

HOUSE BILL REPORT

ESB 6690

As of Second Reading

Title: An act relating to aerospace business and occupation taxes and world trade organization compliance.

Brief Description: Concerning aerospace business and occupation taxes and world trade organization compliance.

Sponsors: Senators Liias and King.

Brief History:

Committee Activity:

None.

Brief Summary of Engrossed Bill

- Changes the manufacturing, wholesaling, and retailing business and occupation (B&O) tax rate for manufacturers of commercial airplanes and manufacturers of components of commercial airplanes to 0.484 percent effective April 1, 2020.
- Changes the manufacturing and wholesaling B&O tax rate for manufacturers of aerospace tooling to 0.484 percent and the retailing B&O tax rate for manufacturers of aerospace tooling to the standard 0.471 percent effective April 1, 2020.
- Allows for a B&O tax rate of 0.357 percent to be imposed beginning April 1, 2021, so long as any agreement resolving the World Trade Organization disputes between the United States and the European Union involving large civil aircraft allows for such a rate and other conditions are met.
- Subjects a significant commercial airplane manufacturer, and the aerospace industry as a whole, receiving the 0.357 percent B&O tax rate to an apprenticeship utilization rate of 1.5 percent of their Washington workforce within 5 years.
- Creates the Aerospace Workforce Council.

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

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.

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 the B&O tax even though they may not have any profits or may be operating at a loss.

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 for activities not classified elsewhere. Several preferential rates also apply to specific business activities.

In addition, a taxpayer may be eligible to utilize other tax preferences, including credits and deductions, to reduce their tax liability. For example, a taxpayer engaging in activities subject to different B&O tax rates may be eligible for a Multiple Activities Tax Credit. A taxpayer may also be eligible for a small business credit that will either eliminate or reduce their B&O tax liability. In general, the credit is \$70 per month for service businesses and \$35 per month for all other businesses, multiplied by the number of months in the reporting period. The amount of the credit available phases out based on the business' gross receipts.

A business does not have to file an annual B&O tax return if the business does not owe other taxes or fees to the Department of Revenue (DOR) and has annual gross proceeds of sales, gross income, or value of products for all B&O tax classifications of less than \$28,000 per year, or less than \$46,667 if at least 50 percent of its taxable income is from services or activities not classified elsewhere.

Aerospace Business and Occupation Tax Incentives.

In 2003 the Legislature adopted tax incentives that were limited to aerospace manufacturers. The incentives included a reduction in the B&O tax rate; a B&O tax credit for pre-production development expenditures; and a B&O tax credit for property taxes paid on property used in the manufacture of commercial airplanes and airplane components. A leasehold tax exemption for port district facilities is available to manufacturers of super-efficient airplanes that are not using the B&O tax credit for property taxes. Also included were sales and use tax exemptions for computer equipment and software, and its installation, used primarily in the development of commercial airplanes and components. These exemptions are scheduled to end in 2024.

In addition, the Legislature reduced the B&O tax rate from 0.484 percent to 0.275 percent for firms that repair equipment used in interstate or foreign commerce. The firms must be classified by the Federal Aviation Administration (FAA) as a Federal Aviation Regulation (FAR) part 145 certificated repair station with airframe and instrument ratings and limited ratings for nondestructive testing, radio, class 3 accessory, and specialized services.

In 2008 the Legislature extended aerospace tax programs to manufacturers, FAR repair stations, and design/engineering services. Sales and use tax exemptions were provided for computer equipment and software, and installation, which are used primarily in aerospace products or providing aerospace services. Under this legislation until July 1, 2024, the B&O

tax rate is 0.2904 percent for sales, either retail or wholesale, of commercial airplanes or components; the manufacturing or sales of tooling used in the manufacturing of commercial airplanes and components of airplanes; or persons classified by the FAA as a FAR 145 certified repair station. Persons claiming this rate must file an annual survey with the DOR. Persons performing aerospace product development are qualified for a 0.9 percent B&O rate and must file an annual survey with the DOR.

The preproduction 1.5 percent B&O tax credit on qualified expenditures was expanded to include Aerospace product development. The B&O tax credit for property taxes paid was extended to aerospace product development, the manufacturing of tooling, and FAR Part 145 certified repair stations.

In 2013 the Legislature extended the expiration date from 2024 to 2040 for the following aerospace B&O tax preferences: 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 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; and the B&O tax credit for property taxes and leasehold taxes on property used exclusively in manufacturing commercial airplanes or components of airplanes.

The act was contingent upon the DOR making a determination that a final decision to locate a significant commercial airplane manufacturing program in the state of Washington has occurred. A significant commercial airplane manufacturing program is the commencement of manufacturing of a new model of a commercial airplane or a new version of an existing model and the manufacturing of the fuselage and wings of the new model or new version. The ongoing availability of the preferential B&O tax rate for the production of a new or remodeled commercial airplane is contingent upon maintaining all final assembly of the aircraft and wing assembly within the state.

In 2014 Boeing announced it would expand its facilities in Everett, Washington, to manufacture the wings for its new 777X jetliner and the extension of the tax incentives enacted in 2013 was triggered.

World Trade Organization.

The World Trade Organization (WTO) is a global international organization that deals with the rules of trade between nations. The member governments run the WTO and all major decisions are made by the membership as a whole, ministers, or ambassadors or delegates.

The WTO agreements are negotiated and signed by many of the world's trading nations and are ratified by the nation's legislative bodies. The agreements cover goods, services, and intellectual property. They include individual countries' commitment to lower customs tariffs and other trade barriers, and to open and keep open service markets. They set procedures for settling disputes and they prescribe special treatment for developing countries. Governments are required by the WTO to make their trade policies transparent by notifying the WTO about changes to the laws and through regular trade policy reports.

In addition, the WTO provides a forum for settling trade disputes. A dispute arises when one country adopts a trade policy measure or takes some action that one or more of the fellow WTO members considers breaking the WTO agreements, or to be a failure to live up to obligations. In addition, a third group of countries can declare that they have an interest in the case and enjoy some rights. If the WTO dispute settlement body determines that a country has done something wrong, the priority is for the losing party to bring its policy into line with the ruling or recommendations.

Rulings are automatically adopted unless there is a consensus to reject a ruling. Any country wishing to block a ruling has to persuade all other WTO members to share its view. A losing party may also appeal the ruling or recommendation. If a losing party fails to act within a reasonable time, it has to enter into negotiations with the complaining country in order to determine mutually-acceptable compensation such as tariff reductions. If no satisfactory compensation is agreed upon, the complaining party may ask the dispute settlement body for permission to retaliate, usually in the same sector as the dispute.

World Trade Organization Large Civil Aircraft Disputes.

In 2004 the European Communities initiated a dispute at the WTO alleging that the subsidies granted by the United States (U.S.) federal, state and local governments to Boeing large civil aircraft violated the 1994 General Agreement on Tariffs and Trade (GATT) and the Agreement Subsidies and Countervailing Measures (ASCM).

The subsidies at issue include:

- payments, access to government facilities, equipment and employees, allocation of intellectual property rights, and the reimbursement of independent research and development (R&D) costs under R&D contracts and agreements between Boeing and the National Aeronautics and Space Administration (NASA), the U.S. Department of Defense, and the U.S. Department of Commerce;
- various federal, state, and local tax measures; and
- infrastructure-related measures.

The dispute included aerospace tax incentives enacted by the Washington Legislature in 2003 and was later expanded to include the changes made in 2008 and 2013.

Among the restrictions in the ASCM, subsidies that are contingent upon export performance or upon the use of domestic over imported goods are prohibited. This type of subsidy is considered by the ASCM to create "significant trade distortions." As a result, a complaining party is not required to demonstrate any adverse effects in order to prevail in a challenge. The European Communities challenged the Washington state aerospace tax preferences under this provision.

The initial WTO panel ruled in favor of the U.S.; however, the appellate body reversed this decision, ruling in favor of the European Communities in 2016. A subsequent WTO appellate panel report in 2017 found that the only remaining subsidy at issue was Washington's B&O rate reduction. It found that the B&O rate reduction to 0.2904 percent benefiting the Boeing 737 MAX and the 737NG caused serious prejudice to the interests of the European Union (E.U.).

In 2004 the U.S. initiated a dispute with the E.U., Germany, France, the United Kingdom, and Spain alleging subsidies granted to Airbus by the E.U. and the four nations violated both GATT and ASCM.

The subsidies included:

- launch aid and member state financing for Airbus A300, A320, A330/A340 and A380;
- French and German governments' capital contributions in connection with the corporate restructuring of Aerospatiale and Deutsche Airbus; and
- German and Spanish authorities' infrastructure-related measures, as well as launch aid and member state financing for the Airbus A250XWB.

The WTO initial panel and the appellate body found that the launch aid and member state financing, along with other benefits conferred to Airbus, were prohibited subsidies.

Summary of Bill:

Beginning April 1, 2020, the preferential B&O tax rate of 0.2904 percent for manufacturing of commercial airplanes and components of commercial airplane, the making of sales at retail or wholesale of commercial airplanes and components of commercial airplanes manufactured by the seller does not apply. Instead, the B&O tax rate for these activities must be 0.484 percent. The retailing rate for aerospace tooling is returned to the retailing B&O tax rate of 0.471 percent.

After March 31, 2021, a B&O tax rate of 0.357 percent may apply, so long as the following conditions are met:

- The Department of Commerce (Commerce) verifies with the U.S. Trade Representative that the U.S. and E.U. have reached an agreement to resolve their WTO disputes regarding large civil airplanes that expressly allows a B&O tax rate of 0.2904 percent, or if that rate is not permissible a specific alternative rate or reduction.
- Commerce notifies the DOR that an agreement has been reached that allows for a preferential rate.
- The Department of Labor and Industries (L&I) notifies the DOR that a significant commercial airplane manufacturer has reach an aerospace utilization rate of 0.3 percent of its qualified apprenticeable workforce in Washington.

The effective date of the reduced B&O tax rate must be communicated by the DOR to affected parties, the Chief Clerk of the House of Representatives, the Secretary of the Senate, and the Office of the Code Reviser. The effective date must be the first day of the next calendar quarter that is at least 60 days after the date the DOR receives the last of two written notices required.

Both a significant commercial airplane manufacturer alone, and the industry as a whole, are subject to an apprenticeship utilization rate of 1.5 percent within 5 years of the effective date

of the reduced B&O tax rate. The L&I is directed to adopt rules to ensure full participation within the industry.

An aerospace workforce council is created and will be comprised of 14 members. Beginning in calendar year 2020, the council must meet at least twice a year to monitor the progress by a significant commercial airplane manufacturer and the aerospace industry as a whole toward the apprenticeship utilization levels required in the bill. The Council must report to the Legislature by December 1, 2023, on the progress being made toward the 1.5 percent utilization rates for both types of aerospace employers.

A "significant commercial airplane manufacturer" means a manufacturer of commercial airplanes with at least 50,000 full-time employees in Washington as of January 1, 2021.

The bill is exempt from the requirements of a tax preference performance statement, a Joint Legislative Audit and Review Committee review, and an automatic 10-year expiration.

Appropriation: None.

Fiscal Note: Requested on March 11, 2020.

Effective Date: The bill contains an emergency clause and takes effect immediately.

Staff Summary of Public Testimony:

(In support) None.

(Opposed) None.

Persons Testifying: None.

Persons Signed In To Testify But Not Testifying: None.