Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Finance Committee

HB 2809

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

Sponsors: Representatives Sullivan, Manweller, Pettigrew, Wilcox, Farrell, Zeiger, Senn, Springer, Fitzgibbon, Morris, Stokesbary, Tarleton, Stanford and Hudgins.

Brief Summary of Bill

- Establishes a business and occupations tax credit for qualified research and development (R&D) expenditures, expiring January 1, 2026.
- Establishes a state and local sales tax deferral program for high-technology R&D and pilot-scale manufacturing facilities, expiring January 1, 2026.
- Establishes performance metrics to measure success of the tax preferences.

Hearing Date: 1/29/16

Staff: Jeffrey Mitchell (786-7139).

Background:

In 1994 the Legislature created a program of business and occupation tax credits for qualified research and development (R&D) expenditures, and a sales tax deferral program for high-technology R&D and pilot-scale manufacturing facilities. The R&D tax preferences expired January 1, 2015.

Business and Occupation Tax.
The business and occupation (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. Revenues are deposited in the State General Fund. A business may have more than one B&O tax rate, depending on the types of activities conducted. Major B&O tax rates include: 0.471 percent for retailing; 0.484 percent for manufacturing, wholesaling, and extracting; and 1.5 percent for professional and personal services, and activities not classified elsewhere.

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.

Business and Occupation Tax Credit for High Technology Research and Development. "Qualified research and development" means R&D performed within this state in the fields of advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology. Until January 1, 2015, a B&O tax credit was available to a person whose qualified R&D spending during the year in which the credit was claimed exceeded 0.92 percent of the person's taxable amount. "Taxable amount" means the amount subject to the B&O tax, as must be reported on combined excise tax returns, less any credit that may be claimed be a person engaged in an activity that is subject to more than one B&O tax rate.

In 2014 the B&O credit available was 1.5 percent of the greater of: (1) R&D expenditures that exceed 0.92 percent of the person's taxable income; or (2) 80 percent of the compensation received for conducting qualified R&D under contract. "Person" is broadly defined to include, among other categories, individuals, companies, political subdivisions, nonprofits, and federal agencies. No person could take more than $2 million a year in credit.

Sales and Local Tax Deferral for Certain Construction-Related Expenses.
Until January 1, 2015, application for deferral of sales taxes could be made before initiation of, construction of, or acquisition of equipment or machinery for an investment project. "Investment project" was defined as 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. The Department of Revenue (DOR) was required to issue a sales and use tax deferral certificate for taxes due on each eligible investment project.

Annual Survey.
Taxpayers claiming tax preferences, the legislative purpose of which is creating jobs or increasing industry competitiveness, must file an annual survey with the DOR. The annual survey includes a report of the tax preference amounts claimed each calendar year and information related to employment positions and wages in Washington.

Performance Metrics.
In 2013 the Legislature required that every bill enacting a new tax preference must include a tax preference performance statement, indicating the legislative purpose for the tax preference and specifying clear, relevant, and ascertainable metrics and data requirements to facilitate review of the tax preference's effectiveness by the Joint Legislative Audit and Review Commission and the Legislature.

Summary of Bill:

A research and development business and occupation (B&O) tax credit and sales tax deferral program are created, effective January 1, 2017, and expiring January 1, 2026.

Business and Occupation Tax Credit for Research and Development.
A business whose qualified research and development (R&D) spending during the same calendar year in which the credit is claimed exceeds 0.92 percent of the business's taxable amount is eligible to receive a B&O tax credit for qualified research and development expenditures. "Qualified research and development" means R&D performed within this state in the fields of life science and environmental technology. Qualified R&D expenditures that may be claimed

include those directly incurred as operating expenses, partner or owner compensation, benefits, supplies, and computer expenses. Excluded as claimable expenses are amounts paid to a person other than a public educational or R&D institution to conduct R&D, and capital costs and overhead, including expenses for land and structures.

The B&O tax credit is calculated by multiplying 1.5 percent times the greater of: (1) qualified R&D expenditures that exceed 0.92 percent of the business's taxable amount; or (2) 80 percent of the compensation received for conducting qualified R&D under contract. The total tax credit that may be claimed by a person is capped at the lesser of $500,000 or the amount of total B&O tax due for the calendar year.

Sales and Local Tax Deferral for Certain Construction-Related Expenses.
The Department of Revenue (DOR) must issue a sales and use tax deferral certificate upon receipt of an application from a person for an eligible investment project, if the application indicates that meaningful construction will occur within 5 years of the application date.

- "Investment project" means an investment in qualified buildings, including labor and services rendered in the planning, installation, and construction or improvement of the project. Investment in qualified machinery and equipment is not tax deferrable.
- "Eligible investment project" means an investment project that either initiates a new operation or expands or diversifies a current operation by expanding or renovating an existing facility. 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.
- "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.
- "Qualified research and development" means research and development performed within this state in the fields of life science and environmental technology.

Meaningful Construction.
"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. Approved deferral applications may be amended to update the completion date, estimated expenses, and square footage of the project. However, requests to amend previously approved applications for projects for which meaningful construction has not commenced within five years of the application date must be denied. The DOR may require additional information, such as project milestones, of applications indicating that meaningful construction will not occur within two years of the application date. If meaningful construction of a project does not begin within five years of the application date, or a project is not operationally complete within 10 years of the application date, the full amount of deferred tax is due immediately.

Sales and Use Tax Deferral Limits.
The total amount of sales and use tax deferred is limited to $1 million per eligible project, per person, and only one eligible project per person may qualify for a deferral under this chapter per calendar year. The DOR may not issue a deferral certificate for investment projects that have

already received certain other deferrals for Investment Projects in Rural Counties or High Technology Businesses. However, qualified R&D projects that are being adapted for use in pilot-scale manufacturing are eligible, even if they have previously received a deferral.

Annual Survey.
A person claiming either tax preference must file a complete annual survey.

Tax Preference Performance Statement.
The Legislature states that the tax preferences are intended to improve industry competitiveness and create or retain jobs. The tax preference should be extended beyond the 2026 expiration date if a review finds that, as compared to the effective date of the act,:

- the number of businesses participating in the tax preference programs have increased; and
- the overall number of jobs for businesses participating in the tax preference programs have increased.

Appropriation: None.

Fiscal Note: Available.

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