this chapter was denied by the department before January 1, 2015.

(2) The department will approve applications that indicate meaningful construction of an eligible investment project will occur within five years of the date of application. Applications indicating that meaningful construction of an eligible investment project will not occur within two years of the date of the application may be required to include additional documentation about the investment project, such as project milestones and other information the department may require. Applications that do not indicate meaningful construction will occur within five years of the date of application must be denied.

(3)(a) Recipients may amend an approved deferral application to update the completion date, estimated expenses, the square footage of the investment project, or other information about the investment project. Amendments must be made in a form and manner prescribed by the department.

(b) Requests to amend a previously approved application for an investment project for which meaningful construction has not commenced within five years of the date of the initial application must be denied.

(4) Each recipient of a deferral of taxes under this chapter must file a complete annual survey with the department under RCW 82.32.585. If the economic benefits of the deferral are passed to a lessee as provided in RCW 82.63.010(7), the lessee must file a complete annual survey, and the applicant is not required to file the annual survey.

((~~(3)~~)) (5) The department must use the information reported on the annual survey required by this section to study the tax deferral program authorized under this chapter. The department must report to the legislature by December 1, 2009, and December 1, 2013. The reports must measure the effect of the program on job creation, the number of jobs created for Washington residents, company growth, the introduction of new products, the diversification of the state's economy, growth in research and development investment, the movement of firms or the consolidation of firms' operations into the state, and such other factors as the department selects.

((~~(4)~~)) (6) A recipient who must repay deferred taxes under RCW 82.63.045 ((~~because the department has found that an investment project is used for purposes other than research and development performed within this state in the fields of advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology~~)) is no longer required to file annual surveys under RCW 82.32.585 ((~~beginning on the date an investment project is used for nonqualifying purposes~~)).

NEW SECTION. **Sec.**  A new section is added to chapter 82.63 RCW to read as follows:

(1) Except as provided in subsection (2) of this section, the department must issue a sales and use tax deferral certificate for state and local sales and use taxes due under chapters 82.08, 82.12, 82.14, and 81.104 RCW on each eligible investment project. The amount of tax imposed under chapters 82.08 and 82.12 RCW eligible for deferral under this chapter is limited to one million dollars per eligible investment project per person. Only one eligible investment project per person qualifies for a deferral under this chapter during a calendar year.

(2) No certificate may be issued for an investment project that has already received a deferral under chapter 82.60 RCW or this chapter, except that an investment project for qualified research and development that has already received a deferral may also receive an additional deferral certificate for adapting the investment project for use in pilot scale manufacturing.

(3) This section expires January 1, 2025.

**Sec.**  RCW 82.63.045 and 2010 c 114 s 141 are each amended to read as follows:

(1) Except as provided in subsection (2) of this section and RCW 82.32.585, taxes deferred under this chapter need not be repaid.

(2)(a) If, on the basis of the survey under RCW 82.32.585 or other information, the department finds that an investment project is used for purposes other than qualified research and development or pilot scale manufacturing at any time during the calendar year in which the investment project is certified by the department as having been operationally completed, or at any time during any of the seven succeeding calendar years, a portion of deferred taxes is immediately due according to the following schedule:

|  |  |
| --- | --- |
| Year in which use occurs | % of deferred taxes due |
| 1 | 100% |
| 2 | 87.5% |
| 3 | 75% |
| 4 | 62.5% |
| 5 | 50% |
| 6 | 37.5% |
| 7 | 25% |
| 8 | 12.5% |

(b) If the department finds that meaningful construction of an investment project did not begin within five years of the date of the application or that an investment project is not operationally complete within ten years of the date of the initial application for deferral, the full amount of deferred taxes is immediately due.

(c) If the economic benefits of the deferral are passed to a lessee as provided in RCW 82.63.010(7), the lessee is responsible for payment to the extent the lessee has received the economic benefit.

(3)(a) Notwithstanding subsection (2) of this section, in the case of an investment project consisting of multiple qualified buildings, the lessee is solely liable for payment of any deferred tax determined by the department to be due and payable under this section beginning on the date the department certifies that the project is operationally complete.

(b) This subsection does not relieve the lessors of its obligation to the lessee under RCW 82.63.010(7) to pass the economic benefit of the deferral to the lessee.

(4) The department must assess interest at the rate provided for delinquent taxes, but not penalties, retroactively to the date of deferral. The debt for deferred taxes will not be extinguished by insolvency or other failure of the recipient. Transfer of ownership does not terminate the deferral. The deferral is transferred, subject to the successor meeting the eligibility requirements of this chapter, for the remaining periods of the deferral.

((~~(5) Notwithstanding subsection (2) of this section or RCW 82.32.585, deferred taxes on the following need not be repaid:~~

~~(a) Machinery and equipment, and sales of or charges made for labor and services, which at the time of purchase would have qualified for exemption under RCW 82.08.02565; and~~

~~(b) Machinery and equipment which at the time of first use would have qualified for exemption under RCW 82.12.02565.~~))

NEW SECTION. **Sec.**  This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and takes effect July 1, 2015.

**--- END ---**