HOUSE BILL REPORT
SSB 6240

As Passed House - Amended:
March 9, 2004

Title: An act relating to tax incentives in rural counties.

Brief Description: Modifying tax incentive provisions for rural counties.

Sponsors: By Senate Committee on Ways & Means (originally sponsored by Senators T. Sheldon, Zarelli, Benton, Hale, McAuliffe, Prentice, Rasmussen, Murray and Haugen; by request of Governor Locke).

Brief History:
Committee Activity:
Finance: 2/27/04, 3/1/04 [DPA].
Floor Activity:
Passed House - Amended: 3/9/04, 93-3.

Brief Summary of Substitute Bill
(As Amended by House)

- A credit against tax liability under the business and occupation (B&O) tax is available until 2011 to businesses that:
  - Provide information technology help desk services from rural counties; or
  - Develop or manufacture computer software in rural counties.
- The rural county and distressed area sales and use tax deferral program for manufacturing, computer programming, or research and development businesses is extended to July 2010.
- The eligibility requirements for tax incentives to businesses in rural areas are expanded to include any county that is less than 225 square miles in area, which applies to Island County.
- Requires recipients of the tax deferral to respond to a survey by the Department of Revenue concerning the tax savings realized, which may be publicly disclosed, as well as employment and wages.

HOUSE COMMITTEE ON FINANCE

Majority Report: Do pass as amended. Signed by 8 members: Representatives

McIntire, Chair; Hunter, Vice Chair; Cairnes, Ranking Minority Member; Orcutt, Assistant Ranking Minority Member; Ahern, Conway, Morris and Santos.

Staff: Mark Matteson (786-7145).

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. The tax is imposed on the gross receipts from all business activities conducted within the state. Revenues are deposited in the state General Fund. A business may have more than one B&O tax rate, depending on the types of activities conducted. The tax rate for most types of service businesses is 1.5 percent and manufacturing businesses is 0.484 percent.

The B&O tax does not permit deductions for the costs of doing business, such as payments for raw materials and wages of employees. Nonetheless, there are many exemptions for specific types of business activities and certain deductions and credits permitted under the B&O tax statutes.

Retail Sales and Use Taxes

The retail sales tax applies to the selling price of tangible personal property and of certain services purchased at retail. The tax is imposed at a 6.5 percent rate by the state. Cities and counties may impose a local tax at a rate up to a maximum of 3.4 percent. As of December 2003, local rates imposed range from 0.5 percent to 2.4 percent. Sales tax is paid by the purchaser and collected by the seller.

The use tax is imposed on items used in the state that were not subject to the retail sales tax, and includes purchases made in other states and purchases from sellers who do not collect Washington sales tax. The state and local rates are the same as those imposed under the retail sales tax. Use tax is paid directly to the Department of Revenue (Department).

Retail sales and use taxes apply to everything within the tax base that is not specifically exempt. A requirement for some exemptions is that the buyer present the seller with an affidavit or certificate demonstrating proof that the buyer is eligible for the exemption.

Former Business and Occupation Tax Credits for Businesses in Rural Areas

In 1999, the Legislature enacted an omnibus tax relief package for rural counties. Part of the legislation allowed a credit against B&O tax liability for businesses that provide information technology help desk services by telephone or electronically from rural counties, defined to be counties that have population densities of 100 persons per square mile or less. The amount of the credit was equal to the amount of B&O tax due from activities performed at the rural county location. Information technology help desk services were defined to include certain activities related to computer hardware and software, including maintenance, diagnostics and troubleshooting, installation, repair information and training, and upgrades.

Another provision of the 1999 rural county tax relief legislation was a B&O tax credit for businesses that develop or manufacture software in rural counties. Such businesses were allowed a credit for employment positions created after July 1, 1999, equal to $1,000 for each job created before July 1 of any year that the credit was effective. The credit was allowed for the first year the position was created and for four years thereafter. For positions created after July 1, the allowable credit was $500 for the first year and $1,000 per year for four years thereafter. For businesses that transferred locations between rural counties, the credit was only applicable to any new jobs created as a result of the relocation. The credit was not available to businesses that took the information technology help desk services credit.

Under each credit, no application was necessary to receive the credit, but a business was required to keep records to allow the Department to verify eligibility. A business that was found by the Department to be ineligible was required to repay the amount of the credit with interest, but not penalties. A business taking the credit was required to submit an annual report to the Department with information about the business activity, employment data, and how long the business has been located in the county.

The Department program data indicates that, for fiscal year 2003, approximately $330,000 in credit was taken with respect to help desk services and about $28,000 was taken with respect to computer manufacturing/software programming.

Each of the rural county B&O tax credits expired at the end of calendar year 2003.

Rural County/Distressed Area Sales and Use Tax Deferral Program

The rural county and distressed area tax deferral, as originally enacted in 1985, provided a deferral of sales and use taxes due on plant construction and expansion or on acquisition of equipment by firms that engaged in manufacturing, research and development, or computer programming activities in counties with high rates of unemployment. In 1999, the program was changed so that the incentive is available in any rural county, defined as a county with a population density of less than 100 people per square mile, and in counties with community empowerment zones (CEZs). Firms that use the deferral in counties with CEZs must meet certain employment requirements, relating to the level of deferral requested. Employees hired pursuant to the requirements must be residents of the CEZs.

Under the program, a person that owns property and leases to another may receive deferral of taxes on qualifying expenditures, if the owner under written contract agrees to pass the economic benefit of the deferral on to the lessee by reducing the amount of the lease payments.

To receive the deferral, a firm must apply to the Department prior to the initiation of construction or acquisition of equipment. The application must contain information regarding the project location, project costs, employment, wages, and project schedules. If the application is complete, the Department is required to issue a sales and use tax deferral certificate.

Recipients of a deferral under the program are required to submit a report to the Department by the end of the year in which the project is put into operations, and for each of the seven following years. The report must contain information that allows the Department to determine whether the recipient is meeting the eligibility requirements of the program.

Since 1994, repayment of deferred taxes has been waived, as long as the firm continues to meet eligibility requirements, thus converting the program into an outright tax exemption. The program is scheduled to expire on July 1, 2004.

Thirty-one counties are eligible as rural counties under the program, and four additional counties are eligible because they contain CEZs. The Department has estimated that there are approximately 70 projects approved annually. Taxpayer savings are approximately $16 million annually.

Current Business and Occupation Tax Credits for Businesses in Rural Areas

A B&O tax credit is authorized for manufacturing, research and development, and computer service businesses located in rural counties or community empowerment zones if they create employment of at least 15 percent above the prior year. Businesses may claim $2,000 as a credit against the tax for each new job created, except the credit is $4,000 if the wages and benefits exceed $40,000 per year. If the business is in a community empowerment zone, the persons filling the new jobs must be residents of the zone. No more than $7.5 million may be taken in any fiscal year by all businesses.

To receive the credit, a business must apply to the Department before filling the new positions. The application is required to contain information pertaining to the location of the business facility, employment, wages, costs, operational time schedules, and other information. The Department must rule on the application within 60 days.

A business that receives a credit for new employment must submit an annual report to the Department. The report must contain information that shows whether the recipient business is meeting the eligibility requirements of the credit program. If the Department finds that the business is ineligible, an amount of tax is due equal to the amount of credit taken. If the reason for ineligibility is failure to meet the employment requirements, interest is also due on the foregone taxes.

Another credit against B&O taxes is allowed to businesses that are eligible for the rural county and distressed area sales and use tax deferral for the value of state-approved, employer-provided job training. The amount of the credit is equal to 20 percent of the value of the training services up to a maximum total of $5,000 per year per business. To receive credit, a business must first obtain approval of the proposed job training services from the Employment Security Department. The application for approval must include a description of the proposed service, how the training is expected to enhance employee performance, and the expected cost of the training.

Tax Incentives and Accountability

A number of tax incentives include accountability provisions. The principal components of these provisions are disclosure requirements and enforcement mechanisms. Firms that take certain incentives are typically required to provide such information as number of jobs created, wages paid, and location of new investments. Generally, this information at the taxpayer level is not required to be made available to the public upon request and is typically summarized in reports prepared by the Department to the Legislature. Some information, such as certain tax-related data, is protected by confidentiality provisions and may not be disclosed at the taxpayer level unless specifically exempted otherwise.

With respect to enforcement mechanisms, taxpayers that receive the benefits of specific tax incentive programs are typically required to meet certain eligibility requirements. If the requirements are not met, the taxpayer is required to repay the tax savings to the state. An example is the requirement under the rural county and distressed area sales and use tax deferral that for counties with community empowerment zones a certain number of employees be hired from within the zones, depending on level of investment. Firms in such an area that fail to meet these requirements are required to repay the deferred taxes.

Summary of Amended Bill:

Credits against B&O tax liability are provided for certain business activity in rural counties through calendar year 2010, and the sales and use tax deferral for projects in rural counties is extended through Fiscal Year 2010. Island County is added as an eligible county under a number of the rural county tax incentives.

A credit against the B&O tax is provided to businesses that provide information technology help desk services by telephone or electronically from rural counties under terms similar to those enacted in 1999 and as subsequently amended. To qualify, information technology help desk services must be provided from a rural county, defined as a county with 100 or fewer persons per square mile or a county smaller than 225 square miles. These services are defined to include services provided by telephone or electronically for the following functions related to software and hardware: maintenance, diagnostics and troubleshooting, installation, repair, information and training, and upgrade. The credit is equal to the full amount of tax due attributable to providing the services from a rural county.

A B&O tax credit is provided to businesses that develop or manufacture software in rural counties under terms that are similar to those enacted in 1999 and as subsequently amended. Such businesses are allowed a credit for employment positions created after January 1, 2004, equal to $1,000 for each job created before July 1 of any year that the credit is effective. The credit is allowed for the first year the position was created and for four years thereafter. For positions created after July 1, the allowable credit is $500 for the first year and $1,000 per year for four years thereafter. Credit may be taken for qualifying positions for which the business was eligible to continue to take under the former credit at the time the former credit expired, for the number of years that remained under the former eligibility requirements. For businesses that transfer locations between rural counties, which are defined to also include counties smaller than 225 square miles, the credit is only applicable to any new jobs created as a result of the relocation. The credit is not available to businesses that receive the information technology help desk services credit.

For each of the new credits, no application is necessary to be eligible, but the business must keep adequate records for the Department to verify eligibility. If the Department finds that a business that has claimed credit is ineligible, the business must repay the amount of the credit with interest, but not penalties. Credits may not be carried over from year to year.

A business taking the credit must submit an annual report to the Department. The report is to contain various information, including the type of business activity, number of employees in the rural county, how long the business has been located in the county. Failure to submit a report does not disqualify the business from receiving the credit, but the Department must contact the business and collect the information so as to verify the program's effectiveness.

The rural county and distressed area sales and use tax deferral program is extended to July 1, 2010 and modified to clarify requirements when the deferral is taken by a landlord and to include reporting requirements.

A person that owns property and leases to another may receive deferral of taxes on qualifying expenditures, under the following conditions:

- The owner agrees to pass the economic benefit of the tax savings on to the lessee through lower rents or through some other means;
- The lessee receiving the benefit agrees in writing with the Department to complete

an annual report; and
- The economic benefit that is passed by the owner to the lessee is at least equal to the tax savings to the owner and is evidenced by written documentation of the financial arrangement to pass on the benefit.

Participants in the sales and use tax deferral program are required to complete an annual survey and provide information on the amount of tax deferred; number of new products, trademarks, patents, and copyrights; number of jobs and the percent of full-time, part-time and temporary jobs; wages by salary band; and number of jobs with employer provided health and retirement benefits. The Department may request additional information necessary to measure the results of the program. Information reported in the survey is confidential, except the amount of taxes deferred, which may be disclosed to the public.

The survey is due by March 31 in the year after the Department determines the project is operationally complete and in each of the seven following years. A business that fails to submit a complete survey in any year is required to pay 12.5 percent of all deferred taxes.

Each year by September 1, the Department will prepare summary descriptive statistics by category from the information provided by the survey. No fewer than three taxpayers will be included in any category.

The Department is required to study the sales and use tax deferral program and report back to the Legislature by December 1, 2009.

The termination date for the sales and use tax deferral program is extended to July 1, 2010.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Amended Bill: The bill contains an emergency clause and takes effect on April 1, 2004.

Testimony For: The Governor supports this measure, supports the accountability measures in the House Bill, and supports the inclusion of Island County.

The Ports Association supports this bill because it encourages manufacturing investment in rural counties, creates a slight differential for investing in rural areas versus urban areas, and puts rural areas on equal footing with respect to states that don’t have sales taxes.

Some rural areas are encountering double digit unemployment. It puts these areas on an equal playing field with areas that have lower tax burdens. If it had not been for these incentives, the firms that provided testimony would have located or expanded elsewhere.

We support this as a jobs creation measure within the computer industry in rural areas.

Testimony Against: None.

Persons Testifying: Jim Hedrick, Office of the Governor; Scott Taylor, Washington Public Ports Association; Ron Newbry, Washington Economic Development Association; and Lew McMurran, Washington Software Alliance.

Persons Signed In To Testify But Not Testifying: None.