
Finance Committee

SSB 5844

Brief Description: Adopting citizen commission 2016 recommendations and making adjustments to the commission's review process.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senator Braun).

Brief Summary of Substitute Bill

- Repeals six unused tax preferences related to the manufacturing of semiconductor materials.
- Provides tax preference performance statements for five tax preferences.
- Requires a review of all tax preferences with a statutory expiration date at least one year prior to the expiration date.

Hearing Date: 3/17/17

Staff: Serena Dolly (786-7150).

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 all business activities conducted within the state, without any deduction for the costs of doing business. Revenues are deposited in the State General Fund. There are several rate categories, and a business may be subject to more than one B&O tax rate, depending on the types of activities conducted.

Sales and Use Tax.

Retail sales taxes are imposed on retail sales of most articles of tangible personal property, digital products, and some services. A retail sale is a sale to the final consumer or end user. If retail sales taxes were not collected when the user acquired the property, digital products, or services, then use taxes apply to the value when used in this state. The state, all counties, and most cities

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levy retail sales and use taxes. The state sales and use tax rate is 6.5 percent; local sales and use tax rates vary from 0.5 percent to 3.9 percent, depending on the location.

Property Tax.

All real and personal property in Washington State is subject to the property tax each year based on its value, unless a specific exemption is provided by law. The tax bill is determined by multiplying the assessed value by the tax rate for each taxing district in which the property is located.

Reviews of Tax Preferences.

A tax preference confers reduced tax liability upon a designated class of taxpayer. Tax preferences include tax exemptions, exclusions, deductions, credits, deferrals, and preferential tax rates. Currently, Washington has over 650 tax preferences.

The Citizen Commission for Performance Measurement of Tax Preferences (Commission) was established by the 2006 Legislature. The Commission develops a schedule to review nearly all tax preferences at least once every 10 years. The Commission may schedule a review of a tax preference that has a statutory expiration date. Tax preference reviews are conducted by the Joint Legislative Audit and Review Committee (JLARC) according to the schedule established by the Commission.

When reviewing tax preferences, the JLARC is required to consider specific factors, including an economic impact analysis using the Washington input-output model. For each tax review, the JLARC provides a recommendation as to whether the tax preference should be continued without modification, modified, further reviewed, or terminated. The JLARC may recommend accountability standards for future review of a tax preference. The JLARC must include comments from the Commission in its final report.

Semiconductor Materials Manufacturing.

In 2016 the JLARC reviewed eight tax preferences related to the manufacturing of semiconductor materials. The preferences apply to different steps in the manufacturing process. Two of the preferences are being used by manufacturers; the other six are not.

The following two preferences are currently being used by manufacturers of semiconductor materials:

- a reduced B&O rate of 0.275 percent for manufacturing semiconductor materials, compared to the general manufacturing rate of 0.484 percent.
- a sales and use tax exemption for purchases of gases and chemicals used in the production of semiconductor materials.

Both preferences expire on December 1, 2018, and were enacted without a tax preference performance statement. The JLARC and the Commission recommended the Legislature review and clarify these two preferences.

Another six preferences have not been used, as they are contingent upon the siting and commercial operation of a significant semiconductor microchip fabrication facility in Washington:

- a sales and use tax exemption for the construction of a new building used for manufacturing semiconductor materials;
- a property tax exemption for machinery and equipment used for manufacturing semiconductor materials when located in a building exempted from sales tax;
- a B&O tax credit of \$3,000 for each manufacturing production job located in a building exempted from sales tax;
- a reduced B&O tax rate of 0.275 percent for manufacturing semiconductor materials, compared the general manufacturing rate of 0.484 percent.
- a sales and use tax exemption for purchases of gases and chemicals used in the production of semiconductor materials; and
- a full B&O tax exemption for manufacturing semiconductor microchips.

The expiration of the unused preferences is contingent on the date the preferences are utilized. The JLARC and the Commission recommended termination of these six preferences.

Clay Targets Purchased by Nonprofit Gun Clubs.

Clay targets purchased by nonprofit gun clubs are exempt from sales and use tax. This exemption is scheduled to expire on July 1, 2017, and was enacted without a tax preference performance statement. As part of the 2016 tax preference review, the JLARC and the Commission recommended the Legislature review and clarify this preference.

Solar Energy and Silicon Product Manufacturers.

Manufacturers of certain kinds of solar energy systems and their components are subject to a reduced B&O tax rate of 0.275 percent, compared to the general manufacturing rate of 0.484 percent. The preferential rate is scheduled to expire on June 30, 2017, and was enacted without a tax preference performance statement. As part of the 2016 tax preference review, the JLARC and the Commission recommended the Legislature review and clarify this preference.

Manufacturing and Extracting of Timber and Wood Products.

A variety of timber-industry related activities are subject to a reduced B&O tax rate of 0.3424 percent. Activities eligible for the reduced rate include: extracting timber; manufacturing or processing for hire timber into timber products or wood products; manufacturing timber products into other timber products or wood products; wholesale sales of timber cut by the seller, or certain timber or wood products manufactured by the seller; and sales of standing timber (but not land) where the timber is cut within 30 months of the sale. The preferential rate is scheduled to expire on July 1, 2024, and was enacted without a tax preference performance statement. As part of the 2016 tax preference review, the JLARC and the Commission recommended the Legislature review and clarify this preference.

Summary of Bill:

Reviews of Tax Preferences.

The Commission must schedule a review of all tax preferences with a statutory expiration date at least one year prior to the expiration date.

The JLARC may conduct its economic impact analysis using a model other than the Washington input-output model if approved by the Office of Financial Management and the JLARC.

For each tax preference without statutory metrics or accountability standard, the JLARC must recommend a metrics or standards that will help determine the effectiveness of the preference in a future review.

Semiconductor Materials Manufacturing.

The six unused preferences for semiconductor materials manufacturing are repealed.

Tax preference performance statements are provided for the remaining two preferences:

- *Reduced B&O rate for manufacturing semiconductor materials:* The tax preference performance statement categorizes this as one intended to induce certain designated behavior by taxpayers, improve industry competitiveness, and create or retain jobs. If a review finds that the number of people employed by a business utilizing the tax preference is the same or more than in 2015, and that at least 50 percent of the employees earn at least \$20 per hour and 80 percent receive health benefits, the Legislature intends to extend the expiration date of the preference.
- *Sales and use tax exemption for purchases of gases and chemicals used in specific phases of the semiconductor production process:* The tax preference performance statement categorizes this as one intended to induce certain designated behavior by taxpayers, improve industry competitiveness, and create or retain jobs. If a review finds that the number of people employed by a business utilizing the tax preference is the same or more than in 2015, and that at least 50 percent of the employees earn at least \$20 per hour and 80 percent receive health benefits, the Legislature intends to extend the expiration date of the preference.

Clay Targets Purchased by Nonprofit Gun Clubs.

A tax preference performance statement is provided for this preference. The statement categorizes this preference as one intended to provide tax relief to certain businesses. If a review finds that nonprofit gun clubs would face financial distress in the absence of the tax preference, and the fiscal impact reasonably conforms to the fiscal note, the Legislature intends to extend the expiration date of the preference.

Solar Energy and Silicon Product Manufacturers.

A tax preference performance statement is provided for this preference. The statement categorizes this preference as one intended to improve industry competitiveness, and to create or retain jobs. If a review finds that the number of people employed by a business utilizing the tax preference is the same or more than in 2015, and that at least 60 percent of the employees earn at least \$60,000 per year and 80 percent receive health benefits, the Legislature intends to extend the expiration date of the preference.

Manufacturing and Extracting of Timber and Wood Products.

A tax preference performance statement is provided. The statement categorizes this preference as one intended to induce certain designated behavior by taxpayers, improve industry competitiveness, and create or retain jobs. If a review finds that the State of Washington remains above the national average for lumber production by board feet, and timber job wages in rural

counties remain higher than the county median income, the Legislature intends to extend the expiration date of the preference.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.