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AMENDATORY SECTION (Amending WSR 03-12-053, filed 5/30/03, effective 6/30/03)

WAC 458-20-24003 Tax incentives for high technology businesses. (1)

Introduction. This rule explains the tax incentives, contained in chapter [82.63](#) RCW and RCW [82.04.4452](#), which apply to businesses engaged in research and development or pilot scale manufacturing in Washington in five high technology areas: Advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology. Eligibility for high technology or research and development tax incentives offered by the federal government or any other jurisdiction does not establish eligibility for Washington's programs.

(2) **Definitions.** For purposes of this rule, the following definitions apply unless otherwise required by the context.

(a) "Advanced computing" means technologies used in the designing and developing of computing hardware and software, including innovations in designing the full spectrum of hardware from hand-held calculators to super computers, and peripheral equipment.

(b) "Advanced materials" means materials with engineered properties created through the development of specialized processing and synthesis technology, including ceramics, high value-added metals, electronic materials, composites, polymers, and biomaterials.

(c) "Applicant" means a person applying for a tax deferral under chapter [82.63](#) RCW.

(d) "Biotechnology" means the application of technologies, such as recombinant DNA techniques, biochemistry, molecular and cellular biology, genetics, including genomics, gene expression and genetic engineering, cell fusion techniques, and new bioprocesses, using living organisms, or parts of organisms, to produce or modify products, to improve plants or animals, to develop microorganisms for specific uses, to identify targets for small molecule pharmaceutical development, or to transform biological systems into useful processes and products or to develop microorganisms for specific uses.

(e) "Electronic device technology" means technologies involving microelectronics; semiconductors; electronic equipment and instrumentation; radio frequency, microwave, and millimeter electronics; optical and optic-electrical devices; and data and digital communications and imaging devices.

(f) "Eligible investment project" means an investment project which either initiates a new operation, or expands or diversifies a current operation by expanding, renovating, or equipping an existing facility.

(i) Prior to June 10, 2004, ((The)) the lessor or owner of the qualified building is not eligible for a deferral unless the underlying ownership of the buildings, machinery, and equipment vests exclusively in the same person, or unless the lessor by written contract agrees to pass the economic benefit of the deferral to the lessee in the form of reduced rent payments.

(ii) Effective June 10, 2004, the lessor or owner of the qualified building is not eligible for a deferral unless:

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(A) The underlying ownership of the buildings, machinery, and equipment vests exclusively in the same person; or

(B) All of the following conditions are met:

(I) The lessor by written contract agrees to pass the economic benefit of the deferral to the lessee;

(II) The lessee that receives the economic benefit of the deferral agrees in writing with the department to complete the annual survey required under RCW 82.63.020(2);

(III) The lessee must receive an economic benefit from the lessor no less than the amount of tax deferred by the lessor; and

(IV) Upon request, the lessor must provide the department with written documentation to support the eligibility of the deferral, including any type of payment, credit, or other financial arrangement between the lessor or owner of the qualified building and the lessee.

(g) "Environmental technology" means assessment and prevention of threats or damage to human health or the environment, environmental cleanup, and the development of alternative energy sources.

(i) The assessment and prevention of threats or damage to human health or the environment concerns assessing and preventing potential or actual releases of pollutants into the environment that are damaging to human health or the environment. It also concerns assessing and preventing other physical alterations of the environment that are damaging to human health or the environment.

(A) Pollutants include waste materials or by-products from manufacturing or other activities.

(B) Environmental technology includes technology to reduce emissions of harmful pollutants but does not include technology to increase fuel economy. Where technology both reduces emissions and increases fuel economy, it is environmental technology if the primary purpose is to reduce emissions. That reducing emissions is the primary purpose of technology can be demonstrated by showing the technology is developed to meet governmental emission standards.

(C) Environmental technology does not include technology for preventive health measures for, or medical treatment of, human beings.

(ii) Environmental cleanup is corrective or remedial action to protect human health or the environment from releases of pollutants into the environment.

(iii) Alternative energy sources are those other than traditional energy sources such as fossil fuels, nuclear power, and hydroelectricity. However, when traditional energy sources are used in conjunction with the development of alternative energy sources, all the development will be considered the development of alternative energy sources.

(h) "Investment project" means an investment in qualified buildings or qualified machinery and equipment, including labor and services rendered in the planning, installation, and construction or improvement

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of the project.

(i) "Person" has the meaning given in RCW 82.04.030; effective June 10, 2004, "person" also includes state universities as defined in RCW 28B.10.016.

(j) "Pilot scale manufacturing" means design, construction, and testing of preproduction prototypes and models in the fields of biotechnology, advanced computing, electronic device technology, advanced materials, and environmental technology other than for commercial sale. "Commercial sale" excludes sales of prototypes or sales for market testing if the total gross receipts from such sales of the product, service, or process do not exceed one million dollars.

(k) "Qualified buildings" means construction of new structures, and expansion or renovation of existing structures for the purpose of increasing floor space or production capacity, used for pilot scale manufacturing or qualified research and development, including plant offices and other facilities that are an essential or an integral part of a structure used for pilot scale manufacturing or qualified research and development.

(i) If a building is used partly for pilot scale manufacturing or qualified research and development and partly for other purposes, the applicable tax deferral shall be determined as follows:

(A) Tax on the cost of construction of areas devoted solely to pilot scale manufacturing or research and development may be deferred.

(B) Tax on the cost of construction of areas not used at all for pilot scale manufacturing or research and development may not be deferred.

(C) Tax on the cost of construction of areas used in common for pilot scale manufacturing or research and development and for other purposes, such as hallways, bathrooms, and conference rooms, may be deferred by apportioning the costs of construction on a square footage basis. The apportioned costs of construction eligible for deferral are established by using the ratio, expressed as a percentage, of the square feet of the construction, expansion, or renovation devoted to pilot scale manufacturing or qualified research and development, excluding areas used in common to the total square feet of the construction, expansion, or renovation, excluding areas used in common. That percentage is applied to the cost of construction of the common areas to determine the costs of construction eligible for tax deferral. Expressed as a formula, apportionment of the cost of the common areas is determined by:

$$\frac{\text{Square feet devoted to research and development or pilot scale manufacturing, excluding square feet of common areas}}{\text{Total cost of construction of common areas}} = \text{Percentage of total cost of construction of common areas}$$

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areas
eligible for
deferral

Total square feet,
excluding square feet of
common areas

(D) The apportionment method described in (A), (B), and (C) above shall be used unless the applicant or recipient can demonstrate that another method better represents a reasonable apportionment of costs, considering all the facts and circumstances.

(ii) Building construction does not include the construction of landscaping or most other work outside the building itself. However, it does include the construction of parking lots connected to or adjacent to the building if the parking lots are for the use of workers performing pilot scale manufacturing or research and development in the building.

(l) "Qualified machinery and equipment" means fixtures, equipment, and support facilities that are an integral and necessary part of a pilot scale manufacturing or qualified research and development operation. "Qualified machinery and equipment" includes: Computers; software; data processing equipment; laboratory equipment, instrumentation, and other devices used in a process of experimentation to develop a new or improved pilot model, plant process, product, formula, invention, or similar property; manufacturing components such as belts, pulleys, shafts, and moving parts; molds, tools, and dies; vats, tanks, and fermenters; operating structures; and all other equipment used to control, monitor, or operate the machinery. For purposes of this rule, qualified machinery and equipment must be either new to the taxing jurisdiction of the state or new to the certificate holder, except that used machinery and equipment may be treated as qualified machinery and equipment if the certificate holder either brings the machinery and equipment into Washington or makes a retail purchase of the machinery and equipment in Washington or elsewhere.

(i) Machinery and equipment is an integral and necessary part of pilot scale manufacturing or qualified research and development if the pilot scale manufacturing or qualified research and development could not be accomplished without it. A laboratory table would be integral and necessary to qualified research and development. Decorative artwork would not be integral and necessary to qualified research and development.

(ii) Qualified machinery and equipment must be used exclusively for pilot scale manufacturing or qualified research and development to qualify for the deferral. However, *de minimis* nonqualifying use will not cause the loss of the deferral. An example of *de minimis* use is the occasional use of a computer for personal e-mail.

(iii) Unlike buildings, if machinery and equipment is used for both qualifying and nonqualifying purposes, the costs may not be apportioned. Sales or use tax may not be deferred on the purchase or use of machinery and equipment used for both qualifying and nonqualifying purposes.

(m) "Qualified research and development" means research and development performed within this state in the fields of advanced computing, advanced materials, biotechnology, electronic device

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technology, and environmental technology.

(n) "Qualified research and development expenditures" means operating expenses, including wages, compensation of a proprietor or a partner in a partnership, benefits, supplies, and computer expenses, directly incurred in qualified research and development by a person claiming the business and occupation tax credit provided by RCW [82.04.4452](#). The term does not include amounts paid to a person other than a public educational or research institution to conduct qualified research and development. Nor does the term include capital costs and overhead, such as expenses for land, structures, or depreciable property.

(i) In order for an operating expense to be a qualified research and development expenditure, it must be directly incurred in qualified research and development. If an employee performs qualified research and development activities and also performs other activities, only the wages and benefits proportionate to the time spent on qualified research and development activities are qualified research and development expenditures under this rule. The wages of employees who supervise or are supervised by persons performing qualified research and development are qualified research and development expenditures to the extent the work of those supervising or being supervised involves qualified research and development.

(ii) The compensation of a proprietor or a partner is determined in one of two ways:

(A) If there is net income for federal income tax purposes, the amount reported subject to self-employment tax is the compensation.

(B) If there is no net income for federal income tax purposes, reasonable cash withdrawals or cash advances are the compensation.

~~(iii) ((Depreciable property within the meaning of this rule is any property with a useful life that extends beyond the accounting year in which it is acquired, regardless of whether the property is depreciated or currently expensed. Expenditures related to depreciable property are not qualified research and development expenditures within the meaning of this rule even though they are currently expensed.))~~ Depreciable property is any property with a useful life of at least a year. Expenses for depreciable property will not constitute qualified research and development expenditures even if such property may be fully deductible for federal income tax purposes in the year of acquisition.

(iv) Computer expenses do not include the purchase, lease, rental, maintenance, ~~((or))~~ repair or upgrade of equipment or software. They do include internet subscriber fees, run time on a mainframe computer, and outside processing.

(v) Training expenses for employees are qualified research and development expenditures if the training is directly related to the research and development being performed. Training expenses include registration fees, materials, and travel expenses. Although the research and development must occur in Washington, training may take place outside of Washington.

(vi) Qualified research and development expenditures include the cost of clinical trials for drugs and certification by Underwriters Laboratories.

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(vii) Qualified research and development expenditures do not include legal expenses, patent fees, or any other expense not incurred directly for qualified research and development.

(viii) Stock options granted as compensation to employees performing qualified research and development are qualified research and development expenditures to the extent they are reported on the W-2 forms of the employees and are taken as a deduction for federal income tax purposes by the employer.

(ix) Preemployment expenses related to employees who perform qualified research and development are qualified research and development expenditures. These expenses include recruiting and relocation expenses and employee placement fees.

(o) "Research and development" means activities performed to discover technological information, and technical and nonroutine activities concerned with translating technological information into new or improved products, processes, techniques, formulas, inventions, or software.

The term includes exploration of a new use for an existing drug, device, or biological product if the new use requires separate licensing by the Federal Food and Drug Administration under chapter 21 CFR, as amended.

The term does not include adaptation or duplication of existing products where the products are not substantially improved by application of the technology, nor does the term include surveys and studies, social science and humanities research, market research or testing, quality control, sale promotion and service, computer software developed for internal use, and research in areas such as improved style, taste, and seasonal design.

(i) A person need not both discover technological information and translate technological information into new or improved products, processes, techniques, formulas, inventions, or software in order to engage in research and development. A person may perform either activity alone and be engaged in research and development.

(ii) To discover technological information means to gain knowledge of technological information through purposeful investigation. The knowledge sought must be of something not previously known or, if known, only known by persons who have not made the knowledge available to the public.

(iii) Technological information is information related to the application of science, especially with respect to industrial and commercial objectives. Industrial and commercial objectives include both sale and internal use (other than internal use software). The translation of technological information into new or improved products, processes, techniques, formulas, inventions, or software does not require the use of newly discovered technological information to qualify as research and development.

(iv) The translation of technological information requires both technical and nonroutine activities. An activity is technical if it involves the application of scientific, engineering, or computer science methods or principles. The term "nonroutine" refers to the specific activities undertaken to achieve a desired result. A customized or

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unique result is not by itself conclusive proof that it was the product of nonroutine activities. Indicia of nonroutine activities include, but are not limited to:

(A) The activity involves overcoming one or more technological barriers under circumstances where the outcome is not certain(~~(+)~~). If it is certain at the outset that the barrier can be overcome, then the activity lacks this particular one of the indicia of a nonroutine activity.

For example, where it is not known when design and testing activities begin whether new materials can be combined to achieve an improved product using new materials, is one of the indicia of the type of uncertainty that will characterize the activities as nonroutine. On the other hand, design and testing activities for improving a product using new materials without any uncertainty about whether the materials can be combined to achieve the desired result lacks this particular one of the indicia of a nonroutine activity.

(B) The activity has not been done before(~~(+ or)~~). The activity must possess something more than mere cosmetic or contextual newness. The presence of a superficial or minor new element is insufficient to characterize the activity as nonroutine. If the means by which a new product is developed are known, or readily discernable, then the activity undertaken to facilitate that development are more likely to be considered routine. Simply because a product or process has not been in existence before does not make its creation nonroutine if the methods to produce the product is known.

For example, an activity that has not been done before that results in or produces discovery and innovation that leads to development of a patentable product is presumed to have involved a nonroutine activity. On the other hand, an activity performed using an existing and known method to produce a new or improved product lacks this particular one of the indicia of a nonroutine activity.

(C) The activity involves a process of experimentation. A process of experimentation is an example of the particular means by which new information is acquired that allows for the technology to be translated into new products.

For example, an activity involved with testing for the purpose of confirmation lacks this particular one of the indicia of a nonroutine activity. On the other hand, an activity involved with discovery of new information and answers has this particular one of the indicia of a nonroutine activity involving a process of experimentation.

(v) A product is substantially improved when it functions fundamentally differently because of the application of technological information. This fundamental difference must be objectively measured, although the R&D involved in developing this fundamental difference does not need to be successful in order for a product to be considered substantially improved. Examples of objective measures include increased value, faster operation, greater reliability, and more efficient performance.

(vi) Computer software is developed for internal use if it is to be used only by the person by whom it is developed. If it is to be available for sale, lease, or license, it is not developed for internal

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use, even though it may have some internal applications. If it is to be available for use by persons, other than the person by whom it is developed, who access or download it remotely, such as through the internet, it is not usually deemed to be developed for internal use. However, remotely accessed software is deemed to be developed for internal use if its purpose is to assist users in obtaining goods, services, or information provided by or through the person by whom the software is developed. For example, software is developed for internal use if it enables or makes easier the ordering of goods from or through the person by whom the software is developed. On the other hand, a search engine used to search the World Wide Web is an example of software that is not developed for internal use because the search engine itself is the service sought.

(vii) Research and development is complete when the product, process, technique, formula, invention, or software can be reliably reproduced for sale or commercial use. However, the improvement of an existing product, process, technique, formula, invention, or software may qualify as research and development.

(p) "Research and development spending" means qualified research and development expenditures plus eighty percent of amounts paid to a person other than a public educational or research institution to conduct qualified research and development.

(q) "Taxable amount" means the taxable amount subject to business and occupation tax required to be reported on the person's combined excise tax returns for the year for which the credit is claimed, less any taxable amount for which a multiple activities tax credit is allowed under RCW [82.04.440](#). See WAC [458-20-19301](#) for information on the multiple activities tax credit.

(3) **Sales and use tax deferral.** Chapter [82.63](#) RCW provides for the deferral of sales and use taxes on eligible investment projects. These are projects that involve research and development or pilot scale manufacturing in five high technology areas: Advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology.

(a) **Application process.**

(i) Applicants must apply for deferral to the department of revenue before the initiation of construction of, or acquisition of equipment or machinery for the investment project. The date of application is the earlier of the postmark date or the date of receipt by the department.

(A) Effective June 10, 2004, initiation of construction means the date that a building permit is issued under the building code adopted under RCW 19.27.031 for:

(I) Construction of the qualified building, if the underlying ownership of the building vests exclusively with the person receiving the economic benefit of the deferral;

(II) Construction of the qualified building, if a lessor passes the economic benefits of the deferral to a lessee as provided in RCW [82.63.010\(7\)](#); or

(III) Tenant improvements for a qualified building, if a lessor

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passes the economic benefits of the deferral to a lessee as provided in RCW 82.63.010(7).

(B) Effective June 10, 2004, initiation of construction does not include soil testing, site clearing and grading, site preparation, or any other related activities that are initiated before the issuance of a building permit for the construction of the foundation of the building.

(C) Effective June 10, 2004, if the investment project is a phased project, initiation of construction must apply separately to each phase.

~~((A))~~ (D) Prior to June 10, 2004, ((Construction)) construction is initiated when workers start on-site building tasks. The initiation of construction does not include land clearing or site preparation prior to excavation of the building site. Also, the initiation of construction does not include design or planning activities.

~~((B))~~ (E) Equipment or machinery is acquired at the time the applicant or its agent obtains dominion and control of the equipment or machinery.

(ii) Application forms may be obtained at department of revenue district offices, by downloading from the department's website (dor.wa.gov), by telephoning the telephone information center (800-647-7706), or by contacting the department's special programs division at:

Department of Revenue
Special Programs Division
Post Office Box 47477
Olympia, WA 98504-7477
FAX 360-586-2163

(iii) Applicants must mail or fax applications to the special programs division at the address or fax number given above.

(iv) The application form shall include information regarding the location of the investment project, the applicant's average employment in Washington 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, and time schedules for completion and operation. The application form may also include other information relevant to the project and the applicant's eligibility for deferral.

~~((v) Applicants must agree to supply the department with nonproprietary information necessary to measure the results of the tax deferral program.)~~

~~((vi))~~ (v) Applications ~~((and other information))~~ received by the department in connection with the deferral program are not confidential and are subject to public disclosure.

~~((vii))~~ (vi) The department must rule on an application within sixty days. If an application is denied, the department must explain in writing the basis for the denial. An applicant may appeal a denial within thirty days under WAC [458-20-100](#).

(b) **Deferral certificate.**

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(i) If an application is approved, the department must issue the applicant a sales and use tax deferral certificate.

(ii) The certificate provides for deferral of state and local sales and use taxes on the eligible investment project. The certificate will state the amount of tax deferral for which the recipient is eligible. It will also state the date by which the project will be operationally complete. The deferral is limited to investment in qualified buildings or qualified machinery and equipment. The deferral does not apply to the taxes of persons with whom the recipient does business, persons the recipient hires, or employees of the recipient.

(iii) A successful applicant, hereafter referred to as a recipient, must present a copy of the certificate to sellers of goods or retail services provided in connection with the eligible investment project in order to avoid paying sales or use tax. Sellers who accept these certificates in good faith are relieved of the responsibility to collect sales or use tax on transactions covered by the certificates. Sellers must retain copies of certificates as documentation for why sales or use tax was not collected on a transaction.

(iv) In cases of leases of qualifying machinery and equipment, the deferral certificate allows for deferral of tax on payments made during the initial term of the lease, and does not allow for deferral for extensions or renewals of the lease. Deferral of tax is not allowed for lease payments for any period after the seventh calendar year following the calendar year for which the project is certified as operationally complete.

(v) The certificate may not be used to defer tax on repairs to, or replacement parts for, qualified machinery and equipment.

(vi) The department may not issue a certificate for an investment project that has already received a deferral under chapters [82.60](#), [82.61](#), or [82.63](#) RCW, except that an investment project for qualified research and development that has already received a deferral may also receive an additional deferral certificate for adapting the investment project for use in pilot scale manufacturing. However, a certificate may be amended or a certificate issued for a new investment project at an existing facility.

(c) Amendment of application or certificate.

(i) Applicants and recipients may make written requests to the special programs division to amend an application or certificate.

(ii) Grounds for requesting amendment include, but are not limited to:

(A) The project will exceed the costs originally stated;

(B) The project will take more time to complete than originally stated;

(C) The original application is no longer accurate because of changes in the project;

(D) Transfer of ownership of the project.

(iii) The department must rule on the request within sixty days. If

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the request is denied, the department must explain in writing the basis for the denial. An applicant or recipient may appeal a denial within thirty days under WAC [458-20-100](#).

(d) Certification.

(i) When the building, machinery, or equipment is ready for use, the recipient must notify the special programs division in writing that the eligible investment project is operationally complete. The department shall, after appropriate investigation: Certify that the project is operationally complete; not certify the project; or certify only a portion of the project. The certification will include the year in which the project is operationally complete.

(ii) If all or any portion of the project is not certified, the recipient must repay all or a proportional part of the deferred taxes. The department will notify the recipient of the amount due, including interest, and the due date.

(iii) The department must explain in writing the basis for not certifying all or any portion of a project. The decision of the department to not certify all or a portion of a project may be appealed under WAC [458-20-100](#) within thirty days.

(e) Repayment of deferred taxes.

(i) Deferred taxes need not be repaid if the investment project is used only for qualified research and development or pilot scale manufacturing during the calendar year for which the department certifies the investment project as operationally complete and during the succeeding seven calendar years.

(ii) Deferred taxes must be repaid if an investment project is used for purposes other than qualified research and development or pilot scale manufacturing during the calendar year for which the department certifies the investment project as operationally complete or at any time during any of the succeeding seven calendar years. Taxes are immediately due according to the following schedule:

Year in which nonqualifying use occurs	% of deferred taxes due
1	100%
2	87.5%
3	75%
4	62.5%
5	50%
6	37.5%
7	25%
8	12.5%

Interest on the taxes, but not penalties, must be paid retroactively to the date of deferral.

(iii) However, if the investment project is used for purposes other than qualified research and development or pilot scale manufacturing during the first eight years, deferred taxes need not be repaid on particular items if the purchase or use of the item would have qualified

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for the machinery and equipment sales and use tax exemptions provided by RCW [82.08.02565](#) and [82.12.02565](#) (discussed in WAC [458-20-13601](#)) at the time of purchase or first use.

(iv) Deferred taxes need not be repaid if qualified machinery and equipment on which the taxes were deferred is destroyed, becomes inoperable and cannot be reasonably repaired, wears out, or becomes obsolete and is no longer practical for use in the project. The use of machinery and equipment which becomes obsolete for purposes of the project and is used outside the project is subject to use tax at the time of such use.

(f) **Transfer of deferral.** Transfer of ownership does not terminate the deferral. The deferral may be transferred to the new owner if the new owner meets all eligibility requirements for the remaining periods of the deferral. The new owner must apply for an amendment to the deferral certificate. If the deferral is transferred, the new owner is liable for repayment of deferred taxes under the same terms as the original owner. If the new owner is a successor to the previous owner under the terms of WAC [458-20-216](#) and the deferral is not transferred, the new owner's liability for deferred taxes is limited to those that are due for payment at the time ownership is transferred.

(g) **No extinguishment of debt.** The debt for deferred taxes will not be extinguished by the insolvency or other failure of the recipient.

(h) **Expiration of sales and use tax deferral program.** The authority of the department to issue deferral certificates expires (~~July 1, 2004~~) January 1, 2015.

(i) Reporting and monitoring procedure.

(i) Applicants for deferral of taxes under chapter 82.63 RCW must complete an annual survey. If an applicant passes the economic benefits of the deferral to a lessee as provided in RCW 82.63.010(7), the lessee must agree to complete the annual survey and the applicant is not required to complete the annual survey.

(ii) The survey is due by March 31st of the year following the calendar year in which the investment project is certified by the department as having been operationally complete and the seven succeeding calendar years.

(iii) The applicant, or its lessee, must complete the survey in a form and manner prescribed by the department. The completed survey may be sent by fax to 360-586-2163 or mailed to the following address:

State of Washington
Department of Revenue
Special Programs Division
P.O. Box 47477
Olympia, WA 98504-7477

The U.S. Post Office postmark or fax date will be used as the date of the submittal.

(iv) If the recipient fails to submit the annual survey by the due date, twelve and one-half percent of the deferred tax is immediately

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due. If an investment project is used for purposes other than qualified research and development or pilot scale manufacturing at any time during the calendar year in which the investment project is certified as having been operationally complete, and the recipient of the deferral fails to submit the annual survey by the due date, then the portion of deferred taxes immediately due is the amount provided in RCW 82.63.045(2)(a).

(v) All information collected in annual surveys, except the amount of tax deferral taken, is confidential and not subject to disclosure. Information on the amount of tax deferral taken in annual surveys is not confidential and may be disclosed to the public upon request.

(j) **Persons engaged in construction activities for the federal government.** Effective June 10, 2004, persons engaged in the business of constructing, repairing, decorating, or improving new or existing buildings or other structures under, upon, or above real property of or for the United States, or any instrumentality thereof, are not liable for sales and use tax on tangible personal property incorporated into, installed in, or attached to such building or other structure, if the investment project would qualify for sales and use tax deferral under chapter 82.63 RCW if undertaken by a private entity.

(4) **Examples relating to the sales and use tax deferral program.** The following examples identify a number of facts and then state a conclusion. These examples should be used only as a general guide. The tax status of each situation must be determined after a review of all of the facts and circumstances. Assume all the examples below occur on or after June 10, 2004.

(a) Lessor and lessee examples.

(i) Prior to the initiation of construction, Owner/Lessor A enters into an agreement with Lessee B, a company engaged in qualified research and development. Under the agreement, A will build a building to house B's research and development activities, will apply for a tax deferral on construction of the building, will lease the building to B, and will pass on the entire value of the deferral (~~((through reduced rent payments))~~) to B. B agrees in writing with the department to complete annual surveys. A applies for the deferral before (~~((construction begins))~~) the date the building permit is issued. A is entitled to a deferral on building construction costs.

(ii) After construction has begun, Lessee C asks that certain tenant improvements be added to the building. Lessor D and Lessee C each agree to pay a portion of the cost of the improvements. D agrees with C in a written agreement that D will pass on the entire value of D's portion of the tax deferral to C, and C agrees in writing with the department to complete annual surveys. C and D each apply for a deferral on the costs of the tenant improvements they are legally responsible for before (~~((work on the tenant improvements has begun))~~) the date building permit is issued for such tenant improvements. Both applications (~~((may))~~) will be approved. While construction of the building was initiated before the applications were submitted, tenant improvements on a building under construction are deemed to be the expansion or renovation of an existing structure. Also, lessees are entitled to the deferral only if they are legally responsible and actually pay contractors for the improvements, rather than merely reimbursing lessors for the costs.

(iii) After construction has begun but before machinery or

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equipment has been acquired, Lessee E applies for a deferral on machinery and equipment. The application will be approved, and E is required to complete annual surveys. Even though it is too late to apply for a deferral of tax on building costs, it is not too late to apply for a deferral for the machinery and equipment.

(b) **Apportionment of building costs.** A building to be constructed will be partially devoted to research and development and partially devoted to marketing, a nonqualifying purpose. The total area of the building is one hundred thousand square feet. Sixty thousand square feet are used only for research and development, twenty thousand square feet are used only for marketing, and the remaining twenty thousand square feet are used in common by research and development employees and marketing employees. Tax on the cost of constructing the sixty thousand square feet used only for research and development may be deferred. Tax on the cost of constructing the twenty thousand square feet used only for marketing may not be deferred. Tax on seventy-five percent of the cost of constructing the common areas may be deferred. (Sixty thousand square feet devoted solely to research and development divided by eighty thousand square feet devoted solely to research and development and marketing results in a ratio expressed as seventy-five percent.)

(5) **Business and occupation tax credit.** RCW [82.04.4452](#) provides for a business and occupation tax credit for persons engaging in research and development in Washington in five areas of high technology: Advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology.

(a) **Eligibility for the credit.** Persons are eligible for the credit if their research and development spending in the calendar year for which credit is claimed exceeds 0.92 percent of the person's taxable amount for the same calendar year.

(b) **Calculating the credit.**

(i) Prior to July 1, 1998. The amount of the credit is equal to the greater of:

the person's qualified research and development expenditures

or

eighty percent of amounts received by a person other than a public educational or research institution as compensation for conducting qualified research and development

multiplied by 0.00515 in the case of a nonprofit corporation or association, and

multiplied by 0.025 in the case of all other persons.

(ii) (~~On and after~~) From July 1, 1998 to June 30, 2004. The amount of the credit is equal to the greater of:

the person's qualified research and development expenditures

or

eighty percent of amounts received by a person other than a public

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educational or research institution as compensation for conducting qualified research and development

multiplied by 0.00484 in the case of a nonprofit corporation or association, and

multiplied by 0.015 in the case of all other persons.

(iii) On and after July 1, 2004. The amount of the credit is calculated as follows:

(A) A business must first determine the greater of the person's qualified research and development expenditures
_____ or

eighty percent of amounts received by a person other than a public educational or research institution as compensation for conducting qualified research and development.

(B) Then the business subtracts, from the amount determined under (A) of this subsection, 0.92 percent of its taxable amount. If 0.92 percent of the taxable amount exceeds the amount determined under (A) of this subsection, the business is not eligible for the credit. Taxable amount is the total amount subject to business and occupation tax after deductions are taken; it does not include any amount for which a multiple activities tax credit is allowed.

(C) The credit is calculated by multiplying the amount determined under (B) of this subsection by:

0.00484 in the case of a nonprofit corporation or association

_____ or

the person's average tax rate in the case of all other persons.

~~((iii))~~ (iv) Persons calculating the credit on the basis of amounts received for conducting qualified research and development must actually perform the research and development themselves. Amounts received for conducting qualified research and development that are paid to other persons who actually perform some or all of the qualified research and development contracted for may not be included in the calculation.

~~((iv))~~ (v) The credit for any calendar year may not exceed the lesser of two million dollars or the amount of business and occupation tax otherwise due for the calendar year.

~~((v))~~ (vi) Credits may not be carried forward or carried back to other calendar years.

(c) Claiming the credit.

~~((The first time persons claim the credit they must complete an Initial Survey, Research and Development Credit form (26 0005) and mail it to the address indicated on the form. The purpose of the initial survey is to gather information necessary to measure the results of the credit program. By law, persons claiming the credit must agree to~~

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provide this information.)) Each person claiming the credit must submit an annual report by March 31st of the year following any year in which a credit is taken. The person must complete the report in a form and manner prescribed by the department.

(ii) ~~((Credits are claimed on the person's combined excise tax return. Every time a credit is claimed, the person making the claim must complete and attach a Declaration, Research and Development Credit form (26 0003) to the return.))~~ In addition, each person claiming the credit must submit an annual survey by March 31st of the year following any year in which a credit is taken. The person must complete the survey in a form and manner prescribed by the department.

If a person fails to submit the annual survey by the due date, the person is not eligible to take or assign the credit in the year the person failed to submit the survey by the due date.

All information collected in annual surveys, except the amount of tax credit taken, is confidential and not subject to disclosure. Information on the amount of tax credit taken in annual surveys is not confidential and may be disclosed to the public upon request, except that persons taking less than ten thousand dollars of credit during the period covered by the survey may request the department to treat the tax credit amount as confidential.

(iii) ~~((The Initial Survey and Declaration forms used in the credit program may be obtained at department of revenue district offices, by downloading from the department's website (dor.wa.gov), or by telephoning the telephone information center (800 647 7706).))~~ The completed report and survey may be sent by fax to 360-586-0527 or mailed to the following address:

State of Washington
Department of Revenue
Taxpayer Account Administration
P.O. Box 47476
Olympia, WA 98504-7476

The U.S. Post Office postmark or fax date will be used as the date of the submittal.

(d) Assignment of the credit.

(i) A person entitled to the credit because of qualified research and development conducted under contract for another person may assign all or a portion of the credit to the person who contracted for the performance of the qualified research and development.

(ii) The assignment is accomplished by use of the ~~((Declaration, Research and Development Credit form))~~ annual report, referred to in ~~((e)(ii))~~ (c)(i) of this subsection. Both the person assigning the credit and the person receiving the credit must file this annual report.

(iii) Both the ~~((person assigning the credit and the person receiving the credit))~~ assignor and the assignee must be eligible under (a) of this subsection for the assignment to be valid.

(iv) The total of the credit claimed and the credit assigned by a person assigning credit may not exceed the lesser of two million dollars or the amount of business and occupation tax otherwise due from the

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assignor in any calendar year.

(v) The total of the credit claimed, including credit received by assignment, may not exceed the lesser of two million dollars or the amount of business and occupation tax otherwise due from the assignee in any calendar year.

(e) **Expiration.** The business and occupation tax credit program for high technology businesses expires (~~(December 31, 2004)~~) January 1, 2015.

(6) **Examples relating to the credit program.** The following examples identify a number of facts and then state a conclusion. These examples should be used only as a general guide. The tax status of each situation must be determined after a review of all of the facts and circumstances. The calculations described in subsections (a) and (b) below are only used for expenditures, tax, and taxable amounts attributable to activity taking place on and after July 1, 2004.

(a) A business, not a nonprofit corporation or association, (~~(which)~~) that engages in qualified research and development, has a taxable amount of (~~(ten million dollars)~~) \$10,000,000 in (~~(2002)~~) a year. It pays (~~(eighty thousand dollars)~~) \$80,000 in (~~(2002)~~) that year in wages and benefits to employees directly engaged in qualified research and development. (~~(Also during 2002, it pays twenty thousand dollars to a person that is not a public educational or research institute to conduct qualified research and development. It is eligible to claim the credit for 2002. Its research and development spending, ninety six thousand dollars (eighty thousand dollars in wages plus eighty percent of twenty thousand dollars for contracted research and development) is more than ninety two thousand dollars (0.92 percent of its taxable amount, ten million dollars).~~)) The business has no other qualified research and development expenditures.

~~((The amount of credit is one thousand two hundred dollars. This is determined by multiplying its qualified research and development expenditures, eighty thousand dollars, by 0.015. The contracted amount is not included in the credit computation.))~~ Its qualified research and development expenditures of \$80,000 are less than \$92,000 (0.92 percent of its taxable amount of \$10,000,000). If a business's qualified research and development expenditures (or eighty percent of amounts received for the conduct of qualified research and development) are less than 0.92 percent of its taxable amount, it is not eligible for the credit.

(b) A business, not a nonprofit corporation or association, that engages in qualified research and development, has a taxable amount of \$10,000,000 in a year. Seven million dollars of this amount is taxable at the rate of 0.015 under the B&O tax classification for services and \$3,000,000 is taxable at the rate of 0.00484 under the B&O tax classification for royalties. The business pays \$119,520 in B&O tax for this reporting period. It pays \$200,000 in that year to employees directly engaged in qualified research and development. The business has no other qualified research and development expenditures.

In order to determine the amount of its credit, the business subtracts \$92,000 (0.92 percent of its taxable amount of \$10,000,000) from \$200,000, its qualified research and development expenditures. The resulting amount of \$108,000 multiplied by the business's average tax rate equals the amount of the credit.

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The business's average tax rate is determined by dividing its B&O tax of \$119,520 by its taxable amount of \$10,000,000. The result, 0.01195, is multiplied by \$108,000 to determine the amount of the credit. The credit is \$1,291 (\$1,290.60 rounded to the nearest whole dollar).

~~((b))~~ (c) A company that engages in environmental cleanup contracted to clean up a site. It had never faced exactly the same situation before, but guaranteed at the outset that it could do the job. It used a variety of existing technologies to accomplish the task in a combination it had never used before. The company was not engaged in research and development in performing this contract. It applied existing technologies in a routine manner, considering the nature of its business, and the outcome was certain.

~~((e))~~ (d) Company A is engaged in research and development in biotechnology and needs to perform standard blood tests as part of its development of a drug. It contracts with a lab, B, to perform the tests. The costs of the tests are qualified research and development expenditures for A, the company engaged in the research and development. Although the tests themselves are routine, they are only a part of what A is doing in the course of developing the drug. B, the lab contracted to perform the testing, is not engaged in research and development with respect to the drug being developed. B is neither discovering technological information nor is it translating technological information into new or improved products, processes, techniques, formulas, inventions, or software. B is not entitled to a credit on account of the compensation it receives for conducting the tests.

~~((d))~~ (e) Company C is engaged in research and development. It enters into a contract with Company D requiring Company D to provide employees to work under the direction of Company C. Company D's only obligation is to provide employees. It is not obligated to perform any other task. Company D's provision of employees is not research and development and it is not entitled to the credit on account of the contract. Company D is neither discovering technological information nor is it translating technological information into new or improved products, processes, techniques, formulas, inventions, or software.