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Washington State Tax Structure Study

Alternatives Subcommittee Paper

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Tax Incentives

Washington's tax incentives are intended to attract or retain businesses and to address competition between states by providing tax treatment available in our competitor states. In both cases, the overall objective is to stimulate economic development in order to provide jobs. The legislature has crafted a variety of means for providing tax incentives to firms. These include tax incentives based directly on job creation, exemptions for construction and machinery and equipment, and preferential excise tax rates for targeted activities.

There are two major types of tax incentives:

1. Statewide tax incentives intended to promote a type of business activity regardless of where it occurs in the state. These include tax incentives for manufacturing, research and development, and warehousing and distribution.
2. Geographically targeted tax incentives designed to result in location or expansion of business activities in areas of the state that are economically distressed or are less densely populated. Tax incentives are available in 31 rural counties and in eight economically disadvantaged urban areas (community empowerment zones and international services districts).

Under the Washington Constitution the state is prohibited from outright grants of money absent a public purpose. For that reason tax incentives in Washington State are usually in the form of exemptions from tax or credits against tax. In addition, tax incentives must serve some public purpose in order to satisfy equal protection requirements. In the past, the legislature enacted sales tax incentives as deferrals so that taxes would be paid after a certain period. Another type of tax incentive required payback only if business did not meet stated objectives. Some tax incentives were enacted with sunset clauses. More recently, several of these limiting provisions have been repealed or delayed.

Other states are able to offer tax incentives that Washington's constitution precludes. These include tax increment financing and property tax abatements, which can be discretionary tools for local governments. Many states with corporate income taxes have changed to single factor sales apportionment of income as an economic development tool.

The issue of whether tax incentives achieve their stated purpose remains an open question. There are limited means to determine who benefits from tax incentives and if they are effective in creating

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jobs. Washington law requires the Department of Revenue to prepare a periodic compilation of the reduction in revenues from all tax incentives and exemptions. A few other states have enacted programs that require firms to publicly disclose information on the amount of their tax savings and on the creation of jobs and goal attainment. Studies that examine the effectiveness of tax incentives have conflicting and inclusive results. Academic studies show small, if any, impact on growth. There are studies involving interviews or surveys showing that for individual firms tax incentives are working to create jobs in the communities in which they locate.

The following charts list the major tax incentives in Washington State.

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Statewide and Rural Tax Incentives

Area of State	Legislative Objective	Activity Targeted	Terms and Conditions
Statewide programs			
M&E Sales/Use Tax Exemption – RCW 82.08.02565, RCW 82.12.02565	Level playing field; retention/expansion; jobs	Manufacturing; R&D; Testing - Equipment	Used directly in a manufacturing, R&D, or testing operation.
R&D B&O Credit – RCW 82.04.4452	Encourage early stages of research; high wage high-skilled jobs	R&D	Expenditures must exceed 92% of gross income. Advanced computing, advanced materials, biotechnology, electronic device technology, or environmental technology. There is a \$2 million annual credit cap for each participant.
R&D Sales/Use Tax Deferral RCW 82.63	Encourage research; create jobs; spur Mfg.	R&D – structures/M&E	Must be engaged in R&D (see B&O credit above) 8 years to get full benefit.
Warehouse/Grain Elevator Sales/Use Tax – RCW 82.08.820, RCW 82.12.820	Facility location; Increase global and regional trade; jobs	Wholesaling, warehousing, and distribution - Structures and M&E	Warehouses over 200,000 square feet Grain elevators over 1 million bushels
Rural/Geographic			
Sales & Use Tax Deferral Rural Counties/CEZ – RCW 82.60	Jobs	Manufacturing; R&D; Testing – Structures/M&E	Must be engaged in manufacturing or R&D for 8 years to get full benefit.
Rural B&O Credit (Mfg; R&D) - rural Counties/CEZs – RCW 82.62	Jobs	Manufacturing; R&D	\$4,000 for job > \$40,000 wages/benefits. \$2,000 for job < \$40,000 wages/benefits. Maintain positions for 12 months.
Rural Local Option Sales/Use Tax Credit – RCW 82.14.370	Locally driven economic development	Public facilities	.08% credit against state sales tax Tax can be collected for 25 years.
International Service Districts B&O Credit; RCW 82.04.44525	Retention and attraction; jobs	Professional services for international customers	\$3,000 per job; five years per position
Rural Software B&O Credit RCW 82.04.4456	Rural job creation; skills	Software and programming	\$1000 per job; five years per position
Rural Helpdesk B&O Credit RCW 82.04.4457	Rural job creation; skills	Help desk technology	100% credit against B&O

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Statewide and Rural Tax Incentives

			Tax Savings*	Annual	
Statewide	Enacted	Expires	(000)	Participation	Terms
Manufacturing/R&D Sales/Use Tax**	1995	No	\$132,100	4,000 taxpayers	Activity
R&D B&O Credit	1994	12/31/04	28,600	500 taxpayers	Spending/Activity
R&D Sales/Use Tax Deferral**	1994	07/01/04	66,800	15 projects	8 years
Warehouse/Grain Elevator Sales/Use Tax	1997	No	2,300	24 taxpayers	Size
Rural/Geographically Targeted					
Rural Sales & Use Tax Deferral (Mfg; R&D)**	1985	07/01/04	19,200	70 projects	8 years
Rural B&O Credit (Mfg; R&D)	1986	No	5,900	50 applications	Wages/Positions
Rural Local Option Sales/Use Tax Credit	1997	No	15,600	31 counties	25 years
International Service Districts B&O Credit	1998	No	Negligible	2 taxpayers	Jobs
Software/Programming B&O Credit	1999	12/31/03	30	25 taxpayers	Jobs
Helpdesk B&O Credit	1999	12/31/03	188	30 taxpayers	Activity

*Dollars in thousands/estimates for FY 2003 based on the most recent information.

**These programs provide partial multiple coverage on equipment purchases.