HOUSE BILL REPORT
ESB 5901

As Passed House - Amended:
March 9, 2022

Title: An act relating to economic development tax incentives for targeted counties.

Brief Description: Concerning economic development tax incentives for targeted counties.

Sponsors: Senators Randall, Billig, Holy, Mullet, Nguyen and Saldaña.

Brief History:
Committee Activity:
Finance: 3/7/22, 3/8/22 [DPA].
Floor Activity:
Passed House: 3/9/22, 69-28.

Brief Summary of Engrossed Bill
(As Amended by House)

- Establishes a state and local sales and use tax deferral program for manufacturing and research and development investment projects in qualifying counties.
- Expands the warehouse sales and use tax exemption to include warehouses over 100,000 square feet in qualifying counties.
- Limits the maximum amount of warehouse sales and use tax that may be exempted for the construction or expansion of any warehouse or grain elevator to $400,000.
- Expires the warehouse sales and use tax exemption on July 1, 2032.

HOUSE COMMITTEE ON FINANCE

Majority Report: Do pass as amended. Signed by 11 members: Representatives Frame, Chair; Berg, Vice Chair; Walen, Vice Chair; Chopp, Harris-Talley, Morgan, Orwall, Ramel,

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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 part of the legislation nor does it constitute a statement of legislative intent.

Springer, Thai and Wylie.

Minority Report: Do not pass. Signed by 2 members: Representatives Dufault, Assistant Ranking Minority Member; Young.

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

Staff: Kyle Raymond (786-7190).

Background:

Retail 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 of the property, digital product, or service. If retail sales taxes were not collected when the user acquired the property, digital products, or services, then use tax applies to the value of property, digital product, or service when used in this state. The state, all counties, and all cities 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.

In general, construction activities constitute retail services subject to sales tax. Construction activities include, but are not limited to installing, repairing, cleaning, improving, constructing and decorating real property; constructing and improving new or existing buildings and structures; and cleaning, fumigating, razing or moving structures. Businesses performing construction activities must also collect and remit retail sales tax on their total charges for the project unless a specific exemption applies. This taxable amount includes charges for permits and other fees, labor, profit, materials and charges for subcontractors. Sales tax rates vary around the state. Contractors performing retail services must collect sales tax based on the tax rate of the jurisdiction in which they perform their services.

Sales and Use Tax Deferral Programs.
Deferral programs authorize businesses the ability to postpone payment of sales and use taxes based on meeting specific requirements and performance criteria. Once an application for a deferral program is filed and approved, businesses are granted a tax deferral certificate which must be provided to vendors and contractors to defer sales or use tax. Over the years, the Legislature has authorized various sales and use tax deferral programs, some of which allow for a complete waiver of sales and use taxes if certain specific requirements and performance criteria are met over a specified period of time.

Warehouse Sale and Use Tax Remittance.
A warehouse tax remittance exists that allows for up to a 100 percent exemption from the state's portion of the retail sales or use tax paid on the eligible construction costs for qualified warehouses, grain elevators, and distribution centers. The remittance also allows for a 50 percent exemption from the state's portion of the retail sales or use tax paid on

purchases and installation of material-handling and racking equipment. The tax remittance is available to: a wholesaler or third-party warehouse who owns or operates warehouses or grain elevators; and retailers who own or operate distribution centers. Eligible taxpayers receive the exemption in the form of a remittance from the Department of Revenue (DOR). The application is filed once retail sales tax or use tax has been paid for a calendar quarter.

The remittance applies to sales and use tax paid on materials and labor on the construction or expansion of the following:

- A warehouse or distribution center of at least 200,000 square feet qualifies for a 100 percent exemption.
- A grain elevator of at least 1 million, but less than 2 million, bushel storage capacity qualifies for a 50 percent exemption.
- A grain elevator of 2 million or more bushel storage capacity qualifies for a 100 percent exemption.

Sales or use tax paid on material-handling and racking equipment for a qualifying facility is eligible for a 50 percent exemption. This includes labor and services for installing, repairing, cleaning, altering or improving the equipment.

Sales and Use Tax Exemption for Machinery and Equipment.
A retail sales and use tax exemption is provided for machinery and equipment used directly in a manufacturing operation or research and development operation. Sales of, or charges made for, labor and services rendered in respect to installing, repairing, cleaning, altering, or improving qualifying machinery and equipment are also exempt from sales tax. In addition, the exemption may be taken for qualifying machinery and equipment used directly in a testing operation by a person engaged in testing for a manufacturer or processor for hire.

Summary of Amended Bill:

Sales and Use Tax Deferral Program for Designated Counties.
A state and local sales and use tax deferral program is established for manufacturing or research and development investment projects in qualifying counties. A qualifying county is a county with a population of less than 650,000 at the time an application for deferral is submitted.

Tax Deferral Program Requirements.
The amount of state and local sales and use taxes eligible for deferral is limited to $400,000 per person. An investment project means an investment in construction of new structures, or expansion or renovation of existing structures, for increasing floor space or production capacity used for manufacturing or research and development activities. An investment project also includes an investment in all new industrial and research fixtures, equipment, and support facilities that are an integral and necessary part of a manufacturing or research and development operation.

An application for deferral of taxes must be made to the Department of Revenue (DOR) before initiation of the construction of the investment project or acquisition of machinery or equipment. The application must contain information regarding the location of the investment project, the applicant's average employment in the state for the prior year, estimated or actual new employment related to the project, estimated or actual wages of employees related to the project, estimated or actual costs, time schedules for completion and operation, and other information required by the DOR.

The DOR must rule on an application within 60 days. The DOR may not accept applications for the deferral after June 30, 2032. If approved, the DOR must issue a sales and use tax deferral certificate for state and local sales and use taxes on each eligible investment project.

The recipient of a deferral certificate must begin meaningful construction on an eligible investment project within two years of receiving a deferral certificate, unless construction was delayed due to circumstances beyond the recipient's control. Lack of funding is not considered a circumstance beyond the recipient's control. If the recipient does not begin meaningful construction within two years, the deferral certificate issued is invalid and taxes deferred are due immediately.

The investment project must be operationally complete within five calendar years from the issuance of the tax deferral certificate.

Each recipient of a deferral certificate must file a complete annual tax performance report with the DOR during the period covered by the schedule above providing wage, employment, and tax savings information.

Lessors or Owners of Qualified Buildings Requirements.
A lessor or owner of a qualified building is only eligible for a deferral if:

- the underlying ownership of the buildings, machinery, and equipment vests exclusively in the same person; or
- the lessor agrees to pass the economic benefit of the deferral to the lessee by written contract, the lessee receiving the deferral agrees in writing to the DOR to complete the annual tax performance report, and the economic benefit of the deferral passed to the lessee is no less than the amount of tax deferred by the lessor and is evidenced by written documentation.

If the economic benefits of the deferral are passed to a lessee, the lessee is responsible for payment to the extent the lessee has received the economic benefit.

Repayment of Deferred Taxes.
The taxes deferred need not be repaid if the recipient utilizes the qualified project for qualified manufacturing or research and development operation for the seven years

following project completion date. If the project is not operationally complete within five years or not utilized for qualifying purposes for the seven years immediately following the project certified as operationally complete, then the deferred taxes are due immediately based on the following schedule:

Year in Which Use Occurs	Percent of Deferred Taxes Due
1	100 percent
2	87.5 percent
3	75 percent
4	62.5 percent
5	50 percent
6	37.5 percent
7	25 percent
8	12.5 percent

Tax Preference Performance Statement.
The Joint Legislative Audit and Review Committee (JLARC), as part of its tax preference review process, must use the information reported on the annual tax performance report to study the tax deferral program. The JLARC must report to the Legislature by December 1, 2030. The report must measure the effect of the program on job creation, the number of jobs created for residents of eligible areas, company growth, and such other factors as the JLARC selects.

Other Provisions.
The DOR must establish a list of qualifying counties, effective July 1, 2022. The list of qualifying counties is effective for a 24-month period and must be updated by July 1 of the year that is two calendar years after the list was established or last updated.

If machinery and equipment, including sales of or charges made for labor and services, qualifies for the existing sales and use tax exemption for machinery and equipment at the time of purchase or first use, the deferred taxes are not required to be repaid.

The DOR must assess interest at the rate provided for delinquent taxes, but not penalties, retroactively to the date of deferral for a recipient who must repay deferred taxes because the DOR has found that an investment project is not eligible for tax deferral. The debt for deferred taxes will not be extinguished by insolvency or other failure of the recipient. Transfer of ownership does not terminate the deferral. The deferral is transferred, subject to the successor meeting the eligibility requirements, for the remaining periods of the deferral.

Applications, reports, and any other information received by the DOR, except applications not approved by the DOR, are not confidential and are subject to disclosure.

Warehouse Sale and Use Tax Remittance.
The warehouse sales and use tax remittance includes warehouses over 100,000 square feet located in a qualifying county. A warehouse is eligible for a 100 percent remittance on the construction or expansion of the facility and a 50 percent remittance on the purchase of material-handling and racking equipment.

A qualifying county is a county with a population of less than 650,000 at the time an application is submitted under the warehouse sales and use tax remittance. The maximum amount of sales and use tax that may be remitted for the construction or expansion of a warehouse or grain elevator is $400,000.

A person claiming the warehouse remittance must file the annual tax preference performance report, beginning in the first calendar year following the year the warehouse, distribution center, or grain elevator is operationally complete and for the next two subsequent years.

The warehouse sales and use tax remittance expires July 1, 2032.

Tax Preference Performance Statement.
A tax preference performance statement is included, stating the Legislature's intent to induce the construction of new or expanded warehouses and distribution centers in certain targeted counties by reducing the square footage requirement in order to diversify the tax base and increase employment within the targeted counties. The JLARC must evaluate the changes in the number of employment positions in the warehousing and distribution industry sector in the targeted counties and changes to the tax base as a result of increased warehousing and distribution activity.

Appropriation: None.

Fiscal Note: Available. New fiscal note requested on March 8, 2022.

Effective Date: The bill takes effect on July 1, 2022.

Staff Summary of Public Testimony:

(In support) The pandemic has illustrated the need for a strong manufacturing sector in Washington. Communities depend on the products manufacturers provide, and the manufacturing sector produces good-paying jobs. A strong manufacturing sector will also help support Washington as a national leader in trade.

The Office of Financial Management is forecasting a decline in the average annual growth rates for manufacturing. The incentive in this bill would provide a nice boost to Washington's manufacturing sector. This bill will also help the Legislature achieve its goal of doubling number of manufacturers in Washington over the next 10 years.

(Opposed) None.

Persons Testifying: Tommy Gantz, Association of Washington Business.

Persons Signed In To Testify But Not Testifying: None.