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**Finance Committee**

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**HB 2546**

**Brief Description:** Modifying high technology and research and development tax incentive provisions.

**Sponsors:** Representatives McIntire, Morris, Hunter, Ruderman, Kessler, Lovick, Hunt, Grant, Hatfield, Fromhold and Clibborn; by request of Governor Locke.

**Brief Summary of Bill**

- Extends the business and occupation tax (B&O) credit for research and development (R&D) spending from December 31, 2004 to January 1, 2011.
- Extends the sales and use tax exemption for new, expanded, or diversified operations in R&D or pilot scale manufacturing from July 1, 2004 to July 1, 2010.
- Allows University of Washington and Washington State University to use the sales and use tax exemption for R&D facilities and equipment.
- Requires credit and exemption users to report annually on job creation, job retention, and other company related information.
- Requires the Department of Revenue to study the credit and exemption and report to Legislature by December 1, 2009.
- Exempts amounts received from the federal small business programs for innovation research and technology transfers from B&O tax.

**Hearing Date:** 1/19/04

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

**Background:**

In 1994 the Legislature enacted tax incentives to encourage additional research and development (R&D) in the high-technology sector. The legislation allows businesses that conduct activities in advanced computing, advanced materials, biotechnology, electronic device technology, or environmental technology to take a credit against the business and occupation (B&O) tax and an exemption from sales and use taxes on construction of R&D and pilot scale manufacturing facilities.

A firm qualifies for the high technology B&O tax credit for R&D spending if the firm's spending on research and development exceeds 0.92 percent of B&O taxable income. For-profit firms may take a credit equal to 1.5 percent of R&D spending. The credit is equal to 0.484 percent of the R&D expenditures for nonprofit organizations. A maximum of \$2 million in credit is available each year to an eligible firm. The tax credit program expires on December 31, 2004.

Firms taking the B&O tax credit file an affidavit that includes the amount of credit claimed, an estimate of anticipated R&D expenditures for the year for which the credit is claimed, an estimate of taxable income for the year, and other information that the Department deems necessary to administer the credit.

Firms that create a new operation or expand or diversify a current operation in R&D or pilot scale manufacturing are eligible for a sales and use tax exemption on the project. The exemption includes sales and use tax on building construction and purchases of equipment. If the investment project is used for a purpose other than qualified R&D or pilot scale manufacturing within the first eight years of operation, a proportionate share of exempted taxes must be paid.

Firms apply for the exemption before starting construction or equipment purchases. The application must include the location of the project, current employment, new employment estimates, estimated wages related to the project, estimated or actual cost data, time schedules for completion and operation, and other information required by the department. No new projects will be approved for exemption after June 30, 2004.

Participants in both tax incentives are required to supply the Department of Revenue with information necessary to measure the results of the tax credit program. The Department was required to do assessments of the programs in 1997, 2000, and 2003. The Department has estimated that about 600 firms utilize the B&O credit for R&D expenditures each year, resulting in tax savings of about \$25 million annually. About 50 to 60 businesses use the sales and use tax exemption each year with annual tax savings of about \$40 million. Firms in the advanced computing and biotechnology sectors have used the majority of the incentives. The majority of the incentives have been used in King County.

### **Summary of Bill:**

The business and occupation tax credit for research and development spending is extended from December 31, 2004 to January 1, 2011. The affidavit that previously was filed with each tax return is changed to a annual report that is filed in the year following use of the credit.

The sales and use tax exemption for new, expanded, or diversified operations in R&D or pilot scale manufacturing is extended from July 1, 2004 to July 1, 2010. State universities (UW and WSU) may take the exemption.

Participants in both programs are required to complete an annual survey and provide information regarding job creation, job retention, the number of full-time equivalent positions created for Washington residents, wage and benefit levels of the jobs, company growth, introduction of new products, the diversification of the state's economy, growth in research and development investment, movement of firms or the consolidation of operations into the state, and any additional information the Department of Revenue may prescribe. The survey is due by March 31st and the responses are confidential.

B&O tax credit participants may not take credits in any year they fail to complete the survey. Sales and use tax exemption participants must pay 12.5% of the tax exempted for each year they fail to complete the survey.

The Department of Revenue is required to study the B&O tax credit program and the sales and use tax exemption program and report back to the Legislature by December 1, 2009.

Amounts received by businesses from the federal small business programs for innovation research and technology transfers are exempt from B&O tax.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** Ninety days after adjournment of session in which bill is passed except the B&O exemptions for amounts received from the federal small business programs for innovation research and technology transfers take effect on July 1, 2004.