

HOUSE BILL REPORT

HB 1693

As Reported by House Committee On:
Technology & Economic Development

Title: An act relating to providing tax relief for new businesses in high growth business sectors.

Brief Description: Providing tax relief for new businesses in high growth business sectors.

Sponsors: Representatives Habib, Magendanz, Morris, Tarleton and Ryu.

Brief History:

Committee Activity:

Technology & Economic Development: 2/19/13, 2/20/13 [DPS].

Brief Summary of Substitute Bill

- Establishes a new deduction of up to \$1 million from the business and occupation tax for new businesses in certain high growth industry sectors.
- Establishes goals and performance benchmarks for use by the Joint Legislative Audit and Review Commission in reviewing the effectiveness of the tax preference.

HOUSE COMMITTEE ON TECHNOLOGY & ECONOMIC DEVELOPMENT

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 16 members: Representatives Morris, Chair; Habib, Vice Chair; Smith, Ranking Minority Member; Crouse, Assistant Ranking Minority Member; Dahlquist, Hudgins, Kochmar, Magendanz, Maxwell, Morrell, Stonier, Tarleton, Vick, Walsh, Wylie and Zeiger.

Staff: Jasmine Vasavada (786-7301).

Background:

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. Revenues are deposited in the State General Fund.

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.

The classification and rate of the B&O tax is based on the type of business activity. The most common types of activities include retailing, wholesaling, manufacturing, and services and other activities, such as sales commissions. There are several rate categories, and a business may be subject to more than one B&O tax rate, depending on the types of activities conducted. There are many exemptions for specific types of business activities, and certain deductions and credits are permitted under the B&O tax statutes.

The B&O tax does not permit deductions for the costs of doing business, such as payments for raw materials and wages of employees. Because the B&O tax is a tax on gross revenues, it has been argued that the B&O tax may be particularly unfavorable to new businesses who are not yet profitable but have begun to generate revenue.

Summary of Substitute Bill:

A new deduction is provided from the B&O tax for certain new businesses in technology-intensive industry sectors.

"New business" means a business that has been in operation in Washington for 36 months or less, and has timely registered with the Department of Revenue (Department). A new business does not include:

- a business that has been restructured, reorganized, reincorporated, or transferred from a substantially similar business;
- a new branch location or other facility of an existing business, whether or not the new branch or facility is established as a separate entity; or
- a business that is substantially similar to a business currently operated, or operated within the past five years, with the same beneficial ownership.

In addition, to be eligible for the tax preference, a new business must have at least four permanent full-time employees who are Washington residents at the time of hiring.

Only certain types of businesses are eligible for the tax relief. These are businesses engaged exclusively in research, development, design, engineering, or manufacturing of one or more of the following:

- computers, mobile devices, and related peripherals;
- software and interactive gaming development;
- biotechnology and biotechnology products;
- electronic medical or navigation instruments;
- pharmaceuticals;
- environmental technology and solar energy system components;
- aerospace products;
- semiconductor materials and other electronic components;
- Internet-based data storage and search technologies; and
- industrial machinery used in research, development, design, engineering, manufacture, or production of any of the above.

The maximum deduction is \$1 million per year. Businesses must apply to the Department for the deduction, who must rule on an application within 30 days. Businesses may apply on a monthly, quarterly, or annual basis, and may apply any time within the first three years of operation.

Persons claiming the tax deduction must file an annual survey, which captures employment, wage, and benefit data, with the Department for every year in which the deduction is sought. Under existing code provisions governing the annual survey, any tax preference claimed in the previous calendar year is immediately due if the person fails to submit the survey as required.

By June 1, 2019, the Joint Legislative Audit and Review Committee (Committee) must report to the Legislature on the use, value, economic impact, and employment impact of the tax preference. Performance metrics for the Committee report are established, to include:

- growth of eligible businesses, measured in terms of capitalization as well as the number of Washington residents employed;
- comparison of growth of businesses claiming the tax preference to growth of such businesses in other states and historic growth; and
- the direct and indirect economic impact of businesses claiming the tax preference on surrounding areas.

The Committee may contract with Innovate Washington or another entity capable of developing a methodology and implementing it to determine these economic impacts.

Substitute Bill Compared to Original Bill:

The substitute bill makes the following changes:

- reduces the size of the maximum annual B&O tax deduction, from \$2 million to \$1 million;
- extends the definition of a new business eligible to receive the tax deduction to include businesses that have been in operation for up to 36 months, instead of up to 24 months;
- limits the availability of the tax deduction to new businesses with at least four in-state employees;
- changes the specific business activities that a new business must engage in to be eligible to receive the deduction;
- allows a new business to apply any time within its first three years of operation, and apply the deduction to taxes paid for periods prior to filing the application;
- adds an intent section and directs the Committee to report on the use, value, economic impact, and employment impact of the tax preference;
- adds a severability clause and an emergency clause with an immediate effective date; and
- adds an expiration date of December 31, 2023.

Appropriation: None.

Fiscal Note: Available.

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

Staff Summary of Public Testimony:

(In support) The B&O tax disproportionately affects companies when they are new. The third year in a start-up's life cycle is very important, as revenues come into the door and the business may begin to obtain venture capital. In the proposed substitute bill, the tax deduction has been scaled back to the first \$1 million in revenue. The fiscal note will not capture the economic benefit of this preference to surrounding communities. Software, Internet, and electronics firms are extremely portable and can locate wherever they want. The need to nurture the technology sector is the reason that some Washington cities have created a coalition of Technology Cities. This program helps businesses when cash is most critical, in their first years. Washington has been documented to be a high tax state for new businesses. The B&O tax can lead a company to die on the vine by sapping a new company's gross receipts while the company's founders are still working at coffee shops and couch surfing to save money to put back into the business. This bill helps promote Washington worldwide as a good place for start-ups. The high technology sector affords opportunities to attract foreign investment and entrepreneurs. This bill can help encourage new businesses to make their home in Washington, which already has a high quality of life and infrastructure that encourage businesses to stick around. Even when budgets are tight, this tax preference is a good investment that will reap fruit in years to come. There are other critical societal needs, like education and transportation, but this does not compete with those critical programs. It is like one leg of a three-legged stool, encouraging a culture of talent, an ecosystem of technology, and helping retain talented people. The technology sector can have higher than average growth. Entrepreneurs, by nature, are some of the most resourceful and innovative people on the planet. The people in the trenches are working hard and are very frugal. In the early stages, the money would be used to hire more employees and contractors and help improve work patterns. In an international climate, Germany and China may be offering these companies hundreds of thousands of dollars to locate there. The return on incentive, from the legislative perspective, exists. This meets the five key criteria that legislators should be concerned about: intent, transparency, metrics, accountability, and expiration date.

(Opposed) None.

Persons Testifying: Representative Habib, prime sponsor; John Stilin, City of Redmond and Washington Tech Cities Coalition; Kevin Minter; Mayor Conrad Lee, City of Bellevue; Lew McMurran, Washington Technology Industry Association; Neil Bergquist, Surf Incubator; Amber Carter, Association of Washington Business; and Nick Demerice, Department of Commerce.

Persons Signed In To Testify But Not Testifying: None.