Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Finance Committee

HB 2145

Brief Description: Honoring the legislature's intent to create and retain local jobs through incentives provided to the aerospace industry by redirecting those incentives to other job creating opportunities if the number of aerospace jobs continue to decline.

Sponsors: Representatives Frame, Robinson, Farrell, Jinkins, Santos, Doglio, Macri, Dolan, Bergquist, Sells, Pollet, Sawyer, Wylie, Ryu, Appleton, Chapman, Gregerson, Cody, Kirby, Stonier, Riccelli, Fitzgibbon, Kloba, Peterson, Fey, Slatter, Tharinger, Stanford, Ortiz-Self and Orwall.

Brief Summary of Bill

- Requires certain employment levels at a significant aerospace firm in this state in order to take advantage of preferential business and occupation (B&O) rates and B&O credits.
- Resets the applicable B&O rates and credits dependent upon the employment levels at a significant aerospace firm in this state on an annual basis.
- Provides for the transfer of any increase in the state general fund resulting from the B&O rate adjustments and credit adjustments under this act to be deposited into the Education Legacy Trust Account and the newly created small business tax credit account.
- Creates a small business tax credit program that is subject to the availability of funds.

Hearing Date: 5/2/17

Staff: Tracey O'Brien (786-7152).

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. The major tax rates are as follows:

- 0.471 percent retailing;
- 0.484 percent manufacturing, wholesaling, and extracting; and
- 1.5 percent services, and activities not classified elsewhere.

A taxpayer may be eligible for a small business credit that will either eliminate or reduce their B&O tax liability. The credit is $35 per month multiplied by the number of months in the reporting period.

Aerospace Tax Incentives.

2003 Legislative Session.
The Legislature enacted several tax incentives that focused on the aerospace industry. These included property tax exemptions, leasehold tax exemptions, sales and use tax exemptions, and B&O rate adjustments and credits.

The B&O rate for manufacturers of commercial airplanes or commercial airplane components was reduced from 0.484 percent to 0.4235 percent effective October 1, 2005. The rate was reduced further to 0.2904 percent effective the latter of July 1, 2007, or upon the commencement of final assembly of a super-efficient airplane.

In addition, several B&O credits were authorized. A manufacturer of commercial airplanes may claim a B&O credit for:
- preproduction development expenditures equal to 1.5 percent multiplied by the amount of qualified expenditures. Credits were allowed to accrue prior to July 1, 2005, but could not be used until July 1, 2005;
- property taxes paid on new buildings built after December 1, 2003, and land upon which the buildings are located;
- property taxes attributable to an increase in assessed value due to the renovation or expansion, after December 1, 2003, of a building used in manufacturing commercial airplanes or components of such airplanes; and
- property taxes paid on machinery and equipment used in manufacturing commercial airplanes or components of such airplanes and acquired after December 1, 2003.

A manufacturer of commercial airplanes could also take a B&O credit for investments related to computer software and hardware used primarily for the digital design and development of commercial airplanes that were incurred between July 1, 1995, and December 1, 2003.

The tax rates and other incentives expire July 1, 2024.

2006 Legislative Session.
The Legislature extended several of the 2003 tax incentives to nonmanufacturing firms engaged in the design, development, and engineering of commercial airplanes and components of commercial airplanes. The extended incentives include the sales and use tax exemption for

computer equipment and software and the B&O tax credit for preproduction development related expenditures.

2008 Legislative Session.
The aerospace tax preferences were expanded to include other manufacturers, Federal Aviation Regulation (FAR) repair stations, and design/engineering services. Until July 1, 2024, the B&O rate of 0.2904 percent applies to:

- sales, retail or wholesale, of commercial airplanes and components of airplanes;
- manufacturing or sales of tooling used in the manufacturing of commercial airplanes or components of airplanes; or
- persons classified as a FAR Part 145 certificated repair station.

In addition, persons performing aerospace product development qualify for a 0.9 percent B&O rate. Aerospace product development also qualifies for the 1.5 percent B&O credit for qualified expenditures. Finally, the B&O tax credit for property taxes was expanded to include aerospace product development, the manufacturing of tooling, and FAR Part 145 certificated repair stations.

2013 Legislative Session.
The expiration date of many of the aerospace tax preferences was extended from 2024 to 2040, contingent upon the occurrence of a final decision to locate a significant commercial airplanes manufacturing program in Washington by June 30, 2017. The Department of Revenue determined this contingency was fulfilled on July 9, 2014.

The aerospace tax preferences with the new 2040 expiration date are: the preferential B&O tax rate for the manufacturing, wholesaling, and retailing of commercial airplanes and airplane components; the preferential B&O tax rate for the manufacturing, wholesaling, and retailing of tooling used in the manufacturing of commercial airplanes and airplane components; the preferential B&O tax rate for retail sales by a FAR Part 145 certificated repair station; the preferential B&O tax rate for businesses performing aerospace product development for others; the B&O tax credit for aerospace product expenditures; the B&O tax credit for property taxes and leasehold taxes on property used exclusively in manufacturing commercial airplanes or components of airplanes; 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 the leasehold excise tax exemption for lessees of port facilities used exclusively in manufacturing commercial airplanes.

Summary of Bill:

The intent section states that the Legislature intends to provide taxpayer accountability for Washington's largest aerospace company by adoption of a minimum annual employment baseline that must be met to fully qualify for the aerospace tax preferences. If the annual employment baseline is not met, the Legislature intends to use those funds to assist small businesses and invest in education. However, if the Department of Revenue (DOR), in consultation with the Employment Security Department (ESD), determines that the failure to meet the annual employment baseline is due to a national economic downturn, rather than outsourcing of jobs, the aerospace tax preferences will remain in place.

A significant aerospace firm means a manufacturer that made a final decision to site a significant commercial airplane manufacturing program on July 9, 2014. An employment position is defined as an employee who works at least 35 hours per week. The calculation for the number of employment positions for a calendar year is based on the average number of employment positions reported to the ESD for January through September. The DOR must make a determination of any required tax rate adjustment by January 1 of the calendar year in which the rate adjustment is required and are recalculated each year.

In order to qualify for the preferential B&O rate of 0.2904 percent, a significant aerospace firm must meet or exceed 70,000 employment positions in Washington for the calendar year. If a significant aerospace firm fails to meet the employment baseline, the new B&O rate is dependent upon how far below the baseline the employment level was for the previous calendar year:

- If the annual employment level is below 70,000 employment positions, but above 67,500 the B&O rate is 0.387 percent.
- If the annual employment level is 67,500 or below the regular B&O rate of 0.484 percent applies.

In addition, the amount of the aerospace B&O tax credit is reduced by 50 percent if the annual employment level is below 70,000 but above 67,500. No credit is allowed if the annual employment level is 67,500 or less.

In the years where the aerospace B&O rate and credit are adjusted, the DOR must provide the State Treasurer with the amount of the resulting increase in general fund revenues by September 1. At the end of the third calendar quarter, the State Treasurer must deposit 50 percent of the estimated increased revenues into the Education Legacy Trust Account. The other 50 percent will be deposited into the newly created Small Business Tax Credit Account.

A new small business tax credit program is created. The DOR will notify taxpayers by December 1 of each year if the small business tax credit will be available based on any deposits made into the Small Business Tax Credit Account. The credit is $1,000 multiplied by the number of net employees at the small business in the calendar year for which the credit is claimed as compared to the immediately preceding calendar year. The credit is available on a first in time basis up to the statewide maximum as set by the DOR for the year. The credit is nonrefundable and may not be carried forward.

An employee is defined as a person directly employed by a small business and who works 35 hours per week, averaged over a calendar year. A small business is defined as any sole proprietorship, corporation, partnership, or other legal entity with gross revenue of less than $5 million as reported on the small business's federal income tax return or its return filed with the DOR over the previous three consecutive years. The small business tax credit expires January 1, 2028; however, the tax preference performance statement states that the Legislature intends to extend the credit if the Joint Legislative Audit and Review Committee determines that more than 20 small businesses participate and the growth of employees by all participating small businesses exceeds 1,000.

In addition, the annual report requirement to include wage and benefit per job information is removed.

This act shall be called the "Aerospace Tax Incentive Accountability Act."

Appropriation: None.

Fiscal Note: Available.

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