

# HOUSE BILL REPORT

## HB 1887

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### As Reported By House Committee On:

Finance

**Title:** An act relating to revising the machinery and equipment tax exemption by more precisely describing terminology and eligibility.

**Brief Description:** Revising the machinery and equipment tax exemption for manufacturers and processors for hire.

**Sponsors:** Representatives Kessler, Lisk, Grant, Wensman, Wolfe and Pennington; by request of Department of Revenue.

### Brief History:

#### Committee Activity:

Finance: 3/4/99, 3/8/99 [DPS].

#### Brief Summary of Substitute Bill

- Explicitly includes logging and rock crushing equipment in the sales and use tax exemption for manufacturing machinery and equipment.
- Exempts from sales and use tax machinery and equipment used to test manufactured products.
- Exempts assembly of products from manufacturing business and occupation tax as long as the amount paid for the components is at least 80 percent of the value of the assembled product.

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### HOUSE COMMITTEE ON FINANCE

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 12 members: Representatives Dunshee, Democratic Co-Chair; Thomas, Republican Co-Chair; Carrell, Republican Vice Chair; Reardon, Democratic Vice Chair; Cairnes; Conway; Cox; Dickerson; Pennington; Santos; Van Luven and Veloria.

**Staff:** Rick Peterson (786-7150).

**Background:**

The sales tax is imposed on retail sales of most items of tangible personal property and some services. Use tax is imposed on the use of an item in this state, when the acquisition of the item or service has not been subject to sales tax. The combined state and local sales and use tax rate is between 7 and 8.6 percent, depending on location.

Major items exempt from sales and use tax include most food for human consumption, prescription drugs, motor vehicle fuel, utility services, professional services (e.g., medical, legal), certain business services (e.g., accounting, engineering), and items that become a component of another product for sale.

Machinery and equipment sold to a manufacturer or a processor for hire that are directly used in a manufacturing operation or research and development operation are exempt from sales tax and use tax. This exemption was enacted July 1, 1995.

There has been some disagreement about which activities are eligible for the manufacturing sales and use tax exemption. On January 16, 1996, the Department of Revenue issued a special notice explaining that logging equipment was not eligible for the exemption. The department stated that logging was an extracting activity not a manufacturing activity. The Department of Revenue has changed their position and now believes that logging equipment is eligible for exemption. In addition, the department's current interpretation is that rock crushing equipment is also exempt.

Equipment used directly in manufacturing and also used for other purposes is called "dual use" property. The sales tax exemption for manufacturing equipment does not explicitly state the share of use in manufacturing required for exemption.

The primary business and occupation (B&O) tax rate on manufacturing and wholesale sales is 0.484 percent. For manufacturing, the rate is applied to the value of the products manufactured. For wholesale sales, the rate is applied to the gross proceeds of the sale. When a product is manufactured in Washington, the manufacturing tax applies on sales to out-of-state customers and, generally, the wholesaling tax applies on sales to in-state customers.

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**Summary of Substitute Bill:**

The definition of manufacturing is modified to include the cutting, delimiting, and measuring of felled, cut, or taken trees, and the crushing and/or blending of rock, sand, stone, gravel, or ore. This change makes certain logging and rock crushing activity eligible for the manufacturing machinery and equipment sales tax exemption.

The provisions related to logging and rock crushing equipment are made retroactive to allow refunds to persons who previously paid the sales or use tax.

Businesses that test products for manufacturers are exempt from sales and use tax on the machinery and equipment used in a testing operation.

Businesses that assemble products from components purchased from other businesses are exempt from manufacturing B&O tax on sales to out-of-state customers as long as the amount paid for the components is at least 80 percent of the value of the assembled product.

**Substitute Bill Compared to Original Bill:** The provisions related to dual use equipment are removed from the substitute bill. The manufacturing B&O tax exemption for assembled products is added to the substitute bill.

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**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date of Substitute Bill:** The bill contains an emergency clause. The provisions related to logging equipment, rock crushing equipment, and assembly take effect immediately. Other sections take effect on July 1, 1999.

**Testimony For:** (Original bill) The sales tax exemption for machinery and equipment has served Washington well. The machinery and equipment exemption is critical for Washington; it is available in 38 states. Jobs have been created due to the exemption. The 1995 legislation was clear in its broad intent but less clear in its particulars. The bill clears up difficulties in interpretation in a way that is consistent with the original act. The Legislature always intended that logging equipment be included. Clarifying the exemption for dual use property will be beneficial for small business. Industry, especially small business, needs flexibility in the definition of dual use property.

(Concerns) (Original bill) The intent clause implies the Department of Revenue is delegated broad authority to decide what machinery and equipment is eligible for exemption. This delegation should be limited to dual use equipment. The bill does not provide guidance about the standard for determining which dual use equipment will be exempt. The proposed language requiring majority use in manufacturing activity is a step forward. Why should resource industries, like logging and rock crushing, be included in the manufacturing machinery and equipment exemption? Do they locate their businesses based on taxation?

**Testimony Against:** None.

**Testified:** Representative Kessler, prime sponsor; Dick Ducharme, Yakima Growers and Shippers Association; Fred Kiga, Director, Department of Revenue; Russ Brubaker, Department of Revenue, Kim Risenmay, Price Waterhouse Coopers; Clair Hesselhoff, Department of Revenue; and Carolyn Logue, National Federation of Independent Business.

(Concerns) Doug Levy, Everett; Judith Frolich, Washington State Association of Counties; and Ron Rosenbloom, Association of Washington Cities.