

HOUSE BILL REPORT

HB 2089

As Reported by House Committee On:

Finance
Appropriations

Title: An act relating to incentivizing a long-term commitment to maintain and grow jobs in the aerospace industry in Washington state by extending the expiration date of aerospace tax preferences and expanding the sales and use tax exemption for the construction of new facilities used to manufacture superefficient airplanes to include the construction of new facilities used to manufacture commercial airplanes or the wings or fuselage of commercial airplanes.

Brief Description: Incentivizing a long-term commitment to maintain and grow jobs in the aerospace industry in Washington state by extending the expiration date of aerospace tax preferences and expanding the sales and use tax exemption for the construction of new facilities used to manufacture superefficient airplanes to include the construction of new facilities used to manufacture commercial airplanes or the wings or fuselage of commercial airplanes.

Sponsors: Representatives Carlyle, Hunter and Morrell; by request of Governor Inslee.

Brief History:

Committee Activity:

Finance: 11/7/13, 11/8/13 [DPS];
Appropriations: 11/8/13 [DPS(FIN)].

Brief Summary of Substitute Bill

- Extends the expiration date of aerospace tax incentives to July 1, 2040, upon the siting of a significant commercial airplane manufacturing program in Washington.
- Expands the availability of a sales and use tax exemption for the construction of facilities used to manufacture commercial airplanes.
- Terminates the preferential business and occupation (B&O) tax rate applicable to new versions or models of commercial airplanes if final assembly, fuselage or wing assembly, or fuselage or wing fabrication, of the new model or version is sited outside the State of Washington.

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.

- Requires the Joint Legislative Audit and Review Committee to specifically review employment changes in the aerospace industry every five years as part of its tax preference review process.

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 10 members: Representatives Carlyle, Chair; Tharinger, Vice Chair; Nealey, Ranking Minority Member; Orcutt, Assistant Ranking Minority Member; Fitzgibbon, Hansen, Lytton, Pollet, Springer and Wilcox.

Minority Report: Do not pass. Signed by 3 members: Representatives Condotta, Reykdal and Vick.

Staff: Jeffrey Mitchell (786-7139).

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 B&O tax even though they may not have any profits or may be operating at a loss. A business may have more than one B&O tax rate, depending on the types of activities conducted. Major tax rates are 0.471 percent for retailing; 0.484 percent for manufacturing, wholesaling, and extracting; and 1.5 percent for services, and activities not classified elsewhere. Several lower rates also apply to specific business activities.

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 taxes apply to the value of property, digital products, or service when used in this state. The state, most cities, and all counties 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 3.0 percent, depending on the location.

Property Tax:

Property taxes are imposed by state and local governments. All real and personal property in this state is subject to the property tax based on its value, unless a specific exemption is provided by law. There are exemptions for certain properties, including property owned by federal, state, and local governments, churches, farm machinery, and business inventory.

Property owned by federal, state, or local governments is exempt from the property tax. However, private lessees of government property are subject to the leasehold excise tax. The purpose of the leasehold excise tax is to impose a tax burden on persons using publicly

owned, tax-exempt property similar to the property tax that they would pay if they owned the property. The tax is collected by public entities that lease property to private parties.

Legislative Background of Aerospace 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 superefficient 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 part 145 certificated repair station with airframe and instrument ratings and limited ratings for nondestructive testing, radio, class 3 accessory, and specialized services.

Businesses that exercise any of these incentives file an annual report with the Department of Revenue (DOR). The report includes employment, wage, and employer-provided health and retirement benefit information for full-time, part-time, and temporary positions.

In 2006 the Legislature extended the sales and use tax exemption for computer equipment and software to nonmanufacturing firms engaged in the development, design, and engineering of commercial airplanes and components of commercial airplanes. The B&O tax credit for preproduction development expenditures related to commercial aircraft was also extended to nonmanufacturing firms. Businesses that use these incentives file an annual report with the DOR.

In 2008 the Legislature extended aerospace tax programs to manufacturers, Federal Aviation Regulation (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. 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 Federal Aviation Administration 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.

Summary of Substitute Bill:

The expiration date is extended from 2024 to 2040 for the following aerospace tax preferences:

1. the preferential business and occupation (B&O) tax rate for the manufacturing, wholesaling, and retailing of commercial airplanes and airplane components;
2. the preferential B&O tax rate for the manufacturing, wholesaling, and retailing of tooling used in the manufacturing of commercial airplanes and airplane components;
3. the preferential B&O tax rate for retail sales by a FAR Part 145 certificated repair station;
4. the preferential B&O tax rate for businesses performing aerospace product development for others;
5. the B&O tax credit for aerospace product expenditures;
6. the B&O tax credit for property taxes and leasehold taxes on property used exclusively in manufacturing commercial airplanes or components of airplanes;
7. the sales and use tax exemptions for computer hardware, computer peripherals, and software used primarily in the development, design, and engineering of aerospace products; and
8. the leasehold excise tax exemption for lessees of port facilities used exclusively in manufacturing commercial airplanes.

The sales and use tax exemption for the construction of facilities used in the manufacturing of superefficient airplanes is modified to apply to facilities used for the manufacturing of commercial airplanes in general.

The bill is contingent upon the Department of Revenue making a determination that a final decision to locate a significant commercial airplane manufacturing program in the state of Washington has occurred. If a decision to locate a significant commercial airplane manufacturing program is not made by June 30, 2017, the bill is null and void. A significant commercial airplane manufacturing program that will culminate in the manufacture 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, fuselage and wing assembly, and fuselage and wing fabrication, of the airplane within the state.

The explicitly described public policy objective of the bill is to maintain and grow Washington's aerospace industry workforce. The Joint Legislative Audit and Review Committee (JLARC) is required to review the tax preferences provided in the bill by December 1, 2019, and every five years thereafter to determine whether this public policy objective is being achieved. The JLARC is required to specifically assess changes in aerospace industry employment in Washington in comparison with other states and internationally.

Substitute Bill Compared to Original Bill:

The substitute bill makes technical corrections that align terminology in section 2 of the bill. The substitute bill also clarifies that the preferential B&O tax rate for a new model or new

version of a commercial airplane will be discontinued if any of the major manufacturing activities with respect to the airplane are sited outside Washington.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The effective date is contingent upon the siting of a significant commercial airplane manufacturing program in the state of Washington.

Staff Summary of Public Testimony:

(In support) The advanced manufacturing of the carbon fiber wing is significant for the state. It will drive the advancement of additional carbon fiber manufacturing and additional advanced manufacturing in the state. This bill will reverse the trend of an outflow of advanced manufacturing jobs from the state, bringing these jobs back to Washington. Ten years ago a key tax incentive package was passed for the aerospace industry. This tax package would extend these key tax incentives which are a good deal for Washington. The proposal includes contingency language to ensure that 777x manufacturing jobs stay in Washington. If manufacturing jobs are moved out of state, the preferential tax rate for the remaining 777x manufacturing activities will be repealed. This bill will have huge direct, indirect, and induced economic benefits for the state. The machinists' union strongly supports this bill. The return on investment for building the 777x is three to one, paying for the tax breaks, therefore worth the investment. This tax package really just means three things: jobs, jobs, jobs. These jobs are not just for manufacturing but jobs in all the aerospace support industries throughout the state. The aerospace industry is the state's number one economic industry driving the state's economy and providing over 90,000 direct aerospace jobs, with an additional 200,000 plus indirect jobs for the state. This bill is essential in growing other aerospace jobs for suppliers and retailers across the state that support the industry.

(In support with concerns) This is an opportunity to extend the accountability measure to other manufacturing lines and the Legislature should consider doing so in this bill. The addition of a claw-back provision should also be considered to ensure jobs stay in this state. It is important that the Legislature consider how other programs will be paid for in the future due to the revenue impact these tax incentives will have on revenues that could be spent on other programs such as education.

(Neutral) The accountability provisions are a good start for this incentive package but could be stronger. A strict accountability section tied to actual jobs from other lines of airplane manufacturing should be considered. A claw-back provision for the migration of jobs out of the state from other manufacturing lines not directly tied to the accountability section of the bill should also be considered.

(With concerns) The lack of transparency for this specific legislation is cause for concern. There was not sufficient notice to the public for this hearing and it seems the rule for five

days notice does not apply to Boeing, but does apply to other small businesses. The requirement of project commencement is a thoughtful provision for accountability, but this type of long-term incentive is not afforded to small business; it should be. Small businesses account for almost half a million jobs in this state. Having the ability to plan because of long-term tax incentives should be used to benefit small businesses not just Boeing.

(Opposed) None.

Persons Testifying: (In support) Governor Jay Inslee; Larry Brown, International Association of Machinists; Dow Constantine, King County Executive; Pat McCarty, Pierce County Executive; John Lovick, Snohomish County Executive; Maud Dandon, Seattle Metropolitan Chamber of Commerce; Steve Mullin, Washington Roundtable; Mark Johnson, Washington Retail Association; Kris Johnson, Association of Washington Business; Dan Jorgenson, ATC Manufacturing; Paul Roberts, Everett City Council; John Mohr, Port of Everett; Troy McClelland, Snohomish County Economic Alliance; Linda Lanham, Aerospace Futures Alliance; Kirk Adams, Lighthouse for the Blind; John Theison, Orion Industries; Greg Root, GM Nameplate; Lynn Wallace, Renton Chamber of Commerce; Ken Colling, Seattle Goodwill; David Manger, Toray Composites America; Tom Pierson, Tacoma-Pierce County Chamber of Commerce; Bruce Kendall, Tacoma-Pierce County Economic Development Board; Jonathan Smith, Grant County Economic Development Council; Ted Sprague, Cowlitz Economic Development Council; Lew McMurrin; and Michael Schutzler, Washington Technology Industry Association.

(In support with concerns) Lonnie Johns-Brown, Our Economic Future Coalition.

(Neutral) Andy Nicholas, Washington Budget and Policy Center.

(With concerns) Patrick Connor, National Federation of Independent Business.

Persons Signed In To Testify But Not Testifying: None.

HOUSE COMMITTEE ON APPROPRIATIONS

Majority Report: The substitute bill by Committee on Finance be substituted therefor and the substitute bill do pass. Signed by 17 members: Representatives Hunter, Chair; Alexander, Ranking Minority Member; Chandler, Assistant Ranking Minority Member; Wilcox, Assistant Ranking Minority Member; Buys, Carlyle, Dahlquist, Harris, Hudgins, Hunt, Morrell, Parker, Pettigrew, Schmick, Seaquist, Springer and Sullivan.

Minority Report: Do not pass. Signed by 5 members: Representatives Ormsby, Vice Chair; Fagan, Haler, Jenkins and Taylor.

Staff: Jeffrey Mitchell (786-7139).

Summary of Recommendation of Committee On Appropriations Compared to Recommendation of Committee On Finance:

No new changes were recommended.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The effective date is contingent upon the siting of a significant commercial airplane manufacturing program in the State of Washington.

Staff Summary of Public Testimony:

(In support) The creation of the carbon fiber wing fabrication program at Renton would be the first of its kind in North America. It will drive the advancement of additional carbon fiber manufacturing and additional advanced manufacturing in the state. This bill will reverse the trend of an outflow of advanced manufacturing jobs from the state, bringing these jobs back to Washington. About half of the aerospace machinists will be eligible to retire within the next five years and those jobs will need to be replaced. These jobs are not just for manufacturing but jobs in all the aerospace support industries throughout the state. The aerospace industry is the state's number one economic industry driving the state's economy and providing over 90,000 direct aerospace jobs, with an additional 200,000 plus indirect jobs for the state. This is not just a Puget Sound issue but also affects Spokane and other areas of the state. This tax package would extend key aerospace tax incentives, which are a good deal for Washington. The proposal includes contingency language to ensure that 777x manufacturing jobs stay in Washington. This bill will have huge direct, indirect, and induced economic benefits for the state. The machinists' union strongly supports this bill. The return on investment for building the 777x is three to one, paying for the tax breaks, therefore worth the investment.

(With concerns) The lack of transparency for this specific legislation is cause for concern. There was not sufficient notice to the public for this hearing and it seems the rule for five days notice does not apply to Boeing, but does apply to other small businesses. The requirement of project commencement is a thoughtful provision for accountability but this type of long-term incentive is not afforded to small business; it should be. Small businesses account for almost half a million jobs in this state. Having the ability to plan because of long-term tax incentives should be used to benefit small businesses not just Boeing. There is a need to ensure there is growth in the aerospace sector here in Washington and to be supportive of the provisions in the bill that require some accountability and reporting back through Joint Legislative Audit and Review Committee on whether and how jobs are created, as well as the trigger that does not provide the tax incentive if jobs move out of Washington. A claw-back provision for some sort of restitution to the state if the jobs move out of state, as they did under the 787 deal, would be helpful. We support the application of the accountability provisions that are in this bill to the existing 787 lines that are here in Washington so those jobs do not go elsewhere, too.

(Opposed) None.

Persons Testifying: (In support) Alex Pietsch, Office of the Governor; Paul Roberts, City of Everett; John Mohr, Port of Everett; Larry Brown, Aerospace Machinists; and George Allen, Seattle Chamber of Commerce.

(With concerns) Patrick Connor, National Federation of Independent Business; Andy Nicholas, Washington Budget and Policy Center; and Nick Federici, Our Economic Future Coalition.

Persons Signed In To Testify But Not Testifying: None.