

HOUSE BILL REPORT

SSB 5977

As Passed House:
June 30, 2017

Title: An act relating to revenue.

Brief Description: Concerning revenue.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senator Rossi).

Brief History:

Committee Activity:

None.

Third Special Session

Floor Activity:

Passed House: 6/30/17, 83-10.

Brief Summary of Substitute Bill

- Increases the tax credit limit for the Washington Main Street Program.
- Reduces the general manufacturing business and occupation (B&O) tax rate and the processing for hire rate from 0.484 percent to 0.2904 percent over four years beginning in 2019.
- Creates a B&O tax exemption for wholesale sales of agricultural crop protection products, seed, and fertilizer under certain conditions.
- Extends tax preferences for solar energy and silicon manufacturing from 2017 to 2027.
- Extends the preferential B&O tax rate of 0.275 percent for semiconductor manufacturing from 2018 to 2028.
- Extends the sales and use tax exemption for gases and chemicals used in the production of semiconductor materials from 2018 to 2028.
- Exempts from sales and use tax all charges for construction related to the conversion of a coal-fired electric generation facility into a natural gas-fired electric generation facility or biomass energy facility.
- Establishes a public utility tax and B&O tax credit for a utility that sells manufactured gas, natural gas, or electricity to a silicon smelter.

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.

- Extends a tax deferral on construction and expenditure costs of up to two new manufacturing facilities each year.
- Extends the sales and use tax deferral for a historic automobile museum.
- Exempts land removed from the designated forest land program due to certain natural disasters from payment of compensating taxes.
- Extends the Motion Picture Competitiveness Program B&O tax credit by an additional 10 years.
- Exempts martial arts from retails sales tax and makes the activity subject to service and other B&O tax.
- Creates a leasehold excise tax credit for certain major universities and provides a leasehold excise tax exemption for certain leasehold interests in facilities owned or used by community or technical colleges.

Staff: Serena Dolly (786-7150).

Background:

Part I - Modifying the Washington Main Street Program.

The Washington Main Street Program (Main Street Program) was created in 2005 to provide technical assistance for local comprehensive downtown or neighborhood commercial district revitalization initiatives. The Main Street Program is operated by the Department of Archeology and Historic Preservation (DAHP).

The DAHP provides initial site evaluations by technical specialists, training for local programs and staff, and design and implementation assistance to local governments and organizations for revitalization programs. The DAHP also may provide financial assistance for initial start-up costs for a local program.

The DAHP may designate local comprehensive downtown or neighborhood commercial district revitalization programs and official local main street programs based on certain criteria. The boundaries of a local program must be approved by the DAHP and are generally defined by the pedestrian core of a traditional commercial district. The DAHP may not designate a program undertaken by a local government with a population over 190,000 people.

The Main Street Trust Fund Account receives private contributions, federal funds, and legislative appropriations for the operation of the Main Street Program.

Private contributions made to the Main Street Program Trust Fund or a designated local Main Street Program are eligible for a business and occupation tax or public utility tax credit. The credit is valued as follows:

- 75 percent of a contribution made directly to a designated program in a city under 190,000; and

- 50 percent of a contribution made to the Main Street Program Trust Fund.

No person may receive a tax credit over \$250,000 in each calendar year. The total tax credits allowed for each designated program may not exceed \$100,000 per calendar year. The total tax credits allowed statewide may not exceed \$1.5 million for each calendar year.

Part II - Lowering the Ceiling of the B&O Manufacturing Tax Rate.

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. A taxpayer may have more than one B&O tax rate, depending on the types of activities conducted. Major B&O 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 preferential rates also apply to specific business activities.

For B&O tax purposes, the term "manufacturer" means every person who, either directly or by contracting with others for the necessary labor or mechanical services, manufactures for sale or for commercial or industrial use from the person's own materials or ingredients any articles, substances, or commodities. The term "to manufacture" means all activities of a commercial or industrial nature wherein labor or skill is applied, by hand or machinery, to materials so that as a result thereof a new, different, or useful substance or article of tangible personal property is produced for sale or commercial or industrial use.

The general manufacturing B&O rate is 0.484 percent; however, there are several preferential rates in the manufacturing sector for more specific manufacturing activities as follows:

- commercial aircraft manufacturing - 0.2904 percent;
- wood biomass fuel manufacturing - 0.138 percent;
- manufacturing wheat into flour, barley into pearl barley, soybeans into soybean oil, or sunflower seeds into sunflower oil - 0.138 percent;
- splitting or processing dried peas - 0.138 percent;
- manufacturing seafood products, dairy products, and fresh fruits and vegetables—exempt until 2025–2025 and thereafter - 0.138 percent;
- slaughtering, breaking and/or processing perishable meat products and/or selling the same at wholesale - 0.138 percent;
- manufacturing timber or wood products - 0.2904 percent;
- manufacturing semiconductor materials - 0.275 percent; and
- manufacturing solar energy systems and components of solar energy systems - 0.275 percent.

Part III - B&O Tax Exemption for Agricultural Fertilizer and Seed.

"Commercial fertilizer" means a substance containing one or more recognized plant nutrients that is used for its plant nutrient content or that is designated for use or claimed to have value in promoting plant growth. Commercial fertilizers include limes, gypsum, and manipulated animal and vegetable manures. Unmanipulated animal and vegetable manures, organic

waste-derived material, and other products exempted by the Department of Agriculture by rule are not considered commercial fertilizer.

"Agricultural crop protection product" means a chemical regulated under the federal Insecticide, Fungicide, and Rodenticide Act when used to control weeds, diseases, or other pests. "Seed" means seed potatoes, any kinds of crop seeds commonly recognized within Washington as agricultural seeds, lawn seeds, and combinations of such seeds that are conditioned for use in planting.

Part IV - Solar Silicon Manufacturing.

Washington tax law provides a preferential B&O manufacturing rate of 0.275 percent on the manufacture of solar energy systems using photovoltaic modules or stirling converters, manufacturing solar grade silicon, silicon solar wafers, silicon solar cells, thin film solar devices, or compound semiconductor solar wafers to be used in the components of such systems. The preference is set to expire June 30, 2017.

Part V - Semiconductor Materials Manufacturing.

Washington provides a preferential B&O manufacturing rate of 0.275 percent on the manufacture or process for hire of semiconductor materials. The exemption is set to expire December 1, 2018.

Washington also provides a sales tax exemption for sales of gases and chemicals used by a manufacturer or processor for hire in the production of semiconductor materials. The exemption is set to expire December 1, 2018.

Six tax preferences for the semiconductor materials manufacturing industry were enacted in 2003 that are contingent upon a firm investing at least \$1 billion in new buildings, machinery, and equipment. The preferences include a sales and use tax exemption on the construction of the new buildings, a property tax exemption for machinery and equipment, a B&O tax credit for jobs created, a reduced B&O tax rate, a sales and use tax exemption on certain purchases, and a B&O tax exemption for the manufacturing of semiconductor chips.

Part VI - Sales Tax Exemption for Coal-Fired Electric Generation Plants.

The only coal-fired electric generation facility located in the state is the TransAlta coal plant in Centralia, Washington. In 2011 the state entered into a memorandum of agreement with TransAlta to transition the coal-fired units away from coal, with one unit shutting down in 2020 and the second unit in 2025.

Part VII - Tax Relief for Silicon Smelters.

Public Utility Tax. Income from utility operations is taxed under the public utility tax (PUT) in lieu of the B&O tax. Other income of the utility, such as retail sales of tangible personal property, is subject to the B&O tax. The PUT only applies on sales to consumers. Five different rates apply, depending upon the specific utility activity. The current rates, including permanent surtaxes, are as follows:

- water distribution businesses - 5.029 percent;
- light and power businesses - 3.873 percent;
- telegraph, natural gas, and sewerage businesses - 3.852 percent;
- urban transportation and watercraft vessels under 65 feet in length - 0.642 percent;
- and
- railroads, railroad car companies, motor transportation, and all other public service businesses - 1.926 percent.

Brokered Natural Gas Use Tax. A use tax is levied on businesses that use natural or manufactured gas within the state if the gas is shipped directly to the business through a pipeline. The use tax rate is equal to the PUT rate for gas distribution businesses. The use tax is not levied on gas that is delivered by some other means for which the PUT has already been paid.

Part VIII - Invest in Washington Program.

In 2015 the Invest in Washington pilot program (pilot program) was established to evaluate the effectiveness of providing a tax incentive for businesses that invest in manufacturing facilities and equipment and reinvest those tax savings in employee training programs. The pilot program consists of five qualified industrial facilities, two of which were required to be located in eastern Washington.

Eligible investment projects include up to \$10 million in sales and use tax on construction costs or purchases of qualified machinery and equipment. Amounts paid for the construction of qualified buildings, machinery, and equipment are eligible for a sales and use tax deferral. The recipient of the deferral must begin repaying the deferred taxes five years after the date that the project is operationally complete. There is no interest charged on deferred taxes, and the taxes may be repaid over a 10-year period in equal annual payments.

Deferred taxes, when repaid, are deposited in the Invest in Washington Account. The account, administered by the State Board for Community and Technical Colleges, must be used to support customized job training programs, job skills programs, job readiness training, workforce professional development, and to assist employers with state-approved apprenticeship programs for manufacturing and production occupations.

All five projects allowed by statute were approved as of March 2016. The approved projects are located in the following counties: Benton, Pierce, Snohomish, which has two, and Spokane.

Part IX - Sales Tax Deferral for Historic Automobile Museums.

Washington residents Harold and Nancy LeMay assembled the largest privately owned collection of automobiles, other vehicles, and memorabilia in the world. America's Car Museum (ACM) was founded to house some of this collection in 1997. The ACM, a nonprofit 501(c)(3) organization, is located in Tacoma. The ACM opened in 2012 and includes a 165,000 square foot museum and a 3.5 acre show field.

Legislation enacted in 2005 authorized a sales and use tax deferral to help historic automobile museums defray some of the construction related costs. The ACM utilized this deferral program. The ACM must begin repaying the deferred taxes in the fifth year after the Department of Revenue (DOR) certifies it as operationally complete.

Part X - Removal of Land from Current Use Due to Natural Disasters.

All property is subject to a tax each year based on the highest and best use, unless a specific exemption is provided by law. The Washington Constitution authorizes qualifying agricultural, timber, and open space lands to be valued on the basis of their current use rather than fair market value. Two programs of current use valuation have been established, one program that includes open space lands, farm and agricultural lands, and timber lands and a second program for designated forestlands.

Taxes and interest apply when land is withdrawn or removed from the program if the use of the property changes, the owner requests withdrawal, or a sale of the property is made and the new owner does not sign a notice of intent to continue within the current use program or designated forestland program.

If property no longer qualifies for the current use program, then an additional tax, penalty, and interest are due. Additional tax is the difference between the fair market value and the current use value for each year, multiplied by that year's levy rate, not to exceed seven years. Interest is calculated at 12 percent per year, the same as for delinquent property taxes. The penalty is 20 percent of the additional tax and interest. The penalty does not apply if the owner provides a two-year withdrawal notice. Property removed from current use classification due to a natural disaster such as a flood, windstorm, earthquake, and other calamity, rather than the landowner changing the use of the property, is exempt from additional tax, penalty, and interest.

If the property no longer qualifies for the designated forestland program, compensating tax is due. Compensating tax is the difference between the fair market value and the current designated forest land value, multiplied by the current levy rate and the number of years the land was in the program; not to exceed nine years, plus an amount using the same calculation for the current year, up to the date of removal. Interest and penalties do not apply on compensating tax when land is removed from the designated forestland program. There are no exemptions from compensating tax for property removed from the program due to natural disaster.

Part XI - Modifying Washington's Motion Picture Tax Credit.

Legislation enacted in 2002 created the Motion Picture Competitiveness Program with the intent of maintaining Washington's position as a competitive location for filming motion pictures, television, and television commercials. The Motion Picture Competitiveness Program allows taxpayers that contribute to an incentive fund to receive a credit against their B&O tax for the full amount contributed. Qualifying production companies that film in Washington can apply for payment from the incentive fund.

The Department of Community, Trade and Economic Development, now the Department of Commerce (Commerce), was directed to adopt criteria for an approved Motion Picture Competitiveness Program. Commerce was also directed to adopt rules, within established criteria, for awarding incentive payments to production companies. Additionally, Commerce was required to collect annual surveys from the production companies receiving the incentives and report on the information in the surveys to the Legislature.

In 2006 legislation created a nonprofit corporation to administer the incentive payments to production companies. Washington Filmworks, the nonprofit corporation, processes the production companies' applications for incentive payments pursuant to Commerce's rules.

In December 2010 the Joint Legislative Audit and Review Committee (JLARC) made recommendations to the Legislature based on its review of the effectiveness of the program. Based on these recommendations, the Legislature extended the expiration date of the credit to July 1, 2017. It also modified various parts of the program including how funding was to be allocated, expanded the purpose of the program, and capped the statewide B&O tax credit at \$3.5 million per calendar year. The credit is also limited to \$1 million per business per year.

The JLARC reviewed the effectiveness of the program again in 2015, specifically reviewing two public policy objectives: (1) to regain Washington's competitive position as a location for motion picture projects; and (2) to provide family wage jobs with health and retirement benefits. The JLARC's recommendation to the Legislature was to review and clarify the public policy objective by providing additional detail on the target for Washington's film industry relative to other states and details pertaining to the desired employment outcomes.

The current Motion Picture Competitiveness Program tax credit expires July 1, 2017.

Part XII - Excise Tax of Martial Arts.

Legislation enacted in 2016 revised the definition of retail sales for physical fitness activities. While the changes excluded most yoga, tai chi, and chi gong events from the definition of retail sales, martial arts was included in the definition of a taxable retail sale. This represented a change as martial arts previously was not considered a retail sale.

The changes enacted in 2016 did include in the definition of retail sales yoga, tai chi, and chi gong events held at an athletic or fitness facility. "Athletic or fitness facility" is defined as an indoor or outdoor facility or portion of a facility that is primarily used for physical activities including exercise classes, personal training, and tennis.

Part XIII - Leasehold Excise Credits and Exemptions for Universities and Colleges.

State leasehold excise taxes are levied and collected on the act or privilege of occupying or using publicly owned real or personal property through a leasehold interest. A leasehold interest is an interest in publicly owned real or personal property which exists by virtue of any lease, permit, license, or other written or verbal agreement between a public owner and a person who would not be exempt from property taxes if that person owned the property. The leasehold excise tax is levied at a rate of 12.84 percent of taxable rent, i.e., the contract rent.

The legislative body of any county or town may also levy and collect a leasehold excise tax on leasehold interests in publicly owned property within the territorial limits of the county or city. The tax levied by a county may not exceed 6 percent of taxable rent and, by a city, may not exceed 4 percent of taxable rent. If imposed, the local leasehold taxes are credited against the state tax so the maximum total rate is 12.84 percent.

In 2013 the Legislature passed Substitute Senate Bill 5444, which removed the requirement of county assessors to determine the value of publicly owned property not subject to property tax. In that same legislation, a leasehold excise tax credit for certain lessees or sub-lessees for whom the excise tax exceeds the amount of the property tax that would otherwise be due was eliminated.

Tax Preference Performance Statement.

All new tax preference legislation is required to include a tax preference performance statement. The performance statement must clearly specify the public policy objectives of the tax preference, and the specific metrics and data that will be used by the JLARC to evaluate the efficacy of the tax preference. An automatic 10-year expiration date applies to new tax preferences if an alternate expiration date is not provided in the new tax preference legislation.

Summary of Bill:

Part I - Modifying the Washington Main Street Program.

The tax credit limit for Main Street Program contributions approved statewide is increased from \$1.5 million to \$2.5 million per year. The following administrative changes are made:

- The DAHP may not accept any applications before the second Monday in January of each calendar year.
- Between the second Monday in January and March 31 of the same calendar year, the DAHP must evenly allocate the amount of statewide credits allowed under the Main Street Program, based on the total number of programs and the Main Street Trust Fund as of January 1 in the same calendar year.
- The DAHP may not approve contributions for a program or the Main Street Trust Fund that would cause the total amount of approved credits for a program or the Main Street Trust Fund to exceed the allocated amount.
- A person that was approved for a credit must make the total approved contribution by November 15 of the calendar year in which the application is approved.
- The program expires January 1, 2028, if a review by the JLARC finds that the number of businesses that are a part of Main Street communities is not equal to or more than the number that were a part of Main Street communities prior to the enactment of the tax preference.

Part II - Lowering the Ceiling of the B&O Manufacturing Tax Rate.

A phased-in reduction of the general manufacturing and the processing for hire B&O tax rates begins January 1, 2020, as follows:

- 0.4356 percent beginning January 1, 2020, through December 31, 2020;
- 0.3872 percent beginning January 1, 2021, through December 31, 2021;
- 0.3388 percent beginning January 1, 2022, through December 31, 2022; and
- 0.2904 percent beginning January 1, 2023.

The tax preference is exempt from the automatic 10-year expiration.

Part III - B&O Tax Exemption for Agricultural Fertilizer and Seed.

An exemption to the B&O tax is created for the sale of commercial fertilizer, agricultural crop protection products, and seed from an eligible distributor to an eligible retailer.

"Eligible distributors" are wholesalers who purchase commercial fertilizer, crop protection products, and seed and sell them to retailers who have at least a 50 percent ownership interest in the wholesaler.

An "eligible retailer" is a person who sells commercial fertilizers, agricultural crop protection products, and seed, who holds at least a 5 percent ownership interest in an entity that holds at least a 50 percent ownership interest in an eligible distributor.

Part IV - Solar Silicon Manufacturing.

The preferential B&O manufacturing rate of 0.275 percent for manufacturers of solar energy and silicon products is extended to December 1, 2027.

The tax preference is subject to JLARC review.

Part V - Semiconductor Materials Manufacturing.

The preferential B&O manufacturing rate of 0.275 percent for manufacturers and processors for hire of semiconductor materials and the sales tax exemption for gases and chemicals used in the production of semiconductor materials are extended to December 1, 2028.

The six unused preferences contingent upon the siting and commercial operation of a significant semiconductor microchip fabrication facility are reenacted. The preferences expire unless a contract for the construction of a significant semiconductor fabrication facility is signed and received by the DOR by January 1, 2024.

Part VI - Sales Tax Exemption for Coal-Fired Electric Generation Plants.

The construction of new structures or renovation of existing structures for the purpose of converting a coal-fired electric generation facility into a natural gas-fired electric generation facility or biomass energy facility is exempt from state and local sales and use tax. The exemption includes the labor and services to construct the facility and the machinery and equipment required for the conversion. The tax exemption is in the form of a remittance. A purchaser may apply to the DOR for the remittance after the conversion of the facility is operationally complete, but not earlier than April 1, 2021. The DOR may not accept any

applications after July 1, 2021, or one year from the date the conversion of the facility is operationally complete, whichever is later. No remittance may be paid earlier than July 1, 2021. The exemption expires July 1, 2027.

A tax preference performance statement characterizes the tax preference as one intended to create jobs. Because the tax preference is intended to expire, it is exempt from review by the JLARC. The remitted sales and use taxes must be repaid if the number of employment positions at the natural gas-fired plant or biomass energy facility decreases by 25 percent from the previous year's employment level at any point beginning one year after the facility is operationally complete and ending January 1, 2031.

Part VII - Tax Relief for Silicon Smelters.

A utility that provides manufactured gas, natural gas, or electricity to a silicon smelter is eligible for a PUT credit or B&O tax credit equal to the gross income from the sale of the electricity or gas to the silicon smelter multiplied by the PUT rate or B&O tax rate, respectively, provided that the contract for the sale of electricity or gas to the silicon smelter specifies that the price charged will be reduced by an amount equal to the credit. "Silicon smelter" means a manufacturing facility that processes silica into high-purity silicon used exclusively in components of photovoltaic solar energy systems.

The PUT and B&O tax credits available to a utility provider of gas or electricity to a silicon smelter do not apply to amounts received from the remarketing or resale of electricity originally obtained by contract for the smelting process. A silicon smelter that uses manufactured or natural gas that was delivered directly through a pipeline is exempt from the brokered natural gas use tax.

A silicon smelter that receives the benefit of the PUT and B&O tax credits available to a utility provider must file an annual survey with the DOR. A silicon smelter must repay an amount equal to the entire economic benefit it received from the tax credits for the previous two calendar years if:

- the average number of employment positions at the silicon smelter is less than 100, as reported to the Employment Security Department for the previous two calendar years; and
- the average annual wage for all employment positions is equal to or less than the average annual wage for the previous two calendar years for the county in which the silicon smelter is located.

The DOR must make a determination as to whether or not repayment by the silicon smelter is required by August 31, 2023. If the DOR determines that repayment is necessary, the tax preference expires January 1, 2024. If the DOR determines that repayment is not necessary, the tax preference expires July 1, 2027.

The tax preferences must be reviewed by the JLARC. The JLARC must look at the number of beneficiaries receiving the PUT and B&O tax credits and smelters receiving the benefit through reduced prices of electricity and gas. (In suppThe JLARC must also include specific

job metrics as part of the review. The JLARC is not required to perform a tax preference evaluation if the tax preference expires on January 1, 2024.

Part VIII - Invest in Washington Program.

A sales tax deferral on construction and expenditure costs of up to two new manufacturing facilities annually is authorized. One facility must be located in eastern Washington, and one must be located in western Washington.

The tax preference is subject to the JLARC review requirements and expires on January 1, 2028.

Part IX - Sales Tax Deferral for Historic Automobile Museums.

The sales and use tax deferral payments are delayed an additional five years, coming due in the tenth year following operational completion.

The tax preference is subject to the JLARC review requirements.

Part X - Removal of Land from Current Use Due to Natural Disasters.

Land removed from the designated forestland program due to natural disaster such as a flood, windstorm, earthquake, or other such calamity is exempt from compensating tax. Clarification is provided that property removed from current use classification due to wildfire is not subject to additional tax, penalty, and interest.

The tax preference is exempted from the JLARC review requirements and from the automatic 10-year expiration.

Part XI - Modifying Washington's Motion Picture Tax Credit.

The Motion Picture Competitiveness Program is extended an additional 10 years, until July 1, 2027. "Associated creative industries" are added to the motion picture production industry as a focus of the Motion Picture Competitiveness Program. The amount a person may claim is reduced to \$750,000 per year.

The tax preference is subject to the JLARC review requirements.

Part XII - Excise Tax of Martial Arts.

Yoga, chi gong, and martial arts activities that do not occur at an athletic or fitness facility, but instead occur at any other facility, such as a community center, school, or stand-alone yoga or martial arts studio, are removed from the definition of retail sale. These activities are not subject to the sales tax, or to the retailing B&O tax rate 0.471 percent, but instead are subject to the service and other activities B&O tax rate of 1.5 percent. "Martial arts" are defined as any of the various systems of training for physical combat or self-defense, including but not limited to karate, kung fu, tae kwon do, Krav Maga, boxing, kickboxing, jujitsu, shootfighting, wrestling, aikido, judo, hapkido, Kendo, tai chi, and mixed martial arts.

The tax preference is exempted from the JLARC review and from the automatic 10-year expiration.

Part XIII - Leasehold Excise Credits and Exemptions for Universities and Colleges.

Leasehold Excise Tax Credit: A leasehold excise tax credit is created for the amount of leasehold excise tax exceeding the property tax would apply if the taxpayer owned the property. The credit only applies to leasehold interests on parcels with a market value of more than \$10 million owned by a state university. If the leasehold interest attaches to two or more parcels, the credit is available if at least one of the parcels has a market value of more than \$10 million.

The tax preference takes effect January 1, 2022, and expires January 1, 2032. The tax preference is subject to the JLARC review requirements.

Leasehold Excise Tax Exemption: Leasehold interests in facilities owned or used by a community college or technical college are exempt from leasehold excise tax if they serve one of the following functions: providing food service for students, faculty, and staff; operating a bookstore on campus; or providing maintenance, operational, or administrative services to the community college or technical college.

The tax preference is exempted from the JLARC review and the automatic 10-year expiration.

Appropriation: None.

Fiscal Note: Not requested.

Effective Date: The bill contains multiple effective dates. Please refer to the bill.