Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Finance Committee

HB 2638

Brief Description: Providing accountability and transparency for aerospace-related tax incentives.

Sponsors: Representatives Robinson, DeBolt, Condotta, Walkinshaw, Frame, Jinkins, Sells, Bergquist, Rossetti, Reykdal, Farrell, Santos, Ormsby and Pollet.

Brief Summary of Bill

- Makes the availability of several aerospace tax incentives contingent upon meeting certain job standards for an aerospace firm with a significant commercial airplane manufacturing program in the state.

Hearing Date: 1/19/16

Staff: Jeffrey Mitchell (786-7139).

Background:

Business and Occupation Tax.
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. Businesses must pay B&O tax even though they may not have any profits or may be operating at a loss. A business may have more than one B&O tax rate, depending on the types of activities conducted. Major tax rates are 0.471 percent for retailing; 0.484 percent for manufacturing, wholesaling, and extracting; and 1.5 percent for services, and activities not classified elsewhere. Several lower rates also apply to specific business activities, including preferential tax rates for the aerospace industry.

Legislative Background of Aerospace Tax Incentives.
In 2003 the Legislature adopted tax incentives that were limited to aerospace manufacturers. The incentives included: a 40 percent reduction in the B&O tax rate; a B&O tax credit for aerospace product development expenditures; and a B&O tax credit for property taxes paid on property

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used in the manufacture of commercial airplanes and airplane components. A leasehold tax exemption for port district facilities is available to manufacturers of superefficient airplanes that are not using the B&O tax credit for property taxes. Also included were sales and use tax exemptions for computer equipment and software, and its installation, used primarily in the development of commercial airplanes and airplane components. These tax preferences were originally scheduled to expire in 2024.

In 2006 the Legislature extended the sales and use tax exemption for computer equipment and software to nonmanufacturing firms engaged in the development, design, and engineering of commercial airplanes and components of commercial airplanes. The B&O tax credit for preproduction development expenditures related to commercial aircraft was also extended to nonmanufacturing firms. Businesses that use these incentives file an annual report with the DOR. In 2008 the Legislature extended aerospace tax programs to other manufacturers, Federal Aviation Regulation (FAR) repair stations, and design/engineering services. Sales and use tax exemptions were provided for computer equipment and software, and its installation, which are used primarily in aerospace products or providing aerospace services. Until July 1, 2024, the B&O tax rate is 0.2904 percent for: sales, either retail or wholesale, of commercial airplanes or components; the manufacturing or sales of tooling used in the manufacturing of commercial airplanes and components of airplanes; or persons classified by the Federal Aviation Administration as a FAR 145 certified repair station. Persons claiming this rate must file an annual survey with the Department of Revenue (DOR). Persons performing aerospace product development are qualified for a 0.9 percent B&O rate and must file an annual survey with the DOR. The preproduction 1.5 percent B&O tax credit on qualified expenditures was expanded to include aerospace product development. The B&O tax credit for property taxes paid was extended to aerospace product development, the manufacturing of tooling, and FAR Part 145 certified repair stations.

During a special session in November of 2013, the expiration date was extended from 2024 to 2040 for the following aerospace tax preferences:

1. the preferential business and occupation (B&O) tax rate for the manufacturing, wholesaling, and retailing of commercial airplanes and airplane components;
2. the preferential B&O tax rate for the manufacturing, wholesaling, and retailing of tooling used in the manufacturing of commercial airplanes and airplane components;
3. the preferential B&O tax rate for retail sales by a FAR Part 145 certificated repair station;
4. the preferential B&O tax rate for businesses performing aerospace product development for others;
5. the B&O tax credit for aerospace product expenditures;
6. the B&O tax credit for property taxes and leasehold taxes on property used exclusively in manufacturing commercial airplanes or components of airplanes;
7. the sales and use tax exemptions for computer hardware, computer peripherals, and software used primarily in the development, design, and engineering of aerospace products; and
8. the leasehold excise tax exemption for lessees of port facilities used exclusively in manufacturing commercial airplanes.

The extension of these tax incentives in the 2013 special session was contingent upon the DOR making a determination that a final decision to locate a significant commercial airplane manufacturing program in the state had occurred by June 30, 2017. The DOR made the required determination on July 9, 2014.

Deposit of Sales and B&O Taxes.
Almost all revenues derived from sales and B&O taxes are deposited into the State General Fund. The Education Legacy Trust Account (ELTA) was created in 2005. Currently, the Washington estate tax is the sole source of revenue for the ELTA. Money in the ELTA can only be used for K-12 and higher education.

State Expenditure Limit.
First enacted in 1993 by Initiative 601, the state expenditure limit allows expenditures from the State General Fund to grow each fiscal year by the fiscal growth factor, which is the average annual growth in state personal income over the prior 10 fiscal years. Whenever the cost of any state program or function is shifted from the State General Fund or moneys are transferred from the State General Fund to another fund or account, the state expenditure limit must be lowered to reflect the shift or transfer.

Summary of Bill:

An aerospace firm with a significant commercial airplane manufacturing program in the state is subject to a reduced or eliminated preferential B&O tax rate and B&O tax credit for aerospace product expenditures, if the firm's employment level is 4,000 or more employment positions below the employment baseline. The employment baseline is 83,295 employment positions. If the firm's employment is between 4,000 and 5,000 employment positions below the employment baseline, the tax savings from the preferential B&O tax rate and tax credit are reduced in half. Once the employment level is more than 5,000 employment positions below the baseline, the firm is subject to the general default B&O tax rates for manufacturing, wholesaling, and retailing and the B&O tax credit may not be claimed. The employment level analysis, and any potential modification to the availability of the preferential tax rate and credit, is done on a year-to-year basis by the Department of Revenue. The degree to which an aerospace firm benefits from the preferential B&O tax rate and tax credit in the current year will remain in place for the subsequent year if employment growth is forecasted to be less than 1 percent for the following year. The forecast is made by the Economic and Revenue Forecast Council as part of its November forecast.

Beginning in 2017, any additional revenue generated because an aerospace firm is not eligible to claim the maximum preferential B&O tax rate or credit is periodically transferred from the general fund to the education legacy trust account. The bill clarifies that each transfer will not reduce the state expenditure limit.

Appropriation: None.

Fiscal Note: Requested on January 18, 2016.

Effective Date: The bill takes effect on August 1, 2016.