

# HOUSE BILL REPORT

## HB 1729

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**As Reported by House Committee On:**  
Finance

**Title:** An act relating to creating and expanding tax incentives for the research, development, production, and sale of hydrogen fuel products in Washington state.

**Brief Description:** Creating and expanding tax incentives for the research, development, production, and sale of hydrogen fuel products in Washington state.

**Sponsors:** Representatives Abbarno, Klicker, Volz, Orcutt, Schmidt and Cheney.

**Brief History:**

**Committee Activity:**

Finance: 2/22/23, 3/9/23 [DPS].

**Brief Summary of Substitute Bill**

- Provides business and occupation preferential tax rate and credits for qualified hydrogen fuel product manufacturers, processor for hires, retailers, and wholesalers.

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### HOUSE COMMITTEE ON FINANCE

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 11 members: Representatives Berg, Chair; Street, Vice Chair; Orcutt, Ranking Minority Member; Barnard, Ramel, Santos, Springer, Stokesbary, Thai, Walen and Wylie.

**Minority Report:** Do not pass. Signed by 1 member: Representative Chopp.

**Minority Report:** Without recommendation. Signed by 1 member: Representative Jacobsen, Assistant Ranking Minority Member.

**Staff:** Tracey Taylor (786-7152).

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not 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 or 1.75 percent for services and for activities not classified elsewhere, depending on the size of the business. 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's 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 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.

### Property Tax.

All real and personal property is subject to a tax each year based on the highest and best use, unless a specific exemption is provided by law. The annual growth of all regular property tax levy revenue is limited as follows:

- For jurisdictions with a population of less than 10,000, revenue growth is limited to 1 percent.
- For jurisdictions with a population of 10,000 or more, revenue growth is limited to the lesser of inflation or 1 percent plus the value of new construction.

The state collects two regular property tax levies for common schools. The revenue growth limit applies to both levies. Participants in the senior citizens, individuals with disabilities, and qualifying veterans' property tax exemption program receive a partial exemption from the original state levy and a full exemption from the additional state levy.

The Washington Constitution also limits regular levies to a maximum of 1 percent of the property's value, such as \$10 per \$1,000 of assessed value. There are individual district rate

maximums and aggregate rate maximums to keep the total tax rate for regular property taxes within the constitutional limit. For example:

- The state levy rate is limited to \$3.60 per \$1,000 of assessed value.
- County general levies are limited to \$1.80 per \$1,000 of assessed value.
- County road levies are limited to \$2.25 per \$1,000 of assessed value.
- City levies are limited to \$3.375 per \$1,000 of assessed value.

For property tax purposes, the state, counties, and cities are collectively referred to as senior taxing districts. Junior taxing districts—a term that includes fire, hospital, flood control zone, and most other special purpose districts—each have specific rate limits as well.

#### 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 that 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.

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 tax is credit against the state tax, so the maximum total rate remains 12.84 percent.

There are several leasehold excise tax exemptions. The exemptions include subsidized military housing as well as space in state prisons used by the division of the Department of Corrections.

#### Tax Preference Performance Statement.

State law provides for a range of tax preferences that confer reduced tax liability upon a designated class of taxpayer. Tax preferences include tax exclusions, deductions, exemptions, preferential tax rates, deferrals, and credits. Currently, Washington has over 650 tax preferences, including a variety of sales and use tax exemptions. Legislation that establishes or expands a tax preference must include a Tax Preference Performance Statement (TPPS) that identifies the public policy objective of the preference, as well as specific metrics that the Joint Legislative Audit and Review Committee (JLARC) can use to evaluate the effectiveness of the preference. All new tax preferences automatically expire after 10 years unless an alternative expiration date is provided.

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### **Summary of Substitute Bill:**

#### Preferential Business and Occupation Tax Rate.

Beginning January 1, 2024, a preferential B&O tax rate of 0.2904 percent is provided to persons engaged in the business of:

- research, development, or deployment of hydrogen fuel products;
- manufacturing hydrogen fuel products, including both manufacturers and processors for hire; and
- making sales at retail or wholesale of hydrogen fuel products.

In order to qualify for the preferential B&O tax rate for retail or wholesale sales, the business claiming the preferential rate must also be the manufacturer of the hydrogen products.

The term "hydrogen fuel products" means a hydrogen fuel cell or a hydrogen electrolyzer.

The preferential B&O rate expires January 1, 2035.

#### Business and Occupation Tax Credit for Research and Development.

A B&O tax credit is allowed for qualified hydrogen fuel product development expenditures. For a manufacturer or processor for hire of hydrogen fuel products, the credit may be earned for qualified hydrogen fuel product development expenditures occurring after January 1, 2024. The amount of the credit is equal to amounts paid for full-time employees directly employed by the business, engaged in hydrogen fuel product development, and paid an annualized amount at or above 125 percent of per capita county personal income.

A credit may be claimed against taxes due for the same calendar year as the expenditures are incurred. The credit may not exceed the amount of B&O tax due and refunds may not be granted. Any unused credits may be accrued and carried forward. The annual statewide cap for this B&O tax credit is \$3 million.

#### Business and Occupation Tax Credit for Property Taxes.

A B&O tax credit is allowed for property taxes and leasehold taxes related to buildings and land used primarily in manufacturing hydrogen fuel products paid during a calendar year.

The amount of the credit is equal to:

- property taxes or leasehold excise paid on buildings constructed after July 1, 2023, and the land upon which the buildings are located so long as the buildings are used primarily in the manufacturing of hydrogen fuel products;
- property taxes attributable to an increase in assessed value due to the renovation or expansion of a building after July 1, 2023, used primarily in the manufacturing of hydrogen fuel products; and
- property taxes paid on machinery and equipment acquired after July 1, 2023, and exempt from sales and use taxes pursuant to RCW 82.08.02565 and 82.12.02565 and based upon a formula.

The annual statewide cap for this B&O tax credit is \$3 million.

The credit may not exceed the amount of B&O tax due and refunds may not be granted. Any unused credits may be accrued and carried forward only to the next succeeding calendar year. Credits may be claimed for reporting periods beginning on or after January 1, 2024, or before December 31, 2033.

A person claiming the property tax B&O credit must file an annual tax preference performance report.

Tax Preference Performance Statement.

The bill contains a TPPS categorizing the tax preferences as ones intended to induce certain designated behavior by taxpayers, improve industry competitiveness, and create or retain jobs. The Legislature's specific public policy objective is to encourage hydrogen fuel product research, development, deployment, manufacture, and sale in Washington to advance hydrogen fuel product technology, production, and adoption in Washington. Metrics for the JLARC study are included.

**Substitute Bill Compared to Original Bill:**

The substitute bill makes several changes:

- adds research, development, and deployment of hydrogen products as business activities eligible for the B&O tax incentives;
- makes revisions to the TPPS;
- allows the preferential B&O tax rate for selling hydrogen fuel products only if the products are manufactured by the seller;
- requires the payment of wages at prevailing wage rates in order to use the preferential B&O tax rate and B&O credit for property taxes, to the extent job classifications of the employer have prevailing wage rates;
- restricts the earning of research and development B&O tax credit to amounts paid for full-time employees directly employed by the business, engaged in hydrogen fuel product development, and paid an annualized amount at or above 125 percent of per capita county personal income;
- caps the total amount of statewide annual B&O tax credits that may be claimed at \$3 million for each credit;
- requires taxpayers to electronically file in order to claim B&O tax credits;
- moves back the effective date for the tax preferences to January 1, 2024;
- clarifies that B&O tax credits may be earned for tax reporting periods beginning on or after January 1, 2024, and before December 31, 2033, and unused credits may be carried over and claimed against the person's tax liability for the next succeeding calendar year; and
- makes other technical clarifications and corrections.

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**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date of Substitute Bill:** The bill takes effect 90 days after adjournment of the session in which the bill is passed.

**Staff Summary of Public Testimony:**

(In support) Washington has applied to become a hydrogen hub. This bill may be small, but it is significant as it targets tax incentives to encourage the development of the green hydrogen industry in Washington. It compliments other efforts to make Washington a leader in clean hydrogen. Washington needs to work on incentivizing private industry to invest in hydrogen in Washington. It leverages research and development and higher education to create jobs. Clean energy and fuel development helps decrease emissions. A port is installing hydrolyzers and these incentives are scalable as demand increases and technology is proven. The first sustainable fuel manufacturer is going to be built in Moses Lake. This bill is about creating a level playing field and diversifying our energy portfolio.

(Opposed) None.

(Other) Very supportive of the idea underlying this bill, but it is recommended to look at the wage and labor standards incorporated into Substitute Senate Bill 5091 as well to improve the focus of the B&O preferential tax rate.

**Persons Testifying:** (In support) Representative Peter Abbarno, prime sponsor; Troy Nichols, Phillips 66; Derek Phelps, Twelve; Dave Warren, Washington Green Hydrogen Alliance; and Michelle Detwiler, Renewable Hydrogen Alliance.

(Other) Stephanie Celt , Washington State Department of Commerce–State Energy Office.

**Persons Signed In To Testify But Not Testifying:** None.