SENATE BILL REPORT

SB 5201

As Reported By Senate Committee On:
Ways & Means, March 6, 1995

Title: An act relating to sales and use tax on manufacturing machinery and equipment, pollution control equipment, and high technology research and development.

Brief Description: Providing tax exemptions for manufacturing and processing.

Sponsors: Senators Bauer, Cantu, McAuliffe, Haugen, Winsley, Snyder, Loveland, Sheldon, Fairley, West, Long, Palmer, Schow, Moyer, Sellar, Rasmussen, Deccio, Heavey, Quigley, C. Anderson, Oke, Roach and Hale; by request of Governor Lowry.

Brief History:
Committee Activity: Ways & Means: 2/2/95, 3/6/95 [DPS].

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: That Substitute Senate Bill No. 5201 be substituted therefor, and the substitute bill do pass.
Signed by Senators Rinehart, Chair; Loveland, Vice Chair; Bauer, Cantu, Finkbeiner, Gaspard, Hochstatter, Johnson, Long, McDonald, Moyer, Roach, Sheldon, Snyder, Strannigan, West, Winsley and Wojahn.

Staff: Terry Wilson (786-7715)

Background: The sales tax is imposed on each retail sale of most articles of tangible personal property and certain services. Taxable services include construction, repair, telephone, lodging of less than 30 days, physical fitness, and some recreation and amusement services. Materials and labor used to alter or improve real or personal property is subject to the tax. Exempt from tax are purchases for resale and purchases of components and ingredients that become part of another product for sale.

Three sales and use tax deferral programs have been enacted to encourage the location of business in Washington.

The distressed area deferral program targets economically distressed areas with unemployment rates that are 20 percent higher than the state average. Manufacturing and research and development businesses may defer sales and use taxes on buildings, machinery and equipment, and installation labor. Manufacturing includes computer related businesses. The business is required to create at least one job per $750,000 of investment. Expansion of an existing facility is eligible if the cost of the expansion exceeds 25 percent of the existing facility. To be eligible, a cogeneration project must be integral to the manufacturing facility and be at least 50 percent owned by the manufacturer. The deferred taxes are forgiven if the investment project meets the program criteria during the repayment period.

The new business deferral program is available statewide to manufacturing and research and development firms that were not doing business in the state prior to 1985. The sales and use tax on new buildings, equipment and machinery, and installation labor is deferred for a three-year period after completion of the project. The business is required to repay the deferred taxes over a five-year period.

The high technology deferral program is available statewide to businesses involved in "high-tech" research and development and pilot scale manufacturing. The business must be involved in biotechnology, advanced computing, electronic device technology, advanced materials, or environmental technology. These businesses may defer sales and use taxes on buildings, machinery and equipment, and installation labor. The sales and use tax is deferred for a three-year period after completion of the project. The business is required to repay the deferred taxes over a five- or six-year period.

In 1994, the Legislature directed the Department of Revenue to study the impact of the current state tax structure on the manufacturing industry.

Summary of Substitute Bill: A statewide sales and use tax exemption is provided and the state's sales and use tax deferral programs are revised as follows.

<u>Sales Tax Exemption</u>. Sales of new and replacement machinery and equipment used directly in the manufacturing process, including installation labor and services, and sales of pollution control equipment to be used in a manufacturing facility, including installation labor and services, are exempt from sales and use taxes.

Manufacturing process does not include research and development activities, the production of electricity, or the preparation of food products on the premises of a person selling food at retail.

<u>Distressed Area Tax Deferral</u>. The distressed area tax deferral program is revised. Sales of machinery and equipment, including installation labor and services, used in businesses located in distressed areas are exempt from sales and use taxes whether or not the project continues to meet the program criteria during the repayment period. The requirement that a business create one job per $750,000 of investment in buildings or machinery and equipment is eliminated except for community empowerment zones and counties that are contiguous to eligible counties. Eligibility for cogeneration projects under the distressed area program is changed to projects which generate power for consumption within the manufacturing site.

An expansion or renovation must increase the floor space or production capacity of an existing structure to qualify rather than costing more than 25 percent of the value of the existing facility.

<u>New Business Tax Deferral</u>. The new business tax deferral program for buildings and machinery and equipment, including labor, for businesses not involved in manufacturing and research and development activities in the state prior to 1985, is terminated December 31, 1995.

High Technology Tax Deferral. Taxes deferred under the high technology tax deferral program need not be repaid. However, if a portion of the facility is used for other than qualified research and development, or pilot scale manufacturing during the eight years following completion of the facility, a pro-rated share of the taxes must be repaid with interest. However, no repayment is required on new and replacement machinery and equipment used directly in the manufacturing process, including installation labor and services, and sales of pollution control equipment used in manufacturing facility, including installation labor and services. An expansion or renovation must increase the floor space or production capacity of an existing structure to qualify rather than costing more than 25 percent of the existing facility.

The legislative fiscal committees are required to analyze the economic impacts of the manufacturers' tax exemption and report to the legislature no later than December 1, 1999.

Substitute Bill Compared to Original Bill: The distressed area tax relief requirement that businesses create one job per $750,000 of investment in buildings or machinery and equipment, including labor and services is restored for community empowerment zones and counties that are contiguous to eligible counties. This requirement is eliminated for cogeneration projects. Instead, eligibility for cogeneration projects under the distressed area program is limited to projects which generate power for consumption within the manufacturing site. Several technical and typographical corrections are made.

The legislative fiscal committees are required to analyze the economic impacts of the manufacturers' tax exemption instead of the Department of Revenue.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains an emergency clause and takes effect July 1, 1995.

Testimony For: Washington ranks 10th out of 12 states in terms of beneficial taxation for manufacturers. This bill moves Washington to 3rd. The lost revenues from the exemption will be replaced by increased economic activity in four to nine years. Local government payback is five years. Taxes are a factor in location decisions when all else is equal. Manufacturing jobs are on the decline nationally. Interstate competition is great. This will encourage new investment in Washington. Every sector of the economy benefits. It is reasonable to use tax policy to encourage economic development in manufacturing and high wage jobs. The Port of Kalama competes with Oregon and needs this. Once here, the businesses pay property tax.

Testimony Against: There is a local government impact that is significant. The deferral program caused Redmond to cut discretionary spending by 10 percent. Redmond has 33 percent manufacturing compared to 18 percent for the average city.

Testified: Senator Bauer, prime sponsor (pro); Senator Cantu, sponsor (pro); Len McComb, Director of Revenue (pro); John Fratt, Port of Kalama (pro); Barbara Kommer, Hewlett-Packard (pro); Bruce Reid, Microsoft (pro); Bob Schaeffer (pro); Larry Young, PACCAR (pro); Steve Evans, Key Technology (pro); Nick Mullen, Weyerhauser (pro); Rob Stern, Jeff

Johnson, WA State Labor Council, AFL/CIO (con); Brent Stumbaugh, Triquest Precision Plastics (pro); Roy Wiseman, AWB (pro); John Urbanchuck, AUS Consultants (pro); Stan Finkelstein, AWC; Mayor Rosemarie Ives, Redmond (con).