

SENATE BILL REPORT

SB 5977

As of June 29, 2017

Title: An act relating to revenue.

Brief Description: Relating to revenue.

Sponsors: Senator Rossi.

Brief History:

Committee Activity: Ways & Means: 6/30/17.

Brief Summary of Bill

- 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 the expiration date of a preferential business and occupation tax rate for solar energy and silicon manufacturing from 2017 to 2027.
- Extends tax preferences that support the solar silicon manufacturing industry from 2018 to 2028.
- Exempts from sales and use taxes 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 business and occupation tax credit for a utility that sells manufactured gas, natural gas, or electricity to a silicon smelter.
- Makes the provision of a pilot program that provides a tax deferral on construction and expenditure costs of up to two new manufacturing facilities an annual provision.
- Extends the sales and use tax deferral date for historical auto museum projects.

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.

- Exempts lands removed from the open space program or the designated forestland program due to a natural disaster from payment of compensating taxes.
- Extends the motion picture and film industries tax credit an additional ten years.
- Exempts martial arts from retail sales tax and makes the activity subject to service and other B&O tax.
- Increases the tax credit limit for the Washington Main Street program.
- 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 colleges or technical colleges.

SENATE COMMITTEE ON WAYS & MEANS

Staff: Dean Carlson (786-7305)

Background: Part 1- Modifying the Washington Main Street program. The Main Street Program (Program) was created in 2005 to provide technical assistance for local comprehensive downtown or neighborhood commercial district revitalization initiatives. The 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, as well as 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 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 2 - Lowering the ceiling of the B&O manufacturing rate to 0.2904%. 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 3 - Business and Occupation tax exemption for Agricultural fertilizer and seed. *Economic Nexus.* On June 1, 2010, Washington adopted an economic nexus standard for certain types of business activity. Effective September 1, 2015, the Department of Revenue adopted rules applying economic nexus standards to out-of-state wholesaling businesses. Under this standard, an out-of-state wholesaling business deriving income within Washington of more than \$267,000 of gross receipts during the prior calendar year is subject to Washington's B&O tax even though the business may not have a physical presence in the state.

Commercial Fertilizer, Agricultural Crop Protection Products, 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, or 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 4 - Solar Silicon Manufacturing. Washington 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 exemption is set to expire June 30, 2017.

Part 5 - 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, and 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 semiconductor chips.

Part 6 - Providing sales and use tax exemptions to encourage coal-fired electric generation plants to convert to natural gas-fired plants or biomass energy facilities. Emission Performance Standards (EPS) were adopted for electric generation plants to meet greenhouse gas emission standards adopted in Washington in 2008. In 2009, the Governor issued an executive order directing the Department of Ecology (Ecology) to work with the existing coal-fired plant within Washington to establish an agreed order to apply the EPS to the facility by no later than December 31, 2025. The agreed order must include a schedule of major decision making and resource investment milestones. In 2011, the Legislature established a schedule for applying the EPS to the Centralia coal-fired electric generation facility.

Part 7 - Tax Relief for Silicon Smelters. *Public Utility Tax (PUT).* Income from utility operations is taxed under the 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 applies only 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 tax has already been paid.

Part 8 - Invest in Washington Program. In 2015, the Invest in Washington 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 ten-year period in equal annual payments.

Deferred taxes, when repaid, are deposited in the Invest in Washington Account. The Invest in Washington 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 9 - Extending the Sales and Use tax Deferral for Historical Auto Museums. In 2005, the Legislature authorized a sales and use tax deferral for historic automobile museums to apply to construction-related costs. In order to be eligible for the deferral, the museum must be a nonprofit-run facility used to exhibit a collection of at least 500 vehicles. Taxes must be repaid beginning in the fifth year after the museum is operationally complete. Ten percent of the tax liability is due each year. If the Department of Revenue finds the project to be ineligible during the deferral period or if the project is not operational after five years from when the deferral was issued, deferred taxes must be repaid with interest.

Part 10 - Concerning removal of land from Current Use due to Natural Disaster. Generally, all real property is subject to a tax each year based on highest and best use. 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.

Open Space Program. The Open Space Program allows agricultural lands, timberlands, and other open space lands to be assessed according to their value as they are currently used rather than the market value. Open space lands are lands which conserve natural resources, promote conservation, enhance public value and recreation, preserve visual quality, or have other legislatively identified attributes of public benefit. Agricultural and timber lands are subject to various requirements regarding size, use, and income.

When property is removed from the current use valuation program, either by the owner or the assessor due to a change in use, the owner must pay additional tax, penalty, and interest. Property removed from current use classification due to a natural disaster such as a flood, windstorm, earthquake, and other calamity, is exempt from additional tax, penalty, and interest.

Designated Forest Land (DFL) Program. The DFL program allows timber on certain lands used primarily for growing and harvesting timber to be exempt from real property tax and subject instead to timber excise tax. To qualify, property owners must apply and provide information regarding the land, harvest history, and a timber management plan, if any.

When land is removed from the DFL program, either by the owner or by the assessor due to a change in use, the owner must pay compensating tax. 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 to compensating tax when land is removed from the DFL program. There are no exemptions for property removed from the program due to natural disaster.

Part 11 - Modifying Washington's Motion Picture and film industries tax credit. *Motion Picture Competitiveness Program.* The Legislature created the Motion Picture Competitiveness Program (Program) in 2002, with the intent of maintaining Washington's position as a competitive location for filming motion pictures, television, and television commercials. The 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 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.

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. JLARC's recommendation to the Legislature was to review and clarify the public policy objective, specifically, to provide additional detail on the target for Washington's film industry relative to other states, as well as details pertaining to the desired employment outcomes.

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

Part 12 - Concerning the excise taxation of martial arts. Legislation enacted in 2016 revised the definition of retail sales in regards to 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 from the definition of retail sales prior enacting those changes where martial arts 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 13 - Leasehold excise tax. 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 – that is, 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 six percent of taxable rent and, by a city, may not exceed four 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 SSB 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.

Leasehold interests in facilities owned or used by a school, college, or university for housing students is exempt from leasehold excise tax.

Summary of Bill: The bill as referred to committee not considered.

Summary of Bill (Proposed Substitute): Part 1 - Modifying the Washington Main Street program. The tax credit limit for contributions made statewide is raised from \$1.5 million to \$2.5 million. The following administrative changes are made to the Program:

- 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 31st of the same calendar year, the DAHP must evenly allocate the amount of statewide credits allowed under the Program, based on the total number of programs and the Main Street Trust Fund as of January 1st 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 15th of the calendar year in which the application is approved; and
- the Program expires January 1, 2028, if a review by the Joint Legislative Audit and Review Committee 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 2 - Lowering the ceiling of the B&O manufacturing rate to 0.2904 percent. The general manufacturing B&O tax rate, and the processing for hire B&O tax rate are each reduced from 0.484 percent to 0.2904 percent incrementally over a four year period beginning January 1, 2019. The new lower rate is fully phased in on January 1, 2022.

Part 3 - Business and Occupation 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 five percent ownership interest in an entity that holds at least a 50 percent ownership interest in an eligible distributor. The exemption is not subject to the ten-year expiration date nor the requirement to prepare a tax preference performance statement.

Part 4 - Solar Silicon Manufacturing. The preferential B&O manufacturing rate of 0.275 percent for manufacturers of solar energy and silicon products is extended to July 1, 2027.

Part 5 - 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. Any person claiming the preferential tax rate must reimburse the Department of Revenue (DOR) for 50 percent of the amount of the preference if the number of persons employed by a person claiming the tax preference is less than 90 percent of the three-year average.

Part 6 - Providing sales and use tax exemptions to encourage coal-fired electric generation plants to convert to natural gas-fired plants or biomass energy facilities. 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 plant or biomass energy facility is exempt from sales and use tax. The exemption includes the labor and services to construct the facility and the machinery and equipment that is required for the conversion.

The tax exemptions are in the form of a remittance and no remittance may be paid until the conversion of the facility is operationally complete, but not earlier than July 1, 2021. Applications for the remittance may not be submitted before April 1, 2021, and the DOR may not accept any application for a remittance that it does not receive by the later of (1) July 1, 2021, or (2) one year after the date that the facility is deemed operationally complete.

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. A repayment obligation is created if the number of employment positions at the new facility declines by 25 percent from the previous year's employment level, beginning one year after the facility is operationally complete and ending January 1, 2031. If the repayment obligation is triggered, no additional exemptions may be claimed.

Part 7 - 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.

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

The tax preferences established in the Act must be reviewed by the JLARC during the committee's normal ten-year review cycle. 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. JLARC must also include specific job metrics as part of the review. JLARC is not required to perform a tax preference evaluation if the tax preference expires on January 1, 2024.

Part 8- Invest in Washington Program. The provision of a tax deferral on construction and expenditure costs of up to two new manufacturing facilities, one of which must be located in eastern Washington and one of which must be located in western Washington, is made an annual provision.

Part 9 - Extending the Sales and Use tax Deferral for Historical Auto Museums. The deferral date for sales and use tax payments is extended an additional five years, coming due in the tenth year following operational completion of a museum project.

Part 10 - Concerning removal of land from Current Use due to Natural Disaster. Property removed from the Open Space Program due to wildfire is not subject to additional tax, penalty, and interest. Compensating tax is not assessed on land removed from the DFL program due to natural disaster such as a flood, windstorm, earthquake, wildfire, or other such calamity.

Part 11 - Modifying Washington's Motion Picture and film industries tax credit. The current Motion Picture Competitiveness program is extended an additional ten 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 of B&O tax credit one person may claim is reduced from \$1 million annually to \$750 thousand.

Part 12 - Concerning the excise taxation of martial arts. Martial arts is removed from the definition of retail sale, except for martial arts events held at an athletic or fitness facility. This means that sales tax cannot be imposed on martial arts classes — except for those held

at an athletic or fitness facility, and that martial arts classes must be taxed at the 1.5 percent B&O service tax rate rather than the .471 percent retailing B&O rate.

“Martial arts” is defined as any of the various systems of training for physical combat or self-defense, and it includes, but is not limited to, karate, kung fu, tae kwon do, Krav Maga, boxing kickboxing, jujitsu, shootfighting, wrestling, aikido, judo, hapkido, Keno, tai chi, and mixed martial arts.

Part 13 - Leasehold excise tax. A leasehold excise tax credit 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.

If the tax parcel does not have a current assessed value, a Washington state-certified general real estate appraiser must perform a market value appraisal. If the leasehold interest applies to less than the entire parcel, the appraisal must include the market value of the portion of the parcel to which the leasehold interest applies.

To calculate the property tax that would apply, the existing consolidated levy rate for the property's tax code area is used.

The amount of the credit is not confidential tax information and can be disclosed.

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: provide food service for students, faculty, and staff; operate a bookstore on campus; or provide maintenance, operational, or administrative services to the community college or technical college.

Appropriation: None.

Fiscal Note: Not available.

Creates Committee/Commission/Task Force that includes Legislative members: No.

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