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NEW SECTION

WAC 458-20-276 Tax incentives for biotechnology product and medical device manufacturers. (1) **Introduction.** This section explains the tax deferral program, contained in chapter 82.75 RCW, which applies to businesses engaged in biotechnology product or medical device manufacturing in Washington. Information provided in this section includes explanations of what purchases are eligible, the application and review process, the requirement of recipients to file an annual survey, and the circumstances under which payment of the deferred taxes is or is not required.

This section contains examples that identify a number of facts and then state a conclusion. The examples should be used only as a general guide. The tax results in all situations must be determined after a review of all facts and circumstances.

(2) **Who is eligible for the sales and use tax deferral program?** A person engaged in biotechnology product or medical device manufacturing in Washington is eligible for this deferral program for its eligible investment project.

(a) **What does the term "person" mean for purposes of this deferral program?** "Person" has the meaning given in RCW 82.04.030. "Person" can be either a lessee or a lessor, who can apply separately for individual investment projects at the same site, if they comply with the other requirements of chapter 82.75 RCW.

(i) The lessor or owner of the qualified building is not eligible for a deferral unless:

(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 82.32.645;

(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.

For example, economic benefit of the deferral is passed through to the lessee when evidenced by written documentation that the amounts paid to the lessor for construction of tenant improvements are reduced by the amount of the sales tax deferred, or that the lessee receives more tenant improvements through a credit for tenant improvements or other mechanism in the lease equal to the amount of the sales tax deferred.

(ii) The lessor of the qualified building who receives a letter of intent from a qualifying lessee may be eligible for deferral, assuming that all other requirements of chapter 82.75 RCW are met. At the time of application, the lessor must provide to the department a letter of intent by the lessee to lease the qualified building and any other information to prove that the lessee will engage in biotechnology product or medical device manufacturing once the building construction is complete. After the investment project is certified as operationally complete, the lessee must actually occupy the building as a lessee and engage in biotechnology product or medical device manufacturing. Otherwise, deferred taxes will be immediately due to the lessor, and interest will be assessed retroactively from the date of deferral. See subsection (9) of this section for more information on certification of an investment project as operationally complete.

(b) **What is "biotechnology product" for purposes of this section?** "Biotechnology product" means any virus, therapeutic serum, antibody, protein, toxin, antitoxin, vaccine, blood, blood component or derivative, allergenic product, or analogous product produced through the application of biotechnology that is used in the prevention, treatment, or cure of diseases or injuries to humans.

The term "biotechnology" means a technology based on the science of biology, microbiology, molecular biology, cellular biology, biochemistry, or biophysics, or any combination of these, and includes, but is not limited to, recombinant DNA techniques, genetics and genetic engineering, cell fusion techniques, and new bioprocesses, using living organisms, or parts of organisms.

(c) **What is "medical device" for purposes of this section?** "Medical device" means an instrument, apparatus, implement, machine, contrivance, implant, in vitro reagent, or other similar or related article, including any component, part, or accessory, that is designed or developed and:

(i) Recognized in the national formulary, or the United States pharmacopeia, or any supplement to them;

(ii) Intended for use in the diagnosis of disease, or in the cure, mitigation, treatment, or prevention of disease or

other conditions in human beings or other animals; or

(iii) Intended to affect the structure or any function of the body of man or other animals, and which does not achieve any of its primary intended purposes through chemical action within or on the body of man or other animals and which is not dependent upon being metabolized for the achievement of any of its principal intended purposes.

(d) **What is "manufacturing" for purposes of this section?** "Manufacturing" has the meaning provided in RCW 82.04.120.

(3) **What is eligible for the sales and use tax deferral program?** This deferral program applies to an eligible investment project for sales and use taxes imposed on the construction, expansion, or renovation of qualified buildings and acquisition of qualified machinery and equipment.

(a) **What is an "eligible investment project" for purposes of this section?** "Eligible 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 of the project. When an application for sales and use tax deferral is timely submitted, costs incurred before the application date are allowable, if they otherwise qualify.

(b) **What is "qualified buildings" for purposes of this section?** "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 biotechnology product manufacturing or medical device manufacturing activities.

(i) "Qualified buildings" is limited to structures used for biotechnology product or medical device manufacturing. "Qualified buildings" includes plant offices, commercial laboratories for process development, quality assurance and quality control, and warehouses or other facilities for the storage of raw material or finished goods that are an essential or an integral part of a factory, plant, or laboratory used for biotechnology product or medical device manufacturing.

(A) "Office" means space used by professional, clerical, or administrative staff. For plant office space to be a qualified building, its use must be essential or integral to biotechnology product or medical device manufacturing. Office space that is used by supervisors and their staff, by technicians, by payroll staff, by the safety officer, and by the training staff are examples of qualifying office space. An office may be located in a separate building from the building used for biotechnology product or medical device manufacturing, but the office must be located at the same site as the qualified building in order to qualify. Each individual office may only qualify or disqualify in its entirety.

(B) A site is one or more immediately adjacent parcels of

real property. Adjacent parcels of real property separated only by a public road comprise a single site.

(ii) "Qualified buildings" does not include construction of landscaping or most other work outside the building itself, even though the landscaping or other work outside the building may be required by the city or county government in order for the city or county to issue a permit for the construction of a building.

However, "qualified buildings" includes construction of specialized sewerage pipes connected to a qualified building that are specifically designed and used exclusively for biotechnology product or medical device manufacturing.

Also, "qualified buildings" includes construction of parking lots connected to or adjacent to the building if the parking lots are for the use of workers performing biotechnology product or medical device manufacturing in the building. Parking lots may be apportioned based upon its qualifying use.

(c) **When is apportionment of qualified buildings appropriate?** The deferral is allowable only in respect to investment in the construction of a new building or the expansion or renovation of an existing building used in biotechnology product or medical device manufacturing. Where a building(s) is used partly for biotechnology product or medical device manufacturing and partly for purposes that do not qualify for deferral under this section, apportionment is necessary.

(d) **What is the apportionment method?** The applicable tax deferral will be determined as follows:

(i) Tax on the cost of construction of areas devoted solely to biotechnology product or medical device manufacturing may be deferred.

(ii) Tax on the cost of construction of areas not used at all for biotechnology product or medical device manufacturing may not be deferred.

(iii) Tax on the cost of construction of areas used in common for biotechnology product or medical device manufacturing 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 biotechnology product or medical device manufacturing, 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:

Square feet devoted to
biotechnology product or
medical device
manufacturing, excluding
square feet of common areas

= Percentage of total cost of
construction of common areas
eligible for deferral

Total square feet, excluding
square feet of common areas

(iv) The apportionment method described in (d)(i), (ii), and (iii) of this subsection must 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. An example is to use the number of employees in a qualified building that is engaged in biotechnology product or medical device manufacturing as the basis for apportionment, if this method is not easily manipulated to reflect a desired outcome, and it otherwise represents a reasonable apportionment of costs under all the facts and circumstances.

(v) Example. A building to be constructed will be partially devoted to biotechnology product manufacturing and partially devoted to marketing, a nonqualifying purpose. The total area of the building is 100,000 square feet. Sixty thousand square feet are used only for biotechnology product manufacturing, 20,000 square feet are used only for marketing, and the remaining 20,000 square feet are used in common by biotechnology product manufacturing employees and marketing employees. Tax on the cost of constructing the 60,000 square feet used only for biotechnology product manufacturing may be deferred. Tax on the cost of constructing the 20,000 square feet used only for marketing may not be deferred. Tax on 75% of the cost of constructing the common areas may be deferred. (Sixty thousand square feet devoted solely to biotechnology product manufacturing divided by 80,000 square feet devoted to biotechnology product manufacturing and marketing results in a ratio expressed as 75%.)

(e) **What is "qualified machinery and equipment" for purposes of this section?** "Qualified machinery and equipment" means all new industrial and research fixtures, equipment, and support facilities that are an integral and necessary part of a biotechnology product manufacturing or medical device manufacturing operation. "Qualified machinery and equipment" includes: Computers; software; data processing equipment; laboratory equipment; manufacturing components such as belts, pulleys, shafts, and moving parts; molds, tools, and dies; operating structures; and all equipment used to control or operate the machinery. It also includes machinery and equipment acquired under the terms of a lease by the recipient. "New" as used in this subsection means either new to the taxing

jurisdiction of the state or new to the certificate holder.

For purposes of this section, "industrial fixture" means an item attached to a building or to land. Examples of "industrial fixtures" are fuel oil lines, boilers, craneways, and improvements to land such as concrete slabs.

(i) **What are "integral" and "necessary"?** Machinery and equipment is an integral and necessary part of biotechnology product or medical device manufacturing if the biotechnology product or medical device manufacturing cannot be accomplished without it. For example, equipment used to manufacture syringes and needles for the purpose of prevention of diseases in human beings is integral and necessary to medical device manufacturing. Shelving used to store syringes and needles is integral and necessary to medical device manufacturing. Decorative artwork, on the other hand, is not integral and necessary to biotechnology product or medical device manufacturing.

(ii) **Must qualified machinery and equipment be used exclusively for qualifying purposes in order to qualify?** Qualified machinery and equipment must be used exclusively for biotechnology product or medical device manufacturing to qualify for the deferral. Operating system software shared by accounting personnel, for example, is not used exclusively for biotechnology product or medical device manufacturing. 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) **Is qualified machinery and equipment subject to apportionment?** Unlike buildings, if machinery and equipment is used for both qualifying and nonqualifying purposes, the costs cannot be apportioned. Sales or use tax cannot be deferred on the purchase or use of machinery and equipment used for both qualifying and nonqualifying purposes.

(iv) **To what extent is leased equipment eligible for the deferral?** In cases of leases of qualifying machinery and equipment, deferral of tax is allowed on payments made during the initial term of the lease, but not 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.

(4) **What are the application and review processes?** Applicants must apply for deferral to the department of revenue, and the department of revenue must approve the deferral application, before initiation of construction or acquisition of equipment or machinery for the investment project. When an application for sales and use tax deferral is timely submitted, costs incurred before the application date are allowable, if they otherwise qualify. For example, costs of labor and

services rendered in the planning phase of the investment project may incur before the date of application.

(a) **What is "initiation of construction" for purposes of this section?**

(i) Initiation of construction means the date that a building permit is issued under the building code adopted under RCW 19.27.031 for:

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

(B) Construction of the qualified building, if a lessor passes the economic benefits of the deferral to a lessee as provided in subsection (2)(a)(i)(B)(I) of this section; or

(C) Tenant improvements for a qualified building, if a lessor passes the economic benefits of the deferral to a lessee as provided in subsection (2)(a)(i)(B)(I) of this section.

(ii) 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.

(iii) If the investment project is a phased project, initiation of construction must apply separately to each building. For purposes of this section, a "phased project" means construction of multiple buildings in different phases over the life of a project. A taxpayer may file a separate application for each qualified building, or the taxpayer may file one application for all qualified buildings. If a taxpayer files one application for all qualified buildings, initiation of construction must apply separately to each building.

(b) **What is "acquisition of machinery and equipment" for purposes of this section?** "Acquisition of machinery and equipment" means the machinery and equipment is under the dominion and control of the recipient or its agent.

(c) **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 biotechnology product manufacturing. Under the agreement, A will build a building to house B's manufacturing 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 to B. B agrees in writing with the department to complete annual surveys. A applies for the deferral and gets the approval of the deferral application from the department, before 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, and they are approved for their deferral applications by the department, before the date the building permit is issued for such tenant improvements. C and D are entitled to the deferrals on the tenant improvements. 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 equipment has been acquired, Lessee E applied for a deferral on machinery and equipment. E agrees to complete annual surveys. The application was approved before the acquisition of machinery and equipment. E is entitled to the deferral on the acquisition of machinery and equipment. 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.

(d) **How may a taxpayer obtain an application form?** Application forms may be obtained at department of revenue district offices, by downloading from the department's web site (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

Applicants must mail or fax applications to the special programs division at the address or fax number given above. Applications received by the department in connection with the deferral program are not confidential and are subject to public disclosure.

For purposes of this section, "applicant" means a person applying for a tax deferral under chapter 82.75 RCW, and "department" means the department of revenue.

(e) **What should an application form include?** The application form should 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 of the project, 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.

(f) **What is the date of application?** The date of application is the earlier of the postmark date or the date of receipt by the department.

(g) **When will the department notify approval or disapproval of the deferral application?** 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 (Appeals).

(5) **What happens after the department approves the deferral application?** If an application is approved, the department must issue the applicant a sales and use tax deferral certificate.

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.

For purposes of this section, "recipient" means a person receiving a tax deferral under chapter 82.75 RCW.

(6) **How should a tax deferral certificate be used?** 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.

The certificate cannot be used to defer tax on repairs to, or replacement parts for, qualified machinery and equipment.

(7) **May an applicant apply for new deferral at the site of an existing deferral project?**

(a) The department must not issue a certificate for an investment project that has already received a deferral under chapter 82.60 or 82.63 RCW. For example, replacement machinery and equipment that replaces qualified machinery and equipment is not eligible for the deferral. Also, if renovation is made from an existing building that has already received a deferral under chapter 82.60 or 82.63 RCW for the construction of the building, the renovation is not eligible for the deferral.

(b) If expansion is made from an existing building that has already received a deferral under chapter 82.60 or 82.63 RCW for

the construction of the building, the expanded portion of the building may be eligible for the deferral. Acquisition of machinery and equipment to be used for the expanded portion of the qualified building may also be eligible.

(c) A certificate may be amended or a certificate issued for a new investment project at an existing facility.

(8) May an applicant or recipient amend an application or certificate? Applicants and recipients may make written requests to the special programs division to amend an application or certificate.

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

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

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

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

(iv) Transfer of ownership of the project.

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

(9) What should a recipient of a tax deferral do when its investment project is operationally complete?

(a) 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 must, 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.

(b) 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.

(c) 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 (Appeals) within thirty days.

(10) Is a recipient of a tax deferral required to submit annual surveys? Each recipient of a tax deferral granted under chapter 82.75 RCW must complete an annual survey. If the economic benefits of the deferral are passed to a lessee as provided in RCW 82.75.010 (5)(b)(ii), the lessee must agree to complete the annual survey and the applicant is not required to complete the annual survey. See WAC 458-20-268 (Annual surveys for certain tax adjustments) for more information on the

requirements to file annual surveys.

(11) Is a recipient of tax deferral required to repay deferred taxes?

(a) **When is repayment required?** Deferred taxes must be repaid if an investment project is used for purposes other than biotechnology product or medical device 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. For purposes of this section, the date of deferral is the date tax-deferred items are purchased.

(b) When is repayment not required?

(i) Deferred taxes need not be repaid if the investment project is used only for biotechnology product or medical device 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 need not be repaid on particular items if the purchase or use of the item would have qualified 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.

(iii) 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.

(12) When will the tax deferral program expire? The authority of the department to issue deferral certificates

expires January 1, 2017.

(13) **Is debt extinguishable because of insolvency or sale?**
The debt for deferred taxes will not be extinguished by the insolvency or other failure of the recipient.

(14) **Does transfer of ownership terminate tax 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 (Successors, quitting business) 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.