

# HOUSE BILL REPORT

## HB 1769

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**As Reported by House Committee On:**  
Technology & Economic Development

**Title:** An act relating to reinstating tax preferences for high-technology research and development.

**Brief Description:** Reinstating tax preferences for high-technology research and development.

**Sponsors:** Representatives Pettigrew, Wilcox, Springer, Manweller, Harris, Farrell, Tarleton, Magendanz, Walkinshaw, Rodne, Peterson, Buys, Zeiger, Senn, Goodman, Reykdal, Morris, Wilson and Young; by request of Office of Financial Management.

**Brief History:**

**Committee Activity:**

Technology & Economic Development: 2/11/15, 3/4/15 [DP].

**Brief Summary of Bill**

- Establishes a business and occupations tax credit for qualified research and development (R&D) expenditures, expiring January 1, 2025.
- Establishes a state and local sales tax deferral program for high-technology R&D and pilot-scale manufacturing facilities, expiring January 1, 2025.
- Establishes performance metrics to measure success of the tax preferences.

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### HOUSE COMMITTEE ON TECHNOLOGY & ECONOMIC DEVELOPMENT

**Majority Report:** Do pass. Signed by 12 members: Representatives Morris, Chair; Tarleton, Vice Chair; Smith, Ranking Minority Member; DeBolt, Assistant Ranking Minority Member; Fey, Hudgins, Magendanz, Nealey, Ryu, Santos, Wylie and Young.

**Minority Report:** Without recommendation. Signed by 1 member: Representative Harmsworth.

**Staff:** Jasmine Vasavada (786-7301).

**Background:**

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

In 1994 the Legislature created a program of business and occupation (B&O) tax credits for qualified research and development (R&D) expenditures, and a sales tax deferral program for high-technology R&D and pilot-scale manufacturing facilities. The R&D tax preferences expired January 1, 2015.

*Business and Occupation 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. 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. Major B&O tax rates include: 0.471 percent for retailing; 0.484 percent for manufacturing, wholesaling, and extracting; and 1.5 percent for professional and personal services, and activities not classified elsewhere.

*Business and Occupation Tax Credit for High Technology Research and Development.*

Under the program that expired January 1, 2015, "qualified research and development" meant R&D performed within this state in the fields of advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology. In 2014 the B&O tax credit available was 1.5 percent of the greater of: (1) qualified R&D expenditures that exceed 0.92 percent of the person's taxable income; or (2) 80 percent of the compensation received for conducting qualified R&D under contract. "Person" was broadly defined to include, among other categories, individuals, companies, political subdivisions, nonprofits, and federal agencies. No person could take more than \$2 million a year in credit. Qualified R&D expenditures that were claimable included those directly incurred as operating expenses, partner or owner compensation, benefits, supplies, and computer expenses. Excluded as claimable expenses were amounts paid to a person other than a public educational or R&D institution to conduct R&D, and capital costs and overhead, including expenses for land and structures. Any credit overclaimed or claimed by an ineligible person must be repaid, with interest but not penalties.

*Sales and Local Tax Deferral for Certain Construction-Related Expenses.*

Until January 1, 2015, application for deferral of sales taxes could be made before initiation of, construction of, or acquisition of, equipment or machinery for an investment project. "Investment project" was defined as an investment in qualified buildings or qualified machinery and equipment, including labor and services rendered in the planning, installation, and construction or improvement of the project. The Department of Revenue (DOR) was required to issue a sales and use tax deferral certificate for taxes due on each eligible investment project.

*Performance Metrics.*

In 2013 the Legislature required that every bill enacting a new tax preference must include a tax preference performance statement, indicating the legislative purpose for the tax preference and specifying clear, relevant, and ascertainable metrics and data requirements to facilitate review of the tax preference's effectiveness by the Joint Legislative Audit and Review Commission and the Legislature.

*Annual Survey.*

Taxpayers claiming tax preferences aimed at creating jobs or increasing industry competitiveness must file an annual survey with the DOR. The annual survey includes a

report of the tax preference amounts claimed each calendar year and information related to employment positions and wages in Washington.

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### **Summary of Bill:**

The high technology business and occupation (B&O) tax credit and sales tax deferral, with certain modifications, are reinstated. The new tax preferences go into effect July 1, 2015 and expire January 1, 2025.

#### *Business and Occupation Tax Credit for High Technology Research and Development.*

A person whose qualified research and development (R&D) spending during the same calendar year in which the credit is claimed exceeds 0.92 percent of the person's taxable amount is eligible to receive a B&O tax credit for qualified research and development expenditures.

"Person" is broadly defined to include, among other categories, individuals, companies, political subdivisions, nonprofits, and federal agencies. The B&O tax credit is calculated by multiplying 1.5 percent times the greater of: (1) qualified R&D expenditures that exceed 0.92 percent of the person's taxable amount; or (2) 80 percent of the compensation received for conducting qualified R&D under contract.

The total tax credit that may be claimed by a person is capped at the lesser of \$500,000 or the amount of total B&O tax due for the calendar year. The \$500,000 cap replaces the \$2 million cap in the former B&O tax credit.

#### *Sales and Local Tax Deferral for Certain Construction-Related Expenses.*

The Department of Revenue (DOR) must issue a sales and use tax deferral certificate upon receipt of an application from a person for an eligible investment project, if the application indicates that meaningful construction will occur within five years of the application date.

1. "Investment project" means an investment in qualified buildings, including labor and services rendered in the planning, installation, and construction or improvement of the project. Investment in qualified machinery and equipment is not tax deferrable.
2. "Eligible investment project" means an investment project that either initiates a new operation or expands or diversifies a current operation by expanding or renovating an existing facility. In the case of an investment project involving multiple qualified buildings, applications must be made for, and before the initiation of construction of, each qualified building. "Qualified machinery and equipment," formerly included in the definition of an "eligible investment project," are now excluded.
3. "Qualified buildings" means construction of new structures and expansion or renovation of existing structures for the purpose of increasing floor space or production capacity used for pilot-scale manufacturing or qualified research and development.
4. "Qualified research and development" means research and development performed within this state in the fields of advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology.

*Meaningful Construction.*

"Meaningful construction" means an active construction site, where excavation of a building site, laying of a building foundation, or other tangible signs of construction are taking place and that clearly shows a progression in the construction process, at the location designated by the taxpayer in the application for deferral. Planning, permitting, or land clearing before excavation of the building site, without more, does not constitute meaningful construction. Approved deferral applications may be amended to update the completion date, estimated expenses, and square footage of the project. However, requests to amend previously approved applications for projects for which meaningful construction has not commenced within five years of the application date must be denied.

The DOR may require additional information, such as project milestones, of applications indicating that meaningful construction will not occur within two years of the application date. If meaningful construction of a project does not begin within five years of the application date, or a project is not operationally complete within 10 years of the application date, the full amount of deferred tax is due immediately.

*Qualified Buildings and Partial Use for Other Purposes.*

Qualified buildings include plant offices and other facilities that are an essential or an integral part of a structure used for pilot-scale manufacturing or qualified research and development. The definition excludes areas for amusement and recreational activities, physical fitness activities, parking, the selling or furnishing of meals or other food and beverages, or similar commercial and noncommercial activities are not essential or integral to pilot-scale manufacturing or qualified research and development.

If a building or buildings are used partly for pilot-scale manufacturing or qualified research and development, and partly for other purposes, the applicable tax deferral shall be determined by apportionment of the costs of construction under rules adopted by the DOR. In addition, if the annual survey or other information causes the DOR to find that an investment project, within seven years of being certified as operationally complete, was used for a purpose other than qualified research and development or pilot-scale manufacturing, a percentage of the deferred taxes are immediately due.

*Sales and Use Tax Deferral Limits.*

The total amount of sales and use tax deferred is limited to \$1 million per eligible project, per person, and only one eligible project per person may qualify for a deferral under this chapter per calendar year. Applicants may be a "person" or "company," broadly defined to include entities such as municipal corporations, a state university, or an affiliate of any such entity. The lessor or owner of a qualified building may be eligible for the deferral, only if the lessor by written contract agrees to pass the economic benefit, in an amount no less than the tax deferred, to the lessee, and the lessee agrees in writing with the DOR to complete the required annual survey. The DOR may not issue a deferral certificate for investment projects that have already received certain other deferrals for Investment Projects in Rural Counties or High Technology Businesses. However, qualified R&D projects that are being adapted for use in pilot-scale manufacturing are eligible, even if they have previously received a deferral.

*Annual Survey.*

A person claiming either tax preference must file a complete annual survey.

*Tax Preference Performance Statement.*

The Legislature states that the tax preferences are intended to improve industry competitiveness and create or retain jobs. The tax preference should be extended beyond the 2025 expiration date if a review finds that, as compared to the effective date of the act: (1) the number of businesses participating in the tax preference programs have increased; and (2) the overall number of jobs for businesses participating in the tax preference programs have increased.

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**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill contains an emergency clause and takes effect on July 1, 2015.

**Staff Summary of Public Testimony:**

(In support) These tax preferences help industries grow and thrive in Washington. The research and development (R&D) and biotechnology industries position the state as an innovator that develops solutions to health and technology issues. There is a trickle effect as a result of fostering these high-paying jobs here in Washington. This kind of tax preference helps children and families, because it drives additional state revenues by inducing businesses to locate in Washington.

Two changes from the former tax preference could affect the University of Washington Medical School. The new definition of "meaningful construction" could compromise projects that have already been granted deferral certificates by the Department of Revenue, because the facilities are constructed in phases, and some projects would have received more deferred taxes than the \$1 million cap proposed in the bill.

Biosciences companies are located in 70 cities throughout the state and are one of the largest industrial sectors in terms of jobs, which continued to grow even in the "great recession." These tax preferences are an imperative tool for continued development of biosciences industry in the state, which must compete with other states for these jobs. States with these incentives have significantly more job growth in the R&D sector. High-technology firms in Washington that participated in the incentives have grown at a higher rate than such firms nationally.

High-technology industries are capital-intensive industries, and it takes a long time to get technologies from the bench to the patient. Start-ups use these deferrals to keep the lights on. The sales tax deferral for qualified machinery and equipment should be reinstated. As companies grow and become larger, they use the sales deferral to buy equipment and make infrastructure investments. The induced economic effect of fostering one successful business is demonstrated by the impact to the state of a world leader in defibrillation products, which was one of the first biotechnology companies in the state and helped make the region the

defibrillation capital of the world. Due to this technology, Washington has higher success rates than other states in addressing cardiac arrests.

Vendors throughout the state have an immense footprint. Industry is a source of significant sales tax and business and occupation tax revenues. Tax rates determine where R&D firms can grow and expand, and such firms will locate where costs of businesses are lower. More than 40 states have such a credit. After Texas' incentives expired, the state lost \$1 billion to their economy. Washington cannot afford an overly-rich tax credit but also cannot afford to turn away R&D firms.

(Opposed) None.

**Persons Testifying:** Representative Pettigrew, prime sponsor; Ian Goodhew, University of Washington Medicine; Chris Rivera, Washington Biotechnology and Biomedical Association; Tracy Day, Physio-Control; Brian Bonlender, Department of Commerce; Doug Levy, City of Redmond and Washington Tech Cities Coalition; Michael Transue, Novo Nordisk; and Amber Carter, Association of Washington Business.

**Persons Signed In To Testify But Not Testifying:** None.