

HOUSE BILL REPORT

HB 2945

As Reported by House Committee On:
Finance

Title: An act relating to aerospace business and occupation taxes and world trade organization compliance.

Brief Description: Concerning aerospace business and occupation taxes and world trade organization compliance.

Sponsors: Representative Sullivan.

Brief History:

Committee Activity:

Finance: 2/25/20, 2/27/20 [DP].

Brief Summary of Bill

- Imposes the business and occupation (B&O) standard tax rates of 0.484 percent on the manufacturing of commercial airplanes and components of commercial airplanes, the making of sales at retail or wholesale of commercial airplanes and components of commercial airplanes manufactured by the seller beginning April 1, 2020.
- Allows for the reimposition of the preferential B&O rate of 0.2904 percent on the manufacturing of commercial airplanes and components of commercial airplanes, the making of sales at retail or wholesale of commercial airplanes and components of commercial airplanes manufactured by the seller if the United States and the European Union resolve their World Trade Organization disputes regarding large civil aircraft and the resolution agreement allows the 0.2904 percent preferential rate.

HOUSE COMMITTEE ON FINANCE

Majority Report: Do pass. Signed by 8 members: Representatives Tarleton, Chair; Walen, Vice Chair; Young, Assistant Ranking Minority Member; Chapman, Orwall, Springer, Vick and Wylie.

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.

Minority Report: Without recommendation. Signed by 4 members: Representatives Orcutt, Ranking Minority Member; Frame, Macri and Stokesbary.

Staff: Tracey O'Brien (786-7152).

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. Businesses must pay the B&O tax even though they may not have any profits or may be operating at a loss.

A taxpayer may have more than one B&O tax rate, depending on the types of activities conducted. Major B&O tax rates are 0.471 percent for retailing; 0.484 percent for manufacturing, wholesaling, and extracting; and 1.5 percent for services and for activities not classified elsewhere. Several preferential rates also apply to specific business activities.

In addition, a taxpayer may be eligible to utilize other tax preferences, including credits and deductions, to reduce their tax liability. For example, a taxpayer engaging in activities subject to different B&O tax rates may be eligible for a Multiple Activities Tax Credit. A taxpayer may also be eligible for a small business credit that will either eliminate or reduce their B&O tax liability. In general, the credit is \$70 per month for service businesses and \$35 per month for all other businesses, multiplied by the number of months in the reporting period. The amount of the credit available phases out based on the business' gross receipts.

A business does not have to file an annual B&O tax return if the business does not owe other taxes or fees to the Department of Revenue (DOR) and has annual gross proceeds of sales, gross income, or value of products for all B&O tax classifications of less than \$28,000 per year, or less than \$46,667 if at least 50 percent of its taxable income is from services or activities not classified elsewhere.

Aerospace Business and Occupation Tax Incentives.

In 2003 the Legislature adopted tax incentives that were limited to aerospace manufacturers. The incentives included a reduction in the B&O tax rate; a B&O tax credit for pre-production development expenditures; and a B&O tax credit for property taxes paid on property used in the manufacture of commercial airplanes and airplane components. A leasehold tax exemption for port district facilities is available to manufacturers of super-efficient airplanes that are not using the B&O tax credit for property taxes. Also included were sales and use tax exemptions for computer equipment and software, and its installation, used primarily in the development of commercial airplanes and components. These exemptions are scheduled to end in 2024.

In addition, the Legislature reduced the B&O tax rate from 0.484 percent to 0.275 percent for firms that repair equipment used in interstate or foreign commerce. The firms must be classified by the Federal Aviation Administration (FAA) as a Federal Aviation Regulation (FAR) part 145 certificated repair station with airframe and instrument ratings and limited ratings for nondestructive testing, radio, class 3 accessory, and specialized services.

In 2008 the Legislature extended aerospace tax programs to manufacturers, FAR repair stations, and design/engineering services. Sales and use tax exemptions were provided for computer equipment and software, and installation, which are used primarily in aerospace products or providing aerospace services. Under this legislation until July 1, 2024, the B&O tax rate is 0.2904 percent for sales, either retail or wholesale, of commercial airplanes or components; the manufacturing or sales of tooling used in the manufacturing of commercial airplanes and components of airplanes; or persons classified by the FAA as a FAR 145 certified repair station. Persons claiming this rate must file an annual survey with the DOR. Persons performing aerospace product development are qualified for a 0.9 percent B&O rate and must file an annual survey with the DOR.

The preproduction 1.5 percent B&O tax credit on qualified expenditures was expanded to include Aerospace product development. The B&O tax credit for property taxes paid was extended to aerospace product development, the manufacturing of tooling, and FAR Part 145 certified repair stations.

In 2013 the Legislature extended the expiration date from 2024 to 2040 for the following aerospace B&O tax preferences: the preferential B&O tax rate for the manufacturing, wholesaling, and retailing of commercial airplanes and airplane components; the preferential B&O tax rate for the manufacturing, wholesaling, and retailing of tooling used in the manufacturing of commercial airplanes and airplane components; the preferential B&O tax rate for retail sales by a part 145 certificated repair station; the preferential B&O tax rate for businesses performing aerospace product development for others; the B&O tax credit for aerospace product expenditures; and the B&O tax credit for property taxes and leasehold taxes on property used exclusively in manufacturing commercial airplanes or components of airplanes.

The act was contingent upon the DOR making a determination that a final decision to locate a significant commercial airplane manufacturing program in the state of Washington has occurred. A significant commercial airplane manufacturing program is the commencement of manufacturing of a new model of a commercial airplane or a new version of an existing model and the manufacturing of the fuselage and wings of the new model or new version. The ongoing availability of the preferential B&O tax rate for the production of a new or remodeled commercial airplane is contingent upon maintaining all final assembly of the aircraft and wing assembly within the state.

In 2014 Boeing announced it would expand its facilities in Everett, Washington, to manufacture the wings for its new 777X jetliner and the extension of the tax incentives enacted in 2013 was triggered.

World Trade Organization.

The World Trade Organization (WTO) is a global international organization that deals with the rules of trade between nations. The member governments run the WTO and all major decisions are made by the membership as a whole, ministers, or ambassadors or delegates.

The WTO agreements are negotiated and signed by many of the world's trading nations and are ratified by the nation's legislative bodies. The agreements cover goods, services, and

intellectual property. They include individual countries' commitment to lower customs tariffs and other trade barriers, and to open and keep open service markets. They set procedures for settling disputes and they prescribe special treatment for developing countries. Governments are required by the WTO to make their trade policies transparent by notifying the WTO about changes to the laws and through regular trade policy reports.

In addition, the WTO provides a forum for settling trade disputes. A dispute arises when one country adopts a trade policy measure or takes some action that one or more of the fellow WTO members considers breaking the WTO agreements, or to be a failure to live up to obligations. In addition, a third group of countries can declare that they have an interest in the case and enjoy some rights. If the WTO dispute settlement body determines that a country has done something wrong, the priority is for the losing party to bring its policy into line with the ruling or recommendations.

Rulings are automatically adopted unless there is a consensus to reject a ruling. Any country wishing to block a ruling has to persuade all other WTO members to share its view. A losing party may also appeal the ruling or recommendation. If a losing party fails to act within a reasonable time, it has to enter into negotiations with the complaining country in order to determine mutually-acceptable compensation such as tariff reductions. If no satisfactory compensation is agreed upon, the complaining party may ask the dispute settlement body for permission to retaliate, usually in the same sector as the dispute.

World Trade Organization Large Civil Aircraft Disputes.

In 2004 the European Communities initiated a dispute at the WTO alleging that the subsidies granted by the United States (U.S.) federal, state and local governments to Boeing large civil aircraft violated the 1994 General Agreement on Tariffs and Trade (GATT) and the Agreement Subsidies and Countervailing Measures (ASCM).

The subsidies at issue include:

- payments, access to government facilities, equipment and employees, allocation of intellectual property rights, and the reimbursement of independent research and development (R&D) costs under R&D contracts and agreements between Boeing and the National Aeronautics and Space Administration (NASA), the U.S. Department of Defense, and the U.S. Department of Commerce;
- various federal, state, and local tax measures; and
- infrastructure-related measures.

The dispute included aerospace tax incentives enacted by the Washington Legislature in 2003 and was later expanded to include the changes made in 2008 and 2013.

Among the restrictions in the ASCM, subsidies that are contingent upon export performance or upon the use of domestic over imported goods are prohibited. This type of subsidy is considered by the ASCM to create "significant trade distortions." As a result, a complaining party is not required to demonstrate any adverse effects in order to prevail in a challenge. The European Communities challenged the Washington state aerospace tax preferences under this provision.

The initial WTO panel ruled in favor of the U.S.; however, the appellate body reversed this decision, ruling in favor of the European Communities in 2016. A subsequent WTO appellate panel report in 2017 found that the only remaining subsidy at issue was Washington's B&O rate reduction. It found that the B&O rate reduction to 0.2904 percent benefiting the Boeing 737 MAX and the 737NG caused serious prejudice to the interests of the European Union (E.U.).

In 2004 the U.S. initiated a dispute with the E.U., Germany, France, the United Kingdom, and Spain alleging subsidies granted to Airbus by the E.U. and the four nations violated both GATT and ASCM.

The subsidies included:

- launch aid and member state financing for Airbus A300, A320, A330/A340 and A380;
- French and German governments' capital contributions in connection with the corporate restructuring of Aérospatiale and Deutsche Airbus; and
- German and Spanish authorities' infrastructure-related measures, as well as launch aid and member state financing for the Airbus A250XWB.

The WTO initial panel and the appellate body found that the launch aid and member state financing, along with other benefits conferred to Airbus, were prohibited subsidies.

Summary of Bill:

Beginning April 1, 2020, the preferential B&O rate of 0.2904 percent for manufacturing of commercial airplanes and components of commercial airplane, the making of sales at retail or wholesale of commercial airplanes and components of commercial airplanes manufactured by the seller does not apply.

The preferential B&O rate of 0.2904 percent may apply again, so long as the following conditions are met:

- the U.S. and E.U. reach an agreement to resolve their WTO disputes regarding large civil airplanes that expressly allows a B&O preferential rate of 0.2904 percent;
- the taxpayer certifies that the taxpayer meets all the requirements of the WTO settlement that allow for the imposition of the preferential 0.2904 percent B&O tax rate; and
- the DOR issues a determination that the conditions are met.

The DOR must provide written notice of the determination and the effective date of the preferential B&O rate to affected parties, the Chief Clerk of the House of Representatives, the Secretary of the Senate, and the Office of the Code Reviser.

The bill is exempt from the requirements of a tax preference performance statement, a Joint Legislative Audit and Review Committee review, and an automatic 10-year expiration.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains an emergency clause and takes effect immediately.

Staff Summary of Public Testimony:

(In support) Originally enacted in 2003, the tax preferences, including the 0.2904 percent B&O tax rate is designed to support and grow aerospace in Washington. Last April the WTO issued ruling that the preferential B&O tax rate violates the WTO rules and as a result, Boeing and hundreds of suppliers face tariffs. Boeing fully supports the timely repeal of the preferential B&O tax rate. Boeing supports the WTO and wants to come into compliance. Airbus has received aid in violation of the WTO and have refused to come into compliance. In fact, Airbus and the E.U. are subject to the U.S. tariffs and still refuse to comply.

In addition to aerospace, many Washington exports, including agricultural products, wine, and information technology, will face high tariffs this summer if the preferential B&O tax rate is not eliminated. It is the sole remaining finding against the U.S. after over 15 years of dispute. It is urgent that this bill passes as Washington is already suffering due to other trade disputes and issues, with 40 percent of Washington jobs dependent to international commerce.

The International Monetary Fund cited trade-related uncertainties as one of the top risks for the global economy. The "snap-back" provision provides more certainty for aerospace businesses. It will also maintain the competitiveness of Washington's current and future companies.

The money saved with the imposition of the preferential B&O tax rate is used to support worker training an education by many of the suppliers. If expressly permitted, a return to the 0.2904 percent B&O tax rate would allow for greater opportunities for workers.

Many of the companies currently taking advantage of the preferential rate would not exist without Boeing. For Snohomish County, aerospace is the past, present and future. But, it is not just the Puget Sound that benefits from the aerospace industry. It is an industry that has a presence statewide. Retaliatory tariffs will hurt everyone.

(Opposed) None.

(Other) Although there is general support for the concept behind the repeal, there is concern about the "snap-back" provision allowing the reimposition of the 0.2904 percent preferential B&O tax rate. There must be strong accountability provisions in any reinstatement.

In 2013 labor supported the tax preference expansion to grow and maintain Washington employment in the aerospace industry. However, despite Boeing taking advantage of the tax preferences, thousands of Boeing jobs have been moved out of state. The aerospace industry

will continue to act in its own self-interest and Washington should ensure that any tax preferences given include assurances that Washington will benefit.

A no-string attached policy will continue to encourage outsourcing of good family wage jobs. The Legislature must know the conditions and how work will be distributed if the preferential B&O tax rate ever goes back into effect. Indeed, there should be a requirement that the next plane assembly line be sited in Washington before "snap-back" is triggered.

Persons Testifying: (In support) Representative Sullivan, prime sponsor; Bill McSherry, The Boeing Company; Lori Otto Punke, Washington Council on International Trade; Josh McDonald, Washington Wine Institute; Mike Brown, Aero-Plastics; Rosemary Brewster, Hobart Machined Products; Lynette Muenzberg, TLG Aerospace; Mark McIntyre, Seattle Chamber of Commerce; Terry Ryan, Snohomish County; and Cara Coon, Greater Spokane Incorporated.

(Other) Brandon Anderson, Society of Professional Engineering Employees in Aerospace; Larry Brown, Washington State Labor Council, American Federation of Labor–Congress of Industrial Organizations; Jon Holden, Identity and Access Management District 751; Lisa Brown, Washington State Department of Commerce; and Misha Werschkul, Washington State Budget and Policy Center.

Persons Signed In To Testify But Not Testifying: None.