SENATE BILL REPORT
SB 6355

As Reported by Senate Committee On:
Trade & Economic Development, February 3, 2016

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

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

Sponsors: Senators Frockt, Fain, Mullet, Rivers, Hobbs, Carlyle, Liias and McAuliffe.

Brief History:
Committee Activity: Trade & Economic Development: 2/03/16 [DP-WM, DNP].

SENATE COMMITTEE ON TRADE & ECONOMIC DEVELOPMENT

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

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

Staff: Jeff Olsen (786-7428)

Background: In 1994, the Legislature authorized business and occupation tax (B&O) 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. The B&O tax credit was available for qualified R&D spending in the fields of advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology, and was capped at $2 million per year per person. The sales tax deferral was available for construction of qualified R&D facilities, pilot-scale manufacturing facilities, and related machinery and equipment.

Summary of Bill: A research and development B&O tax credit and sales tax deferral program are created, effective January 1, 2017, and expiring January 1, 2026. A business whose qualified R&D spending exceeds 0.92 percent of the business's taxable amount is eligible to receive a B&O tax credit for qualified R&D expenditures performed in the fields of life science and environmental technology. 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

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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.

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. To qualify, the application must indicate that meaningful construction will occur within 5 years of the application date. An investment project includes 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. An 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. Qualified building includes 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 R&D. Qualified R&D includes activities performed within this state in the fields of life science and environmental technology.

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.

Appropriation: None.

Fiscal Note: Available.

Committee/Commission/Task Force Created: No.

Effective Date: The bill takes effect on January 1, 2017.

Staff Summary of Public Testimony: PRO: Washington needs to enact tax incentives for life sciences and environmental technology to stay competitive with other states. The life sciences sector is an important sector in our economy and provides high wage jobs. Washington's competitiveness in the research and development field has declined with the recent loss of the Life Sciences Discovery Fund and the R&D tax credits. Life sciences companies, especially start-up and pre-revenue companies, have long lead times, sometimes over 10 years, between research and development to getting a product to market, and tax incentives are critical in the early stages to get companies from start-up, through the "valley of death", to profitability. We should be able to craft a bill that provides an incentive that is fiscally responsible, has accountability measures, and creates jobs.

The environment for research and development in the life sciences sector in particular, have recently changed. While Washington does not have to out-compete other states with their incentives, we just need to remain competitive. For companies that are doing research and development and are not yet profitable, taxes are still due. When companies are deciding on

where to invest in their research and development facilities, incentives play a role in making those decisions. The failure rate for research and development can be very high, but that does not deter companies from investing in new products and treatments. The tax incentives in the bill are significantly reduced from the incentives that expired in 2015. Certain life sciences companies work on important treatments and cures that improve health outcomes. The tax incentives allow companies to focus their resources on research and development, to continue making progress on developing profitable products. There are examples of start-up companies that have used incentives to successfully grow companies from research to world class production facilities in Washington. The loss of the previous tax incentive has decreased research and development work, causing delays in getting products to market, and decreasing revenues to the state.

OTHER: The Department of Commerce (Department) has a sector lead for the life sciences sector to help accelerate the growth of the sector in Washington. The Department has compared the tax incentive "ecosystem" in Washington compared to top competitor states. Generally, states having the most success offer baseline incentives for research and development, in addition to three out of five other incentives.

Persons Testifying: PRO: Senator Frockt, prime sponsor; Marc Cummings, Life Science WA; Gabe Boeckman, Washington Clean Tech Alliance; Tom Clement, Aqueduct Critical Care; Tracy Day, Phyisio Control; Leen Kawas, M3 Biotechnology; Margaret McCormick, Matrix genetics; Michael Transue, Novo Nordisk.

OTHER: Maura Little, Washington State Department of Commerce, Director of Life Science and Global Health Development.

Persons Signed In To Testify But Not Testifying: No one.