AN ACT Relating to sales and use tax exemptions for certain property and services used in manufacturing, research and development, or testing operations, not including changes to RCW 82.08.02565 and 82.12.02565 that reduce state revenue; amending RCW 82.08.02565, 82.04.120, and 82.32.585; adding a new section to chapter 82.08 RCW; adding a new section to chapter 82.12 RCW; creating new sections; and declaring an emergency.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

NEW SECTION. Sec. 1. (1) In 1995, the legislature enacted a sales and use tax exemption for manufacturing machinery and equipment, commonly referred to as the "M&E exemption." The legislature finds that the purposes of this exemption were to encourage the growth and development of the state's private sector manufacturing industry and improve this state's ability to compete with other states for manufacturing investment. The legislature further finds that it was not the purpose of the M&E exemption to provide tax breaks to state agencies and institutions, nor to public utilities and other businesses with respect to machinery and equipment primarily used for activities
that are taxable under the state public utility tax or are otherwise not considered to be manufacturing for business and occupation tax purposes.

(2) The legislature further finds that despite previous attempts at clarifying the M&E exemption, significant ambiguity persists, particularly with respect to the scope of the exemption. Such ambiguity results in costly appeals and litigation and may result in significant unanticipated revenue losses for the state and local governments.

(3) Therefore, the legislature finds it necessary to reaffirm its original intent in establishing the M&E exemption. The legislature declares that the amendments to the existing M&E exemption and to RCW 82.04.120 in this act are clarifying and, as such, apply retroactively as well as prospectively.

(4) The legislature finds that Washington is home to premier public research institutions. The legislature recognizes that the state's public universities provide cutting-edge research and development, which helps stimulate growth in the private sector and is vital to the economic well-being of our state. University research leads directly to new products, companies, production methods, and ways of organizing work. The legislature further recognizes that our public universities will play an important role in shaping the next generation of Washington industries, including biofuels and other renewable energy, global health, and advanced manufacturing. Therefore, because the amendments to the existing M&E exemption in this act clarify that state agencies and institutions are not eligible for the M&E exemption, this act provides a new, stand-alone sales and use tax exemption for machinery and equipment used primarily in technological research and development operations by the state's four-year institutions of higher education.

Sec. 2. RCW 82.08.02565 and 2009 c 535 s 510 are each amended to read as follows:

(1)(a) The tax levied by RCW 82.08.020 does not apply to sales to a manufacturer or processor for hire of machinery and equipment used directly in a manufacturing operation or research and development operation, to sales to a person engaged in testing for a manufacturer or processor for hire of machinery and equipment used directly in a
testing operation, or to sales of or charges made for labor and services rendered in respect to installing, repairing, cleaning, altering, or improving the machinery and equipment (but only when the purchaser provides the seller with).

(b) Sellers making tax-exempt sales under this section must obtain from the purchaser an exemption certificate in a form and manner prescribed by the department by rule. The seller must retain a copy of the certificate for the seller's files.

(2) For purposes of this section and RCW 82.12.02565:

(a) "Machinery and equipment" means industrial fixtures, devices, and support facilities, and tangible personal property that becomes an ingredient or component thereof, including repair parts and replacement parts. "Machinery and equipment" includes pollution control equipment installed and used in a manufacturing operation, testing operation, or research and development operation to prevent air pollution, water pollution, or contamination that might otherwise result from the manufacturing operation, testing operation, or research and development operation. "Machinery and equipment" also includes digital goods.

(b) "Machinery and equipment" does not include:

(i) Hand-powered tools;

(ii) Property with a useful life of less than one year;

(iii) Buildings, other than machinery and equipment that is permanently affixed to or becomes a physical part of a building; and

(iv) Building fixtures that are not integral to the manufacturing operation, testing operation, or research and development operation that are permanently affixed to and become a physical part of a building, such as utility systems for heating, ventilation, air conditioning, communications, plumbing, or electrical.

(c) Machinery and equipment is "used directly" in a manufacturing operation, testing operation, or research and development operation if the machinery and equipment:

(i) Acts upon or interacts with an item of tangible personal property;

(ii) Conveys, transports, handles, or temporarily stores an item of tangible personal property at the manufacturing site or testing site;

(iii) Controls, guides, measures, verifies, aligns, regulates, or tests tangible personal property at the site or away from the site;
(iv) Provides physical support for or access to tangible personal property;

(v) Produces power for, or lubricates machinery and equipment;

(vi) Produces another item of tangible personal property for use in the manufacturing operation, testing operation, or research and development operation;

(vii) Places tangible personal property in the container, package, or wrapping in which the tangible personal property is normally sold or transported; or

(viii) Is integral to research and development as defined in RCW 82.63.010.

(d) "Manufacturer" means a person that qualifies as a manufacturer under RCW 82.04.110. "Manufacturer" also includes a person that prints newspapers or other materials.

(e) "Manufacturing" means only those activities that come within the definition of "to manufacture" in RCW 82.04.120 and are taxed as manufacturing or processing for hire under chapter 82.04 RCW, or would be taxed as such if such activity were conducted in this state or if not for an exemption or deduction. "Manufacturing" also includes printing newspapers or other materials. An activity is not taxed as manufacturing or processing for hire under chapter 82.04 RCW if the activity is within the purview of chapter 82.16 RCW.

(f) "Manufacturing operation" means the manufacturing of articles, substances, or commodities for sale as tangible personal property. A manufacturing operation begins at the point where the raw materials enter the manufacturing site and ends at the point where the processed material leaves the manufacturing site. With respect to the production of class A or exceptional quality biosolids by a wastewater treatment facility, the manufacturing operation begins at the point where class B biosolids undergo additional processing to achieve class A or exceptional quality standards. Notwithstanding anything to the contrary in this section, the term also includes that portion of a cogeneration project that is used to generate power for consumption within the manufacturing site of which the cogeneration project is an integral part. The term does not include ((the production of electricity by a light and power business as defined in RCW 82.16.010 or)) the preparation of food products on the premises of a person selling food products at retail.
"Cogeneration" means the simultaneous generation of electrical energy and low-grade heat from the same fuel.

"Research and development operation" means engaging in research and development as defined in RCW 82.63.010 by a manufacturer or processor for hire.

"Testing" means activities performed to establish or determine the properties, qualities, and limitations of tangible personal property.

"Testing operation" means the testing of tangible personal property for a manufacturer or processor for hire. A testing operation begins at the point where the tangible personal property enters the testing site and ends at the point where the tangible personal property leaves the testing site. The term also includes the testing of tangible personal property for use in that portion of a cogeneration project that is used to generate power for consumption within the manufacturing site of which the cogeneration project is an integral part. The term does not include the testing of tangible personal property for use in the production of electricity by a light and power business as defined in RCW 82.16.010 or the preparation of food products on the premises of a person selling food products at retail.

Sec. 3. RCW 82.04.120 and 2009 c 535 s 406 are each amended to read as follows:

(1) "To manufacture" embraces 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, and (shall) includes:

(a) The production or fabrication of special made or custom made articles;

(b) The production or fabrication of dental appliances, devices, restorations, substitutes, or other dental laboratory products by a dental laboratory or dental technician;

(c) Cutting, delimbing, and measuring of felled, cut, or taken trees; and

(d) Crushing and/or blending of rock, sand, stone, gravel, or ore.
(2) "To manufacture" (shall) does not include:
   (a) Conditioning of seed for use in planting; cubing hay or alfalfa;
   (b) Activities which consist of cutting, grading, or ice glazing seafood which has been cooked, frozen, or canned outside this state;
   (c) The growing, harvesting, or producing of agricultural products;
   (d) Packing of agricultural products, including sorting, washing, rinsing, grading, waxing, treating with fungicide, packaging, chilling, or placing in controlled atmospheric storage;
   (e) The production of digital goods; (e)
   (f) The production of computer software if the computer software is delivered from the seller to the purchaser by means other than tangible storage media, including the delivery by use of a tangible storage media where the tangible storage media is not physically transferred to the purchaser; and
   (g) Any activity that is integral to any public service business as defined in RCW 82.16.010 and with respect to which the gross income associated with such activity: (i) Is subject to tax under chapter 82.16 RCW; or (ii) would be subject to tax under chapter 82.16 RCW if such activity were conducted in this state or if not for an exemption or deduction.

(3) With respect to wastewater treatment facilities:
   (a) "To manufacture" does not include the treatment of wastewater, the production of reclaimed water, and the production of class B biosolids; and
   (b) "To manufacture" does include the production of class A or exceptional quality biosolids, but only with respect to the processing activities that occur after the biosolids have reached class B standards.

NEW SECTION. Sec. 4. A new section is added to chapter 82.08 RCW to read as follows:
   (1)(a) The tax levied by RCW 82.08.020 does not apply to sales to a public research institution of machinery and equipment used primarily in a research and development operation, or to sales of or charges made for labor and services rendered in respect to installing, repairing, cleaning, altering, or improving the machinery and equipment.
(b) Sellers making tax-exempt sales under this section must obtain from the purchaser an exemption certificate in a form and manner prescribed by the department. The seller must retain a copy of the certificate for the seller's files.

(2) A public research institution claiming the exemption provided in this section must file a complete annual survey with the department under RCW 82.32.585.

(3) For purposes of this section, the following definitions apply:

(a) "Machinery and equipment" means those fixtures, pieces of equipment, digital goods, and support facilities that are an integral and necessary part of a research and development operation, and tangible personal property that becomes an ingredient or component of such fixtures, equipment, and support facilities, including repair parts and replacement parts. "Machinery and equipment" may include, but is not limited to: Computers; software; data processing equipment; laboratory equipment, instrumentation, and other devices used in a process of experimentation to develop a new or improved pilot model, plant process, product, formula, or invention; vats, tanks, and fermenters; operating structures; and all equipment used to control, monitor, or operate the machinery and equipment.

(b) "Machinery and equipment" does not include:

(i) Hand-powered tools;

(ii) Property with a useful life of less than one year;

(iii) Buildings; and

(iv) Those building fixtures that are not an integral and necessary part of a research and development operation and that are permanently affixed to and become a physical part of a building, such as utility systems for heating, ventilation, air conditioning, communications, plumbing, or electrical.

(c) "Primarily" means greater than fifty percent as measured by time. If machinery and equipment is used simultaneously in a research and development operation and also for other purposes, the use for other purposes must be disregarded during the period of simultaneous use for purposes of determining whether the machinery and equipment is used primarily in a research and development operation.

(d) "Public research institution" means any college or university included within the definitions of state universities, regional universities, or state college in RCW 28B.10.016.
(e) "Research and development operation" means engaging in research and development as defined in RCW 82.63.010.

NEW SECTION. Sec. 5. A new section is added to chapter 82.12 RCW to read as follows:

(1) The provisions of this chapter do not apply in respect to the use by a public research institution of machinery and equipment used primarily in a research and development operation, or to the use of labor and services rendered in respect to installing, repairing, cleaning, altering, or improving the machinery and equipment.

(2) The definitions in section 4 of this act apply to this section.

(3) A public research institution receiving the benefit of the exemption provided in this section must file a complete annual survey with the department under RCW 82.32.585.

Sec. 6. RCW 82.32.585 and 2010 c 114 s 102 are each amended to read as follows:

(1)(a) Every person claiming a tax preference that requires a survey under this section must file a complete annual survey with the department.

(i) Except as provided in (a)(ii) of this subsection, the survey is due by April 30th of the year following any calendar year in which a person becomes eligible to claim the tax preference that requires a survey under this section.

(ii) If the tax preference is a deferral of tax, the first survey must be filed by April 30th of the calendar year following the calendar year in which the investment project is certified by the department as operationally complete, and a survey must be filed by April 30th of each of the seven succeeding calendar years.

(b) The department may extend the due date for timely filing of annual surveys under this section as provided in RCW 82.32.590.

(2)(a) The survey must include the amount of the tax preference claimed for the calendar year covered by the survey. For a person that claimed an exemption provided in section 4 or 5 of this act, the survey must include the amount of tax exempted under those sections in the prior calendar year for each general area or category of research and development for which exempt machinery and equipment and labor and services were acquired in the prior calendar year.
(b) The survey must also include the following information for employment positions in Washington, not to include names of employees, for the year that the tax preference was claimed:

(i) The number of total employment positions;

(ii) Full-time, part-time, and temporary employment positions as a percent of total employment;

(iii) The number of employment positions according to the following wage bands: Less than thirty thousand dollars; thirty thousand dollars or greater, but less than sixty thousand dollars; and sixty thousand dollars or greater. A wage band containing fewer than three individuals may be combined with another wage band; and

(iv) The number of employment positions that have employer-provided medical, dental, and retirement benefits, by each of the wage bands.

(c) For persons claiming the tax preference provided under chapter 82.60 or 82.63 RCW, the survey must also include the number of new products or research projects by general classification, and the number of trademarks, patents, and copyrights associated with activities at the investment project.

(d) For persons claiming the credit provided under RCW 82.04.4452, the survey must also include the qualified research and development expenditures during the calendar year for which the credit was claimed, the taxable amount during the calendar year for which the credit was claimed, the number of new products or research projects by general classification, the number of trademarks, patents, and copyrights associated with the research and development activities for which the credit was claimed, and whether the tax preference has been assigned, and who assigned the credit. The definitions in RCW 82.04.4452 apply to this subsection (2)(d).

(e) For persons claiming the tax exemption in section 4 or 5 of this act, the survey must also include the general areas or categories of research and development for which machinery and equipment and labor and services were acquired, exempt from tax under section 4 or 5 of this act, in the prior calendar year.

(f) If the person filing a survey under this section did not file a survey with the department in the previous calendar year, the survey filed under this section must also include the employment, wage, and benefit information required under (b)(i) through (iv) of this
subsection for the calendar year immediately preceding the calendar year for which a tax preference was claimed.

(3) As part of the annual survey, the department may request additional information necessary to measure the results of, or determine eligibility for, the tax preference.

(4) All information collected under this section, except the (amount of the tax preference claimed) information required in subsection (2)(a) of this section, is deemed taxpayer information under RCW 82.32.330. Information (on the amount of tax preference claimed) required in subsection (2)(a) of this section is not subject to the confidentiality provisions of RCW 82.32.330 and may be disclosed to the public upon request, except as provided in subsection (5) of this section. If the amount of the tax preference claimed as reported on the survey is different than the amount actually claimed or otherwise allowed by the department based on the taxpayer's excise tax returns or other information known to the department, the amount actually claimed or allowed may be disclosed.

(5) Persons for whom the actual amount of the tax reduced or saved is less than ten thousand dollars during the period covered by the survey may request the department to treat the amount of the tax reduction or savings as confidential under RCW 82.32.330.

(6)(a) Except as otherwise provided by law, if a person claims a tax preference that requires an annual survey under this section but fails to submit a complete annual survey by the due date of the survey or any extension under RCW 82.32.590, the department must declare the amount of the tax preference claimed for the previous calendar year to be immediately due. If the tax preference is a deferral of tax, twelve and one-half percent of the deferred tax is immediately due. If the economic benefits of the deferral are passed to a lessee, the lessee is responsible for payment to the extent the lessee has received the economic benefit.

(b) The department must assess interest, but not penalties, on the amounts due under this subsection. The interest must be assessed at the rate provided for delinquent taxes under this chapter, retroactively to the date the tax preference was claimed, and accrues until the taxes for which the tax preference was claimed are repaid. Amounts due under this subsection are not subject to the
(7) The department must use the information from this section to prepare summary descriptive statistics by category. No fewer than three taxpayers may be included in any category. The department must report these statistics to the legislature each year by October 1st.

(8) For the purposes of this section:
   (a) "Person" has the meaning provided in RCW 82.04.030 and also includes the state and its departments and institutions.
   (b) "Tax preference" has the meaning provided in RCW 43.136.021 and includes only the tax preferences requiring a survey under this section.

NEW SECTION. Sec. 7. The legislature declares that the only reason why the phrase "the production of electricity by a light and power business as defined in RCW 82.16.010" was deleted from the definition of "manufacturing operation" in RCW 82.08.02565(2)(f) in section 2 of this act is because that language is superfluous.

NEW SECTION. Sec. 8. This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and takes effect immediately.

NEW SECTION. Sec. 9. Sections 2 and 3 of this act apply both prospectively and retroactively to any tax period open for assessment or refund of taxes.

NEW SECTION. Sec. 10. If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected.

NEW SECTION. Sec. 11. Nothing in this act may be construed as a repudiation of any provision of WAC 458-20-13601.

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