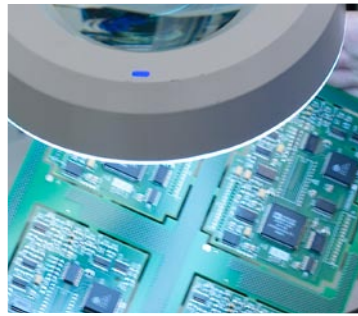


# Washington State Tax Guide

## MANUFACTURING INDUSTRY

EXCISE TAXES & TAX  
INCENTIVE PROGRAMS



## **Introduction**

This Guide was created to help manufacturing businesses understand their tax reporting responsibilities and the various tax incentives available to them. The guide includes general tax reporting information and tax incentives for manufacturers, followed by tax incentives available to specific industries and business located in specific locations.

- Incentives for manufacturers located in rural counties
- High Technology Industries
- Biotechnology and Medical Device Manufacturers
- Aerospace Industry (manufacturers and non-manufacturers)
- Food processing industry
- Biofuel Industry
- Aluminum Smelting Industry
- Timber/wood products industry
- Solar Energy
- Semiconductor industry

The information contained in this publication is current as of the date it was published. Please remember that state laws change on a regular basis and this guide will not reflect changes that occur after printing.

This guide is intended to provide general tax information only. For more information or to get answers to specific questions, please contact the Department of Revenue using the mailing address, phone number, or web site listed below:

Taxpayer Services Division  
Washington State Department of Revenue  
PO Box 47478  
Olympia, WA 98504-7478

**Telephone Information Center**  
**1-800-647-7706**

**Web site: <http://dor.wa.gov>**

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## *Chapter 1*

# **General Manufacturing Activities / Operations**

## **Manufacturing Business and Occupation (B&O) Tax**

Persons who manufacture products in this state are subject to the manufacturing business and occupation (B&O) tax upon the value of the products, including by-products, unless the activity qualifies for one of the special manufacturing B&O tax rates discussed later in the chapter.

### **Retailing and Wholesaling B&O tax**

Manufacturers who sell their products at retail or wholesale in this state are also subject to either the retailing or wholesaling B&O tax, as the case may be. In such cases, the manufacturer must report under both the "production" (manufacturing) and "selling" (wholesaling or retailing) classifications of the B&O tax.

### **Multiple Activities Tax Credit (MATC)**

Manufacturers and extractors, who report B&O tax on multiple activities in Washington, may qualify for the multiple activities tax credit (MATC). The MATC is a B&O tax credit that is available to certain manufacturers, extractors, and sellers doing business in Washington. Businesses are eligible for this credit against the state B&O tax for gross receipts taxes paid in another jurisdiction or for taxes paid on multiple activities within Washington. The business must complete the Multiple Activities Tax Credit, Schedule C, each time the credit is claimed and attach it to their excise tax return. The form is available on our web site at <http://dor.wa.gov> under Forms. See WAC 458-20-19301 for a more detailed explanation of the MATC reporting requirements.

### **Definitions for B&O tax purposes**

**"Manufacturer"** means every person who, either directly or by contracting with others for the necessary labor or mechanical services, manufactures for sale or for commercial or industrial use from his or her own materials or ingredients any articles, substances or commodities. (RCW 82.04.110)

Manufacturer does **not** include:

- producers of aluminum master alloys, regardless of the portion of the aluminum provided by that person's customer:
- non-residents of Washington that own materials that are being processed instate.
- owners of materials from which nuclear fuel assembly is made for it by a processor for hire.

**"To manufacture"** embraces all activities of a commercial or industrial nature where labor or skill is applied, by hand or machinery, to materials so that as a result thereof a new, different or useful substance or article of tangible personal property is produced for sale or commercial or industrial use, and **shall include:**

The production or fabrication of special made or custom made articles;

- The production or fabrication of dental appliances, devices, restorations, substitutes, or other dental laboratory products by a dental laboratory or dental technician;
- Cutting, delimiting, and measuring of felled, cut, or taken trees;
- Crushing and/or blending of rock, sand, stone, gravel, or ore; and
- Cleaning (removal of the head, fins, or viscera) of fish.

A **manufacturing B&O tax exemption** is available for the cleaning of fish, if the cleaning activities are limited to the removal of the head, fins, or viscera from fresh fish without further processing other than freezing. (RCW 82.04.2403)

Processors for hire performing these cleaning activities remain subject to the processing for hire B&O tax.

**"To manufacture" shall not include:**

- Conditioning of seed for use in planting;
- Cubing hay or alfalfa;
- Activities which consist of cutting, grading, or ice glazing seafood which has been cooked, frozen, or canned outside this state;
- The growing, harvesting, or producing of agricultural products;
- Packing of agricultural products, including sorting, washing, rinsing, grading, waxing, treating with fungicide, packaging, chilling, or placing in controlled atmospheric storage. (RCW 82.04.120)

**Manufacturing B&O tax classifications**

- Manufacturing – Catch All classification if manufacturing activity is not provided a special B&O tax rate
- Commercial Aircraft Manufacturing – Effective October 1, 2005
- Biofuel Manufacturing
- Manufacturing wheat into flour, barley into pearl barley, soybeans into soybean oil, or sunflower seeds into sunflower oil
- Splitting or processing dried peas
- Manufacturing seafood products that remain in a raw, raw frozen, or raw salted state **Effective July 1, 2006, B&O tax exemption when sold at wholesale and transported outside the state by the purchasers. Expires July 1, 2012. *Special Notice, Seafood Processors Receive B&O Tax Exemption***
- Manufacturing by canning, preserving, freezing, processing, or dehydrating fresh fruits and vegetables - **Effective July 1, 2005, B&O tax exemption when sold at wholesale and transported outside the state by the purchasers. *Special Notices, Fruit and Vegetable Processors Tax Exemption – New E-file Requirement (2006), Fruit and Vegetable Processors Tax Exemption(2005)***

- Manufacturing nuclear fuel assemblies
- Slaughtering, breaking and/or processing perishable meat products and/or selling the same at wholesale - combines manufacturing and non-manufacturing activities into a single taxable business activity. Includes meat processing that results in a non-perishable product (canned foods). *Special Notice – Processing Perishable Meat Products*
- Processing for hire
- Printing and Publishing

**Other activities subject to manufacturing B&O tax classification:**

**Logging**

Extracting: The felling, cutting (severing), or taking of trees is an extracting activity. (RCW 82.04.100) The extracting B&O tax applies to the value of the products, which is the value of the severed trees prior to any cutting, delimiting, or other manufacturing activity.

Manufacturing: The cutting, delimiting, and measuring of felled, cut, or taken trees is a manufacturing activity. RCW 82.04.120. The manufacturing B&O tax applies to the value of the products, which is generally the gross proceeds of sale, whether the manufactured product is sold at retail or wholesale.

**Mining & Quarrying**

Extracting: Mining and quarrying operations are extracting activities, and generally include the screening, sorting, and piling, of rock, sand, stone, gravel, or ore. For example, an operation that extracts rock, then screens, sorts, and with no further processing places the rock into piles for sale, is an extracting operation.

Manufacturing: The crushing and/or blending of rock, sand, stone, gravel, or ore are manufacturing activities. These are manufacturing activities whether or not the materials were previously screened or sorted.

Screening, sorting, piling, or washing of the material, when the activity takes place in conjunction with crushing or blending at the site where the materials are taken or produced, is considered a part of the manufacturing activity if it takes place after the first screen. If there is no separate first screen, only those activities subsequent to the materials being deposited into the screen are considered manufacturing activities.

However, rock crushing performed by the same business that is hired to perform road building (**public roads or logging roads**) is **not** an activity that qualifies for the manufacturer's tax exemption since the product (the crushed rock) is not sold as tangible personal property but is instead applied to the road being built.

## *Chapter 2*

### **Manufacturer's Sales/Use Tax Exemption For Machinery and Equipment (M&E)**

Generally, a business must report under one or more of the manufacturing B&O tax classifications to be eligible for the manufacturer's sales and use tax exemption. Other requirements apply.

#### **M&E Exemption**

The Manufacturers' Sales and Use Tax Exemption (M&E) applies to purchases by manufacturers or processors for hire of machinery and equipment used directly in a manufacturing operation, testing operation, or research and development operation. The exemption also applies to charges for labor and services for installing, repairing, cleaning, altering, or improving qualifying machinery and equipment. (RCW 82.08.02565 and 82.12.02565)

The exemption may be taken by a **manufacturer or processor for hire who manufactures articles, substances, or commodities for sale as tangible personal property**, and who, for the item in question, meets the used directly test and overcomes the majority use threshold.

However, for **research and development** operations, there is no requirement that the operation produces tangible personal property for sale.

Persons who engage in **testing** for manufacturers or processors for hire are eligible for the M&E exemption.

#### **To qualify for the M&E sales and use tax exemption:**

1. The purchase or use must be by a manufacturer or processor for hire or person engaged in testing for a manufacturer or processor for hire.
2. The property must be used directly in a manufacturing operation, testing operation, or research and development operation and overcomes the majority use threshold.
3. In order to qualify as a manufacturing operation the product being manufactured must be for sale and must be tangible personal property.
4. The property must qualify as "machinery and equipment" as defined in RCW 82.08.02565. The statute also list four types of property that are to be excluded from the definition of "machinery and equipment," even if the property is used directly in a manufacturing operation.

**The purchase or use must be by a manufacturer or processor for hire or person engaged in testing for a manufacturer or processor for hire.**

**"Manufacturing operation"** means the manufacturing of articles, substances, or commodities for sale as tangible personal property.

A manufacturing operation **begins at the point where the raw materials enter the manufacturing site and ends at the point where the processed material leaves the manufacturing site.** The operation includes:

- storage of raw materials at the site,
- storage of in-process materials at the site, and
- storage of the processed material at the site.

The manufacturing operation is defined in terms of a process occurring at a location. To be eligible as a qualifying use of M&E, the use must take place within the manufacturing operation, unless specifically exempted by law. Storage of raw material or other tangible personal property, packaging of tangible personal property, and other activities that potentially qualify under the "used directly" criteria, and that do not constitute manufacturing in and of themselves, are not within the scope of the exemption unless they take place at a manufacturing site.

**Note:** The statute specifically allows testing to occur away from the site.

**"Testing"** means activities performed to establish or determine the properties, qualities, and limitations of tangible personal property.

**"Testing operation"** means the testing of tangible personal property for a manufacturer or processor for hire.

A testing operation begins at the point where the tangible personal property enters the testing site and ends at the point where the tangible personal property leaves the testing site. The term also includes that portion of a cogeneration project that is used to generate power for consumption within the site of which the cogeneration project is an integral part. The term does not include the production of electricity by a light and power business as defined in RCW 82.16.010 or the preparation of food products on the premises of a person selling food products at retail.

The testing operation is defined in terms of a process occurring at a location. To be eligible as a qualifying use of M&E, the use must take place within the testing operation, unless specifically exempted by law.

**"Research and development operation"** means engaging in research and development as defined in RCW 82.63.010 by a manufacturer or processor for hire.

RCW 82.63.010 defines "research and development" to mean: 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, C.F.R., 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.

## **Manufacturing Sites**

### **What is a Site?**

A site is one or more immediately adjacent parcels of real property. The ownership status of the property is not relevant – a parcel can be owned, rented, or leased by the manufacturer or processor for hire. Adjacent parcels of real property separated only by a public road comprise a single “site.” The public road dividing the site is an incidental separation of what would otherwise be one site.

### **Temporary Manufacturing Sites**

A manufacturing operation can exist where the manufacturing site is temporary and where the manufacturing equipment is mobile. For example, operations using portable saw mills or rock crushing equipment are considered "manufacturing operations" if the activity in which the person is engaged is manufacturing.

- Rock crushing equipment that deposits material onto a roadway is not used in a manufacturing operation because this is a part of the constructing activity, not a manufacturing activity.
- Likewise, a portable cement mixer at a construction site is not used in a manufacturing operation because the activity is constructing, not manufacturing.
- Other portable equipment used in non-manufacturing activities, such as continuous gutter trucks or trucks designed to deliver and combine aggregate, or specialized carpentry tools, do not qualify for the same reasons.

Excise Tax Advisory: 2012-6S.08.12.13601

### **Multiple Manufacturing Sites**

Manufacturing tangible personal property for sale can occur in stages. Each stage can take place at different manufacturing sites. For example, if a taxpayer processes pulp from wood at one site, and transfers the resulting pulp to another site that further manufactures the product into paper; two separate qualifying manufacturing operations exist if the end product is sold as tangible personal property.

### At the Site or Away from the Site

Questions have been raised regarding whether, and to what extent, the M&E exemption includes a requirement that qualifying activity take place at a manufacturing site. The M&E statute provides an exemption from tax for machinery and equipment “used directly in the manufacturing operation.” The phrase “manufacturing operation” is defined as “the manufacturing of articles, substances, and commodities for sale as tangible personal property.” The M&E statute also describes the manufacturing operation in terms of a process, with a beginning and an end, taking place at a location. The statutory definition of “manufacturing operation” provides in part, “a manufacturing operation begins at the point where the raw materials enter the manufacturing site and ends at the point where the processed material leaves the manufacturing site.” The definition of “testing operation” has similar language. The definition of “research and development operation” does not have any language regarding site.

Under the statute, machinery and equipment must be “used directly” in a manufacturing operation in order to be eligible for the exemption. There are eight used directly tests. The tests are discussed elsewhere in this guide.

If an activity comes under the “used directly” test of “controls, guides, measures, verifies, aligns, regulates, or tests tangible personal property at the site or away from the site” then no part of the activity need take place at the site. The activity described above, meaning the controlling or guiding, and so forth of tangible personal property, must be performed within the scope of the “manufacturing operation.” The “manufacturing operation” begins with raw materials and ends with processed material.

Therefore, an activity outside of this operation, such as design, does not qualify. All of the other “used directly” tests require that the machinery and equipment and the activity in question be located/performed at a manufacturing site.

### **Machinery and Equipment defined**

"M&E" means "machinery and equipment."

"Machinery and equipment" means:

- **Industrial fixtures**
  - "Industrial fixture" means an item attached to a building or to land. Fixtures become part of the real estate to which they are attached and upon attachment are classified as real property, not personal property. Examples of "industrial fixtures" are fuel oil lines, boilers, craneways, and certain concrete slabs.
- **Devices**
  - “Devise” is an item that is not attached to the building or site. Examples of devices are: Forklifts, chainsaws, air compressors, clamps, free standing shelving, software, ladders, wheelbarrows, and pulleys.
- **Support facilities, and**
  - "Support facility" means a part of a building, or a structure or improvement, used to contain or steady an industrial fixture or device. A support facility must

be specially designed and necessary for the proper functioning of the industrial fixture or device and must perform a function beyond being a building or a structure or an improvement. It must have a function relative to an industrial fixture or a device. To determine if some portion of a building is a support facility, the parts of the building are examined. For example, a highly specialized structure, like a vibration reduction slab under a microchip clean room, is a support facility. Without the slab, the delicate instruments in the clean room would not function properly. The ceiling and walls of the clean room are not support facilities if they only serve to define the space and do not have a function relative to an industrial fixture or a device.

- **Tangible personal property** that becomes an **ingredient or component** of any of the above, including **repair parts and replacement parts**.

"Machinery and equipment" **includes**:

pollution control equipment installed and used in a qualifying operation to prevent air pollution, water pollution, or contamination that might otherwise result from the operation.

**The machinery & equipment must be “used directly in a manufacturing operation, testing operation, or research and development operation.”**

Items that are not **used directly** in a qualifying operation are not eligible for the exemption. RCW 82.08.02565 provides eight descriptions of the phrase "used directly." The manner in which a person uses an item of machinery and equipment must match one of these descriptions. If machinery and equipment is not "used directly" it is not eligible for the exemption.

Machinery and equipment is "used directly" in a manufacturing operation, testing operation, or research and development operation, if the machinery and equipment meets any one of the following criteria:

- (a) **Acts upon or interacts with an item of tangible personal property.**

Examples of this are drill presses, cement mixers (agitators), ready-mix concrete trucks, hot steel rolling machines, rock crushers, and band saws. Also included is machinery and equipment used to repair, maintain, or install tangible personal property. **Computers** qualify under this criteria if:

(i) They direct or control machinery or equipment that acts upon or interacts with tangible personal property; or

(ii) If they act upon or interact with an item of tangible personal property.

- (b) **Conveys, transports, handles, or temporarily stores an item of tangible personal property at the manufacturing site or the testing site.**

Examples of this are wheelbarrows, handcarts, storage racks, forklifts, tanks, vats, robotic arms, piping, and concrete storage pads. Floor space in buildings does not qualify under this criterion. **Not eligible under this criterion are items that are**

**used to ship the product or in which the product is packaged, as well as materials used to brace or support an item during transport.**

Storage of raw material or other tangible personal property, **packaging of tangible personal property**, and other activities that potentially qualify under the "used directly" criteria, and that do not constitute manufacturing in and of themselves, **are not within the scope of the exemption unless they take place at a manufacturing site. For example, packing of products for a manufacturer by another business is not manufacturing.** The statute specifically allows testing to occur away from the site.

**(c) Controls, guides, measures, verifies, aligns, regulates, or tests tangible personal property at the site or away from the site.**

Examples of "away from the site" are road testing of trucks, air testing of planes, or water testing of boats, with the machinery and equipment used off site in the testing eligible under this criteria. Machinery and equipment used to take readings or measurements is eligible under this criterion.

**(d) Provides physical support for or access to tangible personal property.**

Examples of this are catwalks adjacent to production equipment, scaffolding around tanks, braces under vats, and ladders near controls. Machinery and equipment used for access to the building or to provide a work space for people or a space for tangible personal property or machinery and equipment, such as stairways or doors, is not eligible under this criteria.

**(e) Produces power for or lubricates machinery and equipment.** A generator providing power to a sander is an example of machinery and equipment that produces power for machinery and equipment. An electrical generating plant that provides power for a building is not eligible under this criterion. Lubricating devices, such as hoses, oil guns, pumps, and meters, whether or not attached to machinery and equipment, are eligible under this criterion.

**(f) Produces another item of tangible personal property for use in the manufacturing operation, testing operation, or research and development operation.** Machinery and equipment that makes dies, jigs, or molds, and printers that produce camera-ready images are examples of this.

**(g) Places tangible personal property in the container, package, or wrapping in which the tangible personal property is normally sold or transported.**

**(h) Is integral to research and development as defined in RCW 82.63.010.** "Integral" means a part of the whole, and in this context means that the machinery and equipment is necessary for research and development.

**For example: *Electrical Apparatus – Research and Development Operations***

Electrical apparatus used directly in a research and development operation need only be "integral" to the research and development operation to be entitled to the M&E exemption. There is no requirement that it act upon or interact with an item of tangible personal property or produce power for machinery and equipment

**Examples of items that are not used directly in a qualifying operation:**

- cafeteria furniture,
- safety equipment not part of qualifying M&E,
- packaging materials,
- shipping materials, or
- administrative or office equipment.

**What is eligible for the exemption?**

A **manufacturer** is exempt from sales and use tax on:

- Purchases of machinery and equipment.
- Purchases of tools for repairing qualifying machinery and equipment.
- Charges for hiring someone to repair machinery and equipment.
- Renting equipment (with or without operator) to repair or install machinery and equipment.

Because the exemption is limited to items with a useful life of one year or more, some charges for repair, labor, services, and replacement parts may not be eligible for the exemption.

In the case of labor and service charges that cover both qualifying and non-qualifying repair and replacement parts, the labor and services charges are presumed to be exempt. If all of the parts are non-qualifying, the labor and service charge is not exempt.

***Renting or Leasing of Tangible Personal Property***

**Bare Rentals**

The “renting or leasing of tangible personal property,” sometimes referred to as a bare rental or true lease, is eligible for the M&E exemption if all other conditions of the exemption are satisfied. For example, the rental of a crane on a bare rental basis to a manufacturer, whose employee operates the crane to move equipment to the top of a building, may be eligible for the M&E exemption.

***Rental of Equipment with an Operator***

The “rental of equipment with an operator” is a separate and distinct activity from the “renting or leasing of tangible personal property.” The “rental of equipment with an operator” is a sale of a service and not a sale of tangible personal property. While the seller is providing equipment along with the equipment operator, the customer is purchasing the knowledge, skills, and expertise of an operator needed to operate the equipment at the customer’s direction. Because the “rental of equipment with an operator” is not a sale of tangible personal property, it is not eligible for the M&E exemption.

For example, manufacturer hires a company to provide a crane with operator to move equipment to the top of a building. While the company's employee operates the crane, the equipment is actually installed by manufacturer's employees. The purchase of the crane with operator service is not eligible for the M&E exemption.

The tax application of any scenario depends on the facts and circumstances of the particular situation. For example, consider the situation where a manufacturer hires a company to provide a crane with operator to move equipment to the top of a building and the personnel to install the equipment. In this case, the purchased services may be eligible for the M&E exemption because the company hired by the manufacturer is responsible for installing the equipment. Refer to WAC 458-20-211 (Rule 211) for additional guidance for distinguishing when a person is renting or leasing tangible personal property, providing a rental of equipment with an operator, or is performing construction or installation services.

#### ***Electrical Apparatus—Manufacturing Operations and Testing Operations***

Electrical apparatus such as motor control centers, starters, switches, regulators, and exciters “act upon or interact with” tangible personal property, often in a sequential manner. The motor control center, for example, produces an action that results in a reaction by the motor. Switches and exciters work in much the same way. Similarly, circuit breakers and comparable equipment react to an event in another item, and this cause and effect behavior falls under the “acts upon or interacts with” criteria. Thus, these items are eligible for the M&E exemption, subject to meeting the other requirements of the exemption. Converters, transformers, and other equipment on site, that alter the characteristics of the electricity “produce power” for machinery and equipment, and qualify for the M&E exemption, subject to meeting the other requirements of the exemption. Apparatus that are part of a utility system used for qualifying and non-qualifying purposes should be examined using the allocation standard set forth below. Transmission and distribution systems located off site do not qualify for the M&E exemption.

#### ***Utility Systems used for Qualifying and Nonqualifying Purposes – Allocation***

(Excise Tax Advisory: 2012-3S.08.12.13601)

The M&E exemption defines “machinery and equipment” to, in part, exclude building fixtures that are not integral to the manufacturing operation, testing operation, or research and development operation that are permanently affixed to and become a physical part of the building, such as utility systems for heating, ventilation, air conditioning, communications, plumbing, or electrical. RCW 82.08.02565(2)(b)(iv). Conversely, building fixtures are eligible if they are integral to the manufacturing operation, testing operation, or research and development operation, and meet the other requirements of the exemption, such as the “used directly” test. Thus, while the M&E exemption contemplates that these utility systems are to be separately considered as potentially eligible industrial fixtures and not a part of a “building” for purposes of exemption, not all such systems are eligible for the exemption. Utility systems that serve a building purpose, as opposed to a manufacturing purpose, do not qualify.

For example, a utility system used to perform a general building purpose, such as a HVAC system controlling the air temperature or air quality in general, is not eligible for

the M&E exemption. If a utility system is used for both qualifying and non-qualifying purposes, the system should be allocated so that only the qualifying portion of the system receives the exemption, and the building portion does not receive an exemption. One way of allocating a utility system is by applying the ratio of the qualifying use made of the system to the total use of the system. This ratio must be established and substantiated by sufficient documentation, such as, but not limited to, engineering analyses and power bills. Thus, if the taxpayer can document that 30 percent of a system is used for the manufacturing activity (e.g., 30 percent of the system is dedicated to manufacturing frozen raspberries vs. 70 percent dedicated to cold storage) then this 30 percent qualifies for the exemption.

The concept of allocating portions of a utility system as qualifying or non-qualifying for purposes of the M&E exemption is limited to utility system machinery and equipment considered a building fixture, when used to support both manufacturing machinery and equipment and the building systems. Allocation is not applicable to any other situation. In other areas dealing with dual use of machinery and equipment (dual use meaning property is used in both qualifying and non-qualifying activities) the majority use threshold is applicable. Rule 13601(10) sets forth the criteria used in applying the majority use test. The statute specifically excludes from the scope of the M&E exemption building fixtures that are not integral to the manufacturing operation. This directly implies that building fixtures that are integral can qualify. However, application of the majority use test to building fixtures would conflict with the legislative intent because it would provide a total exemption for such property. The allocation between exempt use and non-exempt use of a utility system achieves the Legislature's intent in this area.

### **Devices**

(Excise Tax Advisory: 2012-4S.08.12.13601)

The statute does not provide a definition of "device." Device is defined in WAC 458-20-13601, the M&E rule. This rule defines device as "an item that is not attached to the building or site" and provides examples that are ordinarily considered to be equipment or machinery. The examples in Rule 13601 are "forklifts, chainsaws, air compressors, clamps, free standing shelving, software, ladders, wheelbarrows, and pulleys." These examples fit within the common dictionary definition of "machinery and equipment" and "device."

### ***Software***

Software satisfies Rule 13601's definition of device because it performs a task and is also not attached to a building or site. Consequently, software can qualify for the M&E exemption if it meets a used directly test. The issue is whether the software performs a task in relation to the qualifying operation.

For example, a software program that controls the operation of equipment that cuts logs into lumber qualifies for the M&E exemption. It performs a task, the control of a piece of eligible machinery, and is used directly in the manufacturing operation. On the other hand, a CD-ROM of a repair manual for this equipment does not qualify for the M&E exemption because the software does not perform a task in the manufacturing operation. The Department uses the definition of "software" in RCW 82.04.215:

“Software” means any information, program, or routine, or any set of one or more programs, routines, or collections of information used, or intended for use, to convey information that causes one or more computers or pieces of computer-related peripheral equipment, or any combination thereof, *to perform a task or set of tasks*. [Emphasis ours]

### **Design and Product Development**

(Excise Tax Advisory: 2012-5S.08.12.13601)

The Department makes a distinction between activities that take place within the manufacturing operation and activities that either precede or follow the manufacturing operation. For example, creation and design of information, such as writing text for a newspaper, is an activity that takes place before the manufacturing operation begins. However, the preparation of this information for use in a manufactured product, is an activity that generally occurs in the manufacturing operation. Composition of a book or the writing of a newspaper article are activities that are considered product development and outside of the manufacturing operation, and thus are not considered to be within the scope of the M&E exemption.

Similarly, design of an automobile, or engineering of a piston are considered product development and outside of the manufacturing operation. However, taking a completed manuscript and preparing it for printing could be part of the manufacturing operation, as could be the layout and pagination of a newspaper. Other products that have information content, such as compact discs and music are subject to the same tax application. Essentially, the creation of the information is not manufacturing and is not part of the manufacturing operation. Property that is used both in product development and in manufacturing of tangible personal property may be eligible for the M&E exemption, if all other requirements of the exemption are met. The Department will presume that design activity is not part of the manufacturing operation and machinery and equipment used in design is not eligible for the M&E exemption. Equipment used in redesign or refinement of a product after manufacturing has begun is not eligible for the M&E exemption. This presumption can be overcome by showing that the design decisions and the application of labor and skills to the raw materials are the same activity.

### **Machinery and equipment used in research and development**

(Excise Tax Advisory 2012-10S.08.12.123601)

The M&E exemption applies to sales of machinery and equipment used directly in an R&D operation by a manufacturer or processor for hire. Machinery and equipment is used directly in an R&D operation if it is integral to R&D as defined in RCW 82.63.010.

Examples of machinery and equipment include computer hardware, software, data processing equipment, and laboratory equipment. Machinery and equipment does not include property with a useful life of less than one year.

#### ***Integral to research and development operation***

Machinery and equipment is integral to an R&D operation if R&D cannot be accomplished without such machinery and equipment. For example, a laboratory table is integral to an R&D operation. Likewise, telephones, computer hardware (e.g., cables,

scanners, printers, etc.), and computer software (e.g., Word, Excel, Windows, Adobe, etc.) used in a typical workstation for an R&D personnel are integral to an R&D operation. Also, a chair used in a laboratory workstation is integral to an R&D operation. A chair used in a lobby area, however, is not integral to an R&D operation. Similarly, decorative artwork is not integral to an R&D operation.

***Research and development operation***

"R&D operation" means engaging in R&D by a manufacturer or processor for hire. R&D can be performed away from a manufacturing site, and the machinery and equipment used to perform such R&D may still qualify for the M&E exemption.

R&D includes the following activities:

- Activities performed to discover technological information,
- Technical and non-routine activities concerned with translating technological information into new or improved products, processes, techniques, formulas, inventions, or software, and
- 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, C.F.R., as amended.

R&D does not include the following activities:

- Adaptation or duplication of existing products without substantial improvement by application of the technology,
- 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 to improve style, taste, or seasonal design.

Refer to WAC 458- 20-24003 for additional information on what constitutes R&D.

***Majority use requirement for machinery and equipment used in research and development***

Machinery and equipment used in R&D operation must satisfy the majority use threshold in order to qualify for the M&E exemption. Machinery and equipment that does not satisfy the majority use threshold is subject to use tax at the time the majority use threshold is no longer met. For example, a laboratory table used solely for qualifying R&D purposes and then converted solely to non-qualifying uses is subject to use tax at the time of conversion.

## What is not eligible for the exemption?

In addition to items that are not eligible because they do not meet the used directly test or fail to overcome the majority use threshold, there are four categories of items that are statutorily excluded from eligibility. The following property is not eligible for the M&E exemption:

1. Hand-powered tools. Screw drivers, hammers, clamps, tape measures, and wrenches are examples of hand-powered tools. Electric powered, including cordless tools, are not hand-powered tools, nor are calipers, plugs used in measuring, or calculators.
2. Property with a **useful life of less than one year**. All eligible machinery and equipment must satisfy the useful life criteria, including repair parts and replacement parts. For example, items such as blades and bits are generally not eligible for the exemption because, while they may become component parts of eligible machinery and equipment, they generally have a useful life of less than one year. Blades generally having a useful life of one year or more, such as certain sawmill blades, are eligible. (See subsection on thresholds to determine useful life.)
3. Buildings, other than machinery and equipment that is permanently affixed to or becomes a physical part of a building. Buildings provide work space for people or shelter machinery and equipment or tangible personal property. The building itself, and some of its components, such as walls, partitions, floors, ceilings, windows, and doors, are not eligible for the exemption. The industrial fixtures and support facilities that become affixed to or part of the building might be eligible. The subsequent real property status of industrial fixtures and support facilities does not affect eligibility for the exemption.
4. Building fixtures that are not integral to the manufacturing operation, testing operation, or research and development operation that are permanently affixed to and become a physical part of a building, such as utility systems for heating, ventilation, air conditioning, communications, plumbing, or electrical. Examples of nonqualifying fixtures are: Fire sprinklers, building electrical systems, or washroom fixtures. Fixtures that are integral to the manufacturing operation might be eligible, depending on whether the item meets the other requirements for eligibility, such as the used directly test.

### **Useful Life**

The "useful life" threshold. RCW 82.08.02565 states that property with a useful life of less than one year is not eligible for the M&E exemption. The useful life threshold identifies items that do not qualify for the exemption, such as supplies, consumables, and other classes of items that are not expected or intended to last a year or more.

For example, tangible personal property that is acquired for a one-time use and is discarded upon use, such as a mold or a form, has a useful life of less than one year and is not eligible. **If it is clear from taxpayer records or practice that an item is not used**

**for at least one year, the item is not eligible, regardless of the answers to the four threshold questions.**

The following steps should be used in making a determination whether an item meets the "useful life" threshold. The series of questions progress from simple documentation to complex documentation. In order to substantiate qualification under any step, a taxpayer must maintain adequate records. Catastrophic loss, damage, or destruction of an item does not affect eligibility of machinery and equipment that otherwise qualifies.

**Assuming the machinery and equipment meets all of the other M&E requirements and does not have a single one-time use or is not discarded during the first year, useful life can be determined by answering the following questions for an individual piece of machinery and equipment:**

1. Is the machinery and equipment capitalized for either federal tax purposes or accounting purposes?
  - If the answer is "yes," it qualifies for the exemption.
  - If the answer is "no," go to the next question.
2. Is the machinery and equipment warranted by the manufacturer to last at least one year?
  - If the answer is "yes," it qualifies for the exemption.
  - If the answer is "no," go to the next question.
3. Is the machinery and equipment normally replaced at intervals of one year or more, as established by industry or business practice? (This is commonly based on the actual experience of the person claiming the exemption.)
  - If the answer is "yes," it qualifies for the exemption.
  - If the answer is "no," go to the next question.
4. Is the machinery and equipment expected at the time of purchase to last at least one year, as established by industry or business practice? (This is commonly based on the actual experience of the person claiming the exemption.)
  - If the answer is "yes," it qualifies for the exemption.
  - If the answer is "no," it does not qualify for the exemption.

### **The majority use threshold**

Machinery and equipment both used directly in a qualifying operation and used in a non-qualifying manner is eligible for the exemption only if the qualifying use satisfies the majority use requirement. Examples of situations in which an item of machinery and equipment is used for qualifying and non-qualifying purposes include:

- The use of machinery and equipment in manufacturing and repair activities, such as using a power saw to make cabinets in a shop versus using it to make cabinets at a customer location;
- The use of machinery and equipment in manufacturing and constructing activities, such as using a forklift to move finished sheet rock at the manufacturing site versus using it to unload sheet rock at a customer location; and
- The use of machinery and equipment in manufacturing and transportation activities, such as using a mixer truck to make concrete at a manufacturing site versus using it to deliver concrete to a customer.

Majority use can be expressed as a percentage, with the minimum required amount of qualifying use being greater than fifty percent compared to overall use. To determine whether the majority use requirement has been satisfied, the person claiming the exemption must retain records documenting the measurement used to substantiate a claim for exemption. Majority use is measured by looking at the use of an item during a calendar year using any of the following:

- (i) **Time.** Time is measured using hours, days, or other unit of time, with qualifying use of the M&E the numerator, and total time used the denominator. Suitable records for time measurement include employee time sheets or equipment time use logs.
- (ii) **Value.** Value means the value to the person, measured by revenue if the qualifying and non-qualifying uses both produce revenue. Value is measured using gross revenue, with revenue from qualifying use of the M&E the numerator, and total revenue from use of the M&E the denominator. If there is no revenue associated with the use of the M&E, such as in-house accounting use of a computer system, the value basis may not be used. Suitable records for value measurement include taxpayer sales journals, ledgers, account books, invoices, and other summary records.
- (iii) **Volume.** Volume is measured using amount of product, with volume from qualifying use of the M&E the numerator and total volume from use of the M&E the denominator. Suitable records for volume measurement include production numbers, tonnage, and dimensions.
- (iv) **Other comparable measurement for comparison.** The department may agree to allow a taxpayer to use another measure for comparison, provided that the method results in a comparison between qualifying and non-qualifying uses. For example, if work patterns or routines demonstrate typical behavior, the taxpayer can satisfy the majority use test using work site surveys as proof.

Each piece of M&E does not require a separate record if the taxpayer can establish that it is reasonable to bundle M&E into classes. Classes may be created only from similar pieces of machinery and equipment and only if the uses of the pieces are the same. For example, forklifts of various sizes and models can be bundled together if the forklifts are doing the same work, as in moving wrapped product from the assembly line to a storage area. An example of when not to bundle classes of M&E for purposes of the majority use threshold is the use of a computer that controls a machine through numerical control versus use of a computer that creates a camera ready page for printing.

Typically, whether the majority use threshold is met is decided on a case-by-case basis, looking at the specific manufacturing operation in which the item is being used. However, for purposes of applying the majority use threshold, the department may develop industry-wide standards. For instance, the aggregate industry uses concrete mixer trucks in a consistent manner across the industry. Based on a comparison of selling prices and delivery prices the department has determined that concrete trucks overcome the majority use threshold. Only in those limited instances where it is apparent that the use of the concrete truck is atypical for the industry would the taxpayer be required to provide recordkeeping on the use of the truck in order to support the exemption.

## **Other types of property – Do they qualify for the M&E exemption?**

### **Prototypes**

Property that is the object of the manufacturing activity does not itself qualify for the exemption. The thing being made is the object of the activity and as such is not “machinery and equipment” as that phrase is used in the M&E exemption. If a prototype is not used to make, build, or test a different product or used in some supportive capacity (used directly) in stages of the manufacturing operation, its use does not qualify. Any product made by a manufacturer and used in a qualifying manner potentially qualifies for exemption – subject to not being the object of the activity itself. For example, a “prototype” used as a manufacturing mockup to calibrate tools will qualify as machinery and equipment. A prototype used as a test bed will qualify if it can be shown that the information gained from the test will be used for a different product or process, and will not be used to refine or change the product itself.

The phrase “test bed” means that the prototype is used to test other property, and not the prototype itself. A “test bed” typically evaluates how property operates under a range of working conditions. If the prototype is being tested itself, then it is not being used as a “test bed.”

### ***Presumption***

In order to determine whether a product made by a manufacturer is eligible for the exemption, an examination of the facts, as supported by documentation or other credible evidence regarding the property’s use, must be undertaken. The Department presumes that a manufacturer of an item that is being developed or manufactured is not using the property in a manner eligible for the M&E exemption. To overcome this presumption, the manufacturer must establish that the item is being used to test something other than itself. This determination will be done on a case by case basis, and will in each case be based on

the individual facts and circumstances. For example, in order for a prototype of a fire extinguisher to be eligible for use in an R&D operation, use of the prototype must be part of activities relating to another product and not be in regard to R&D on the fire extinguisher itself.

The Department also presumes that a product and all of its components are the thing being tested. The burden is on the taxpayer to demonstrate, and support by documentation or other credible evidence, that the product is being used as a “test bed.” Documentation will need to reflect the basis for the activity and the intent of the manufacturer.

### **Reporting/Documentation**

**Buyers** must provide the seller with a properly completed *Manufacturer’s Sales and Use Tax Exemption Certificate* or *Buyers’ Retail Sales Tax Exemption Certificate*.

Both certificates are available on our website at <http://dor.wa.gov> under Forms.

**Sellers** remain subject to the retailing B&O tax on all sales of machinery and equipment to consumers if delivery is made within the state of Washington. The retail sales tax exemption must be itemized on the Deduction Detail page of the excise tax return under the explanation “Sale of Manufacturing Mach/Equip; Install Labor.” The seller must retain the certificate in their records.

### **Laws and Rules**

- RCW 82.08.02565 Sales of manufacturing machinery and equipment
- RCW 82.12.02565 Use of manufacturing machinery and equipment
- WAC 458-20-135 Extracting Natural Products
- WAC 458-20-13501 Timber Harvest Operations
- WAC 458-20-136 Manufacturers and processors-for-hire, fabricating
- WAC 458-20-13601 Manufacturing Machinery and Equipment Sales and Use Tax Exemption
  
- ETA 2012 Manufacturers’ Machinery and Equipment Exemption
- ETA 2012-1S Rental of tangible personal property and rental of equipment with an operator
  
- ETA 2012-2S Pollution control equipment
- ETA 2012-3S Electrical apparatus and utility systems
- ETA 2012-4S Devices
- ETA 2012-5S Design and Product Development
- ETA 2012-6S Manufacturing site
- ETA 2012-7S Buildings, fixtures, and support facilities
- ETA 2012-8S Computers
- ETA 2012-9S Prototypes
- ETA 2012-10S Research and Development

*Chapter 3*  
**Rural County Incentives**

**Rural County Business and Occupation Tax Credit for New Employees**

The Rural Area Business and Occupation (B&O) Tax Credit Program for New Employees provides a:

- \$2,000 credit for each new qualified employment position with annual wages and benefits of \$40,000 or less; or
- \$4,000 credit for each new employment position with wages and benefits of more than \$40,000 annually.

The credit is taken against the B&O tax for each new employment position filled and maintained by qualified businesses located in eligible areas.

***Eligible Areas***

**NOTE:** The list of eligible areas is revised annually (effective July 1 through June 30). Businesses making investment decisions should be aware that a specific area may not be on the list every year. Before making a final investment decision based on these programs, the business should contact the Department.

- ***Rural Counties:*** Counties with a population density of less than 100 persons per square mile or a county smaller than 225 square miles as determined by the Office of Financial Management, and published each year by the Department for the period of July 1 to June 30. The eligible rural counties from July 1, 2006 through June 30, 2007 are listed at the end of this chapter. For current information, please go to: <http://www.ofm.wa.gov/popden/default.asp>
- ***Community Empowerment Zones (CEZs):*** An area meeting the requirements of RCW [43.31C.020](#) and officially designated by the director of the department of community, trade, and economic development. **The business must be located within the zone. Only positions filled by CEZ residents qualify.** Maps of the CEZs are available on our web site at <http://dor.wa.gov> under the Tax Incentives or call our Telephone Information Center at 1-800-647-7706.

***Requirements***

**An application must be filed with the Department of Revenue BEFORE filling the new positions.** Positions may be filled after the application is submitted to the Department of Revenue. However, a credit cannot be taken until the application is approved and a valid credit certificate is issued.

The business must be a (excluding light and power business):

- manufacturer,
- research and development company,
- computer programmer, producer of computer software, or other computer-related services, or
- commercial testing laboratory that locates or expands in a designated distressed county or other eligible area.

**"Research and development"** means the development, refinement, testing, marketing, and commercialization of a product, service, or process before commercial sales have begun. "Commercial sales" 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.

Businesses must create a new work force, or expand the existing work force by a 15 percent average increase (full-time employment positions) over the preceding calendar year by December 31 of the calendar year credits are applied for. All positions created by a new business will qualify for the credit the first year from the date the application is received by the Department of Revenue.

New full-time employment positions must be maintained for 12 consecutive months.

To qualify, a new application must be submitted to the Department of Revenue EACH calendar year that a 15 percent average increase in the number of positions over the previous year is anticipated. **Note: Application to the Department must be made before filling these new positions.**

When a person filling a position quits or is fired, the approved credit for that position will not be canceled as long as that vacant position is filled within 30 days and the position is maintained for 12 consecutive months. An employee "in-training" qualifies as filling a position, as long as that employee is working at least 35 hours a week.

#### ***Application***

The **Rural Area Application For B&O Tax Credit on New Employees** is available on our web site at <http://dor.wa.gov> under Forms.

The Department of Revenue must approve or deny applications within 60 days. If denied, the business may appeal the decision to the Department's Appeals Division.

#### ***Limitations***

For a full-time employment position to be eligible for credit, it must be requested on the application and approved by the Department of Revenue. Any position(s) created that exceed the amount approved on your application are not eligible for the credit.

The position(s) must be NEW. Positions may not be transferred from an established site in Washington to a new site or other qualified location unless the vacated positions are filled.

#### **How To Determine A Full-Time Employment Position**

A full-time employment position is one that is filled by one or more employees who:

- Work 35 hours per week for 52 weeks; or
- Work 455 hours each quarter (excluding overtime) of the year; or
- Work 1,820 hours annually (excluding overtime) during a period of 12 consecutive months.

**NOTE: Tax credits for qualified businesses that hire seasonal employees may be approved if certain requirements are met. See Excise Tax Advisory 535.04.240 for more information.**

**15 Percent Average Employment Increase (Worksheet Directions)**

Qualification for tax credit depends upon whether enough new positions are expected to be filled to meet the 15 percent average increase test. Positions filled in the current calendar year prior to making application are not eligible for a credit, but the positions are used to calculate whether the 15 percent threshold has been met.

To determine if the number of new positions anticipated is an average increase of 15 percent:

1. Add the number of all full-time employees (455 hours or more worked) as reported to Employment Security for each quarter of the preceding year to find the number of full-time employees for that quarter;
2. Add the hours of the remaining employees on each report for the preceding year, and divide by 455 to find the number of other full-time equivalent (FTE) employees;
3. Add the totals from 1 and 2 above to find the total FTEs for the quarter (see table 14, lines a-d);
4. Add the FTEs for all four quarters together for the annual total (table 14, line e); and
5. Divide the annual total FTEs by four. The answer represents the average number of full-time employment positions (table 14, lines f and g).

A worksheet is included with the *Rural Area Application for B&O Tax Credit on New Employees*. To obtain the average number of FTEs for the previous and current calendar years, complete the tables on the worksheet. The average number of FTEs for the current calendar year must be 15 percent higher than the average number of FTEs for the previous calendar year (table 15).

**NOTE:** Tables 14 and 15 are to be used with example one and two.

**Table 14. Number of FTEs for Previous Year**

a. Quarter 1	<u>11</u>
b. Quarter 2	<u>15</u>
c. Quarter 3	<u>16</u>
d. Quarter 4	<u>11</u>
e. Total FTEs (add a through d)	<u>53</u>
f. Divided by 4	<u>÷ 4</u>
g. Average number of FTEs for previous year	13.25 = 13 <i>(due to rounding)</i>

(Transfer this number to page 2, line 15 of the application)

**Table 15. Average Number of FTEs for Previous Year Multiplied by 1.15**

a. Multiply total on line (g) by 1.15	<u>13 x 1.15</u>
b. Total	<u>15.2375 = <b>15</b></u>

*(due to rounding)*

(Transfer this number to page 2, line 15 of the application)

**Example One:** Although the company hires two new employees in Quarter 1 of the current year, they do not meet the 15 percent average test and will receive no credit for the positions. Table 16 shows that the average FTE for the current year remains 13. The average FTE for the current year needs to be at least 15 (see table above).

**Table 16. Estimated Average Number of FTEs for Current Year**

a. Quarter 1	<u>13</u>
b. Quarter 2	<u>13</u>
c. Quarter 3	<u>13</u>
d. Quarter 4	<u>13</u>
e. Total FTEs (add a through d)	<u>52</u>
f. Divided by 4	<u>÷ 4</u>
g. Average FTEs for current year	<u><b>13</b></u>

**Example Two:** Company hires four new employees in Quarter 1 of current year. In this instance, the company will meet the 15 percent increase test, and will receive a credit for four new positions if maintained for 12 consecutive months.

**17. Estimated Number of FTEs for Current Year**

a. Quarter 1	<u>15</u>
b. Quarter 2	<u>15</u>
c. Quarter 3	<u>15</u>
d. Quarter 4	<u>15</u>
e. Total FTEs (add lines a through d)	<u>60</u>
f. Divided by 4	<u>÷ 4</u>
g. Average FTEs for current year	<u><b>15</b></u>

(Transfer this number to page 2, line 16 of the application)

***Using The Credit***

Once approved, a credit of \$2,000 or \$4,000 will be authorized for each position requested in the application. The Department will send an **Employee Credit Certificate** to the business following approval of the application. **AFTER** the business has received the certificate **AND** each new position is filled, the business may apply the credit against its B&O tax liability. The credit used on each return must not be greater than the amount of B&O tax due on that return.

**NOTE:** This credit may **not** be used to offset sales or other taxes owed on the return, only the B&O tax.

To take the credit, a copy of the *Employee Credit Certificate* must be attached to the Combined Excise Tax Return.

The amount of the credit should be entered on page two of the Combined Excise Tax Return under the CREDITS section, credit ID number 810. The total of all credits is then entered on page one of the Combined Excise Tax Return in the TOTALS section, and subtracted from the subtotal of taxes due for that period.

Businesses with approved applications must file an annual report with the Department of Revenue that covers the calendar year the credit is claimed, as well as the calendar year after the credit is claimed. Employment Security reports can be requested to verify eligibility. Wage and benefit information may also be necessary to verify the credit.

The B&O tax credit will be canceled if the required reports are not submitted or do not contain the necessary information (verification that the positions were created and filled for 12 consecutive months). If the credit is canceled, the business will be required to pay back any credit taken on the Combined Excise Tax Return, plus interest, immediately.

#### ***Reporting / Documentation***

- **Rural Area Application For B&O Tax Credit on New Employees** must be filed with the Department before filling the new positions.
- Annual report must be filed with the Department of Revenue by January 31.
  - Report is mailed by the Department to those businesses claiming the credit. If you have questions about the report, please call (360) 902-7175.
- No Electronic Filing Required.

#### ***Laws & Rules***

RCW 82.62 — Tax Credits for Eligible Business Projects.

WAC 458-20- 240 — Manufacturers, tax credits (Distressed Area Business and Occupation Tax Credits).

## Rural County Sales and Use Tax Deferral Program

The Rural County Sales/Use Tax Deferral Program grants a deferral of sales and use tax for manufacturing, and computer-related businesses, research and development laboratories, and commercial testing facilities (excluding light and power businesses) **locating in rural counties, Community Empowerment Zones (CEZ) or a county containing a CEZ.** This program expires on July 1, 2010.

The sales and/or use taxes on qualified construction and equipment costs for such businesses located in these specific geographic areas are **waived** when all program requirements have been met and verified.

These **waiver** requirements include:

- An annual survey covering each calendar year must be filed by March 31 of the following year.
- All purchases have been verified as eligible by the Department of Revenue.
- The facility must be used for qualified activities during the year in which the investment project is certified as operationally complete by the Department and the following **seven years**.
- Employment requirements have been met for a business located in a CEZ or county containing a CEZ.

Employment requirements are explained later in this article.

### *Eligible Areas*

NOTE: The list of eligible areas is revised annually (effective July 1 through June 30). Businesses making investment decisions should be aware that a specific area may not be on the list every year. Before making a final investment decision based on these programs, the business should contact the Department.

- *Rural Counties:* Counties with a population density of less than 100 persons per square mile or a county smaller than 225 square miles as determined by the Office of Financial Management, and published each year by the Department for the period of July 1 to June 30. There is a list of rural counties at the end of this chapter. For updated information go to:  
**<http://www.ofm.wa.gov/popden/default.asp>**
- *Community Empowerment Zones (CEZs):* A designated CEZ or a county containing a CEZ. Please see the Community Empowerment Zone maps available on our web site at <http://dor.wa.gov> under the Tax Incentives or call our Telephone Information Center at 1-800-647-7706.

### *Requirements/Qualifications*

The business must be located in a rural county or a county containing a CEZ.

The business must be engaged in manufacturing, computer programming, the production of computer software, or other computer-related services, or the activities performed by research and development laboratories and commercial testing laboratories.

The business must invest in facility construction, expansion, or machinery and equipment acquisition. The machinery and equipment must be new to the business or the state and must be integral and necessary to the operation of the eligible business activity. Used machinery qualifies. A new building is not required.

The cost of the expansion or modernization of an existing facility must increase floor space or production capacity.

A lessor or owner of the qualified building can be eligible for a deferral when:

- The underlying ownership of the buildings, machinery, and equipment vests exclusively in the same person; **or**
- the lessor by written contract agrees to pass the full amount of the economic benefit of the deferral to the lessee and written documentation of any type is maintained to show this has taken place; **and**
- the lessee that receives the economic benefit of the deferral agrees in writing with the Department of Revenue to complete the annual survey.

All costs of the investment project, including labor and services performed in the planning, installation and construction of the project, are used to determine the eligible portion for deferral. If the facility is used partly for manufacturing and partly for other purposes, the tax deferral shall be determined by apportioning the costs of construction.

Cogeneration facilities that are part of a manufacturing facility qualify on the portion that is used to generate power for on-site consumption.

**Employment requirements for businesses locating in a CEZ, or a county containing a CEZ are:**

- At least one qualified employment position must be created for every \$750,000 of investment on which a deferral is requested.
- The new qualified employment positions created must be filled by persons who, at the time of hiring, are residents of the CEZ within the county where the investment project is located. **Application** for the deferral must be made to the Department **prior** to hiring the CEZ employee. "Qualified employment position" means a permanent full-time employee employed by a qualifying business during a period of 12 consecutive months. The term "full-time" means at least 35 hours a week, 455 hours a quarter, or 1,820 hours a year.
- By the end of the second calendar year following the year in which the project is certified as operationally complete, the required employment positions must have been hired and retained for 12 consecutive months or all deferred taxes are immediately due.

***Application***

**An application must be filed with the Department of Revenue PRIOR to initiation of construction or taking possession of machinery or equipment.** Once an application is filed, construction or possession of machinery or equipment may begin. The granting or denial of the application can take up to 60 days.

Copies of the *Rural County Application for Sales and Use Tax Deferral* are available on our web site at <http://dor.wa.gov> under Forms.

The Department of Revenue must approve or deny applications within 60 days. If approved, a Tax Deferral Certificate is issued to the business to provide to vendors and contractors at the time of purchase. If denied, the business may appeal the decision to the Department's Appeals Division.

### ***Use of Deferral Certificate***

The deferral certificate allows vendors and contractors to sell to approved businesses without charging retail sales tax. Sales and use tax may be deferred on three kinds of expenditures:

1. **Qualified Buildings** include structures, expansions, and renovations of existing structures. This includes materials, labor, and services (including labor and services rendered in the planning and installation).
2. **Qualified Machinery and Equipment** includes machinery and equipment that are an integral and necessary part of the manufacturing or research and development operations.
3. **Labor and services** rendered in the planning, installation, and construction of the project.

The purpose of the Rural County Deferral program is to relieve qualified firms, undertaking qualified investment projects in eligible areas, of the obligation to pay tax on the retail construction services. However, it is not a comprehensive sale and use tax exemption. The deferral does not extend to prime construction contractors or subcontractors. It does not relieve contractors or subcontractors of their obligation to pay tax on the purchase or rental of tools, equipment, and supplies that are not incorporated into the final project, even though the ultimate cost of the tax is passed on to the person making the investment.

### ***Required Annual Survey***

An annual survey must be completed by each recipient of a deferral, including a lessee who received the benefit through a lessor. **The survey must be received by March 31** 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. If a business fails to complete a survey by the due date, 12.5 percent of the deferral tax shall be immediately due. The survey shall include:

- the amount of tax deferred.
- the number of new products or research projects by general classification.
- the number of trademarks, patents, and copyrights associated with activities at the investment project.

The survey shall also include the following information for Washington employment positions:

- The number of total employment positions

- Full-time, part-time, and temporary employment positions as a percent of total employment
- The number of employment positions according to the following wage bands:
  - less than \$30,000
  - \$30,000 - \$59,000
  - \$60,000 or greater

(A wage band containing fewer than three individuals may be combined with another wage band.)

- The number of employment positions that have employer-provided medical, dental, and retirement benefits, by each of the wage bands

The amount of tax deferral is public information. All other information collected on the survey is not disclosable to the public.

### ***Audit of the project***

When your application is approved, a deferral certificate will be issued using the estimates from your application. Upon completion of the project, an auditor will verify that you are performing qualified activities at this facility. They will also verify that the approved percentage of your structure and 100 percent of the machinery and equipment are eligible for deferral. The auditor may adjust the allowable deferral based on his or her findings.

To minimize inconvenience and the time it takes to complete an audit, please have the following records for the audit period available for your meeting with the auditor:

- Purchase invoices (i.e., accounts payable, receipts)
- Supporting documentation for the construction, such as construction contracts
- Original Sales and Use Tax Deferral Certificate

Although most audits can be completed with the above records, additional documents may be required during the audit.

### ***Reporting/Documentation required***

- An application must be filed with the Department of Revenue PRIOR to initiation of construction or taking possession of machinery or equipment.
- Annual survey must be filed by March 31<sup>st</sup> of the following year.  
Survey is available online at <http://dor.wa.gov> under Forms, Annual Survey.

### **Laws and Rules**

RCW 82.60— Tax Deferrals for Investment Projects in Distressed Areas

WAC 458-20-24001 — Sales and use tax deferral — Manufacturing and research/development facilities in distressed areas

WAC 458-20-268 – Annual surveys for certain tax adjustments

## Software Manufacturer/Programmer B&O Tax Credit

Effective April 1, 2004, the B&O tax credit for new jobs doing programming or manufacturing of computer software in a rural county is reestablished.

Under this credit, businesses can claim a credit of \$1,000 for each new qualified employment position created in a rural county after January 1, 2004, for up to five consecutive years. Persons who claimed credit under the expired program are eligible to earn credit for each year the position is maintained over the subsequent consecutive years, for up to four years.

**"Computer software"** means a set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task. All software is classified as either prewritten or custom. Consistent with this definition "computer software" includes only those sets of coded instructions intended for use by an end user and specifically excludes retained rights in software and master copies of software.

**"Manufacturing"** means the same as "to manufacture" under RCW 82.04.120. It includes all activities of a commercial or industrial nature wherein labor or skill is applied, by hand or machinery, to materials so that as a result thereof a new, different or useful substance or article of tangible personal property is produced for sale or commercial or industrial use. Manufacturing includes the activities of both manufacturers and processors for hire.

**"Qualified employment position"** means a permanent full-time position doing programming of computer software or manufacturing of computer software. This excludes administrative, professional, service, executive, and other similar positions. If an employee is either voluntarily or involuntarily separated from employment, the employment position is considered filled on a full-time basis if the employer is either training or actively recruiting a replacement employee. Full-time means a position for at least thirty-five hours a week.

### *General Provisions*

- The business must be located in a rural county. (Non-rural counties with a CEZ do not qualify.) A person who partially or totally relocates a business from one rural county to another rural county is eligible for any new qualifying employment positions created as a result of the relocation but is not eligible to receive credit for the jobs moved from one county to the other.
  - **Rural Counties:** Counties with a population density of less than 100 persons per square mile or a county smaller than 225 square miles as determined by the Office of Financial Management, and published each year by the Department for the period of July 1 to June 30. A list is available at the end of this chapter.
- No application is necessary for this credit program.

- Transfer of business ownership does not affect credit eligibility.
- The credit earned during one calendar year may not be carried over to a subsequent calendar year.
- An annual report in a letter form must be filed with the Department of Revenue by January 30 of the year following the year for which a credit is taken. The report must include the following information:
  - Number of positions for which credit is being claimed,
  - Type of position for which credit is being claimed,
  - Type of activity in which the person is engaged in the county,
  - How long the person has been located in the county, and
  - Taxpayer's name and registration number.

***Reporting/Documentation***

- No application
- Annual letter/report must be filed by January 30 of the following year. The Department mails the report to those businesses claiming the credit. If you have questions regarding the report, please call (360) 902-7175.
- No electronic filing requirement
- The B&O tax credit programs expire January 1, 2011.

***Laws & Rules***

RCW 82.04.4483 - Credit -- Programming or manufacturing software in rural counties  
 RCW 82.04.215 – definitions

## Information Technology Help Desk Services B&O Tax Credit

Effective April 1, 2004, the B&O tax credit for persons engaged in the business of providing information technology help desk services to third parties in a rural county is reestablished.

The credit is equal to 100 percent of the B&O tax due that is attributable to providing such services. B&O tax attributable to providing such services between January 1, 2004 and March 31, 2004 is not eligible for the tax credit.

“**Information technology help desk services**” means software and hardware maintenance, diagnostics and troubleshooting, installation, repair, information and training, and upgrades performed using electronic and telephonic communication.

### *General Provisions*

- The business must be providing information technology help desk services to third parties.
- The business must be located in a rural county. (Non-rural counties with a CEZ do not qualify.)
  - **Rural Counties:** Counties with a population density of less than 100 persons per square mile or a county smaller than 225 square miles. A list of qualifying counties is available at the end of this chapter. For current information, please go to: <http://www.ofm.wa.gov/popden/default.asp>
- Transfer of business ownership does not affect credit eligibility.
- The credit earned during one calendar year may not be carried over to a subsequent calendar year.
- An annual report in a letter form must be filed with the Department of Revenue by January 30 of the year following the year for which a credit is taken. The report must include the following information:
  - Type of business activity being performed in the rural county,
  - Number of employees in the rural county,
  - How long the person has been located in the county, and
  - Taxpayer’s name and registration number.

### *Reporting/Documentation*

- No application
- Annual letter/report must be filed by January 30 of the following year. The Department mails the report to those businesses that claimed the credit. If you have questions about the report, please call (360) 902-7175.
- No electronic filing requirement

The B&O tax credit programs expire January 1, 2011.

### *Laws & Rules*

RCW 82.04.4484 - Credit - Information technology help desk services in rural counties

### **Rural Counties (July 1, 2006 – June 30, 2007)**

Adams	Grant	Pend Oreille
Asotin	Grays Harbor	San Juan
Benton	Jefferson	Skagit
Chelan	Kittitas	Skamania
Clallam	Klickitat	Stevens
Columbia	Lewis	Wahkiakum
Cowlitz	Lincoln	Walla Walla
Douglas	Mason	Whatcom
Ferry	Okanogan	Whitman
Franklin	Pacific	Yakima
Garfield		

This list is in effect through June 30, 2007. It will be updated on July 1, 2007, using the Office of Financial Management (OFM) county population estimates for April 1, 2007.

For updated information, go to: **<http://www.ofm.wa.gov/popden/default.asp>**

**Community Empowerment Zone (CEZ)** maps are available on our web site at <http://dor.wa.gov> under Tax Incentives. Cities with CEZs:

Bremerton   Spokane   Tacoma   Yakima   Duwamish and White Center

*Chapter 4*  
**High Technology Tax Incentives**

**High Technology B&O Tax Credit**

The "High Tech" B&O tax credit is codified under Chapter 82.63RCW. Effective June 10, 2004, the program provides a B&O tax credit of up to \$2 million annually based on eligible research and development expenditures by firms that are engaged in one or more of the following areas of high technology:

**Advanced computing.** "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.

**Advanced materials.** "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.

**Biotechnology.** "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.

**Electronic device technology.** "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.

**Environmental technology.** "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.

The credit is based on eligible expenditures on research and development (R&D) in excess of 0.92 percent of the firm's taxable income. The percentage threshold was based on national average expenditures for R&D. The calculation procedure to determine the credit amount was revised in 2004 and again in 2005.

***Important Definitions for Calculating the Credit***

**"Average tax rate"** means a person's total B&O tax liability for the calendar year for which the credit is claimed divided by the taxpayer's total taxable amount under the B&O tax for the calendar year for which the credit is claimed.

**“Taxable amount”** means the taxable amount subject to the B&O tax and required to be reported on the person’s excise tax returns for the calendar year for which the credit is claimed, less any taxable amount for which a credit is allowed under RCW 82.04.440 (Multiple Activities Tax Credit).

**“Research and development spending”** means qualified research and development expenditures plus 80 percent of amounts paid to a person other than a public educational or research institution to conduct qualified research and development.

**“Qualified research and development expenditures”** means operating expenses, including wages, compensation of a proprietor or a partner in a partnership as determined under rules adopted by the Department, benefits, supplies, and computer expenses, directly incurred in qualified research and development by a person claiming the credit provided in this section. 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.

**“Qualified research and development”** means research and development performed within this state in the fields of advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology.

### *Calculating the Credit*

If the person meets the threshold of research and development spending to qualify for the credit, the credit shall be calculated as follows:

Step 1: Determine the greater of the amount of qualified research and development expenditures of a person or 80 percent of amounts received by a person other than a public educational or research institution in compensation for the conduct of qualified research and development.

Step 2: Subtract 0.92 percent of the person’s taxable amount from the amount determined in step one.

Step 3: Multiply the amount determined under step two by the following:

- For the period June 10, 2004, through December 31, 2006, the person’s average tax rate for the calendar year for which the credit is claimed;
- For the calendar year ending December 31, 2007, the greater of the person’s average tax rate for that calendar year or 0.75 percent;
- For the calendar year ending December 31, 2008, the greater of the person’s average tax rate for that calendar year or 1.0 percent;
- For the calendar year ending December 31, 2009, the greater of the person’s average tax rate for that calendar year or 1.25 percent;
- For the calendar year ending December 31, 2010, and thereafter, 1.50 percent.

### ***End of the Year Reconciliation Required***

For purposes of calculating the credit, if a person's reporting period is less than annual, the person may use an estimated average tax rate for the calendar year for which the credit is claimed by using the person's average tax rate for each reporting period. A person who uses an estimated average tax rate must make an adjustment to the total credit claimed for the calendar year using the person's actual average tax rate for the calendar year when the person files its last return for the calendar year for which the credit is claimed.

### ***Electronic Filing Required***

Virtually all persons receiving tax benefits from the High Technology B&O tax credit provided by RCW 82.04.4452 **must file all returns, surveys, reports, and any other required forms or information in an electronic format** as provided or approved by the Department **effective January 1, 2006**.

However, upon request, the Department may relieve a person from the requirement to file electronically if the person's cumulative tax benefit from all tax credits and waiver programs is less than \$1,000 annually.

### ***Annual Survey***

Persons claiming the credit must file an annual survey. This document is due by **March 31st** of the year following any year in which a credit is taken. If a person fails to complete the survey by the due date, that person is not eligible to take the credit for the entire year in which the survey was due. If a person has already taken the credit, the Department must, pursuant to law, declare the amount of taxes for which the credit was taken to be immediately due and payable.

### ***Reporting/Documentation***

- No application required
- Annual survey by March 31<sup>st</sup> of the following year
- Electronic filing of all documents with the Department required
- End of the year reconciliation required for any one person filing less than annually

This program expires January 1, 2015.

### ***Laws & Rules***

RCW 82.63 – Tax deferrals for high technology businesses.

RCW 82.04.4452 – Credit research and development spending.

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

WAC 458-20-268 – Annual surveys for certain tax adjustments

## **High Technology Sales & Use Tax Deferral Program for Research and Development (R&D) Facilities**

The High Tech Sales & Use Tax Deferral/Waiver for R&D Facilities grants a deferral, and eventual waiver, of retail sales and use tax for businesses that construct a new R&D facility or pilot-scale manufacturing facility and acquire equipment or expand, renovate, or equip an existing facility in Washington involved in one of the following areas of high technology (RCW 82.63):

**Advanced computing** - 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.

**Advanced materials** - 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.

**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.

**Electronic device technology** - 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.

**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.

### ***Requirements***

**Applications must be filed with the Department of Revenue BEFORE:**

- **a building permit is issued under the building code, or**
- **machinery and/or equipment is acquired.**

The *High Technology Application for Sales and Use Tax Deferral* is available on our web site at <http://dor.wa.gov> under Forms or by calling 1-800-647-7706.

The investment project must be devoted to research and development or pilot scale manufacturing to qualify for the deferral. The investment must consist of machinery and equipment, new structures, and/or expansion or renovation to increase floor space or production capacity. The machinery and equipment may be used, but must be new to the state or business.

A person who owns property and leases to another may receive deferral of taxes on qualifying expenditures if:

- The underlying ownership of the buildings, machinery, and equipment vests exclusively in the same person, or
- The owner agrees in writing to pass the entire economic benefit of the program to the lessee, the lessee agrees in writing to complete the annual survey, and the economic benefit of the deferral passed to the lessee is no less than the amount of tax deferred by the lessor and is evidenced by written documentation of the financial arrangement between the owner and the lessee.

If a building is used partly for pilot scale manufacturing or qualified research, and partly for other purposes, the tax deferral will be apportioned on the basis of the cost of the area used for the qualified purposes.

**Note: Businesses are not required to file electronically all returns, reports, or surveys with the Department to take advantage of this program.**

**“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 new use for an existing drug, device, or biological product if the new use requires a separate licensing by the FDA under chapter 21. 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.

**“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.

**“Qualified machinery and equipment”** means fixtures, equipment and support facilities that are an integral and a necessary part of pilot scale manufacturing or qualified research and development operation. This includes computers, software, data processing equipment, laboratory equipment, instrumentation, and other devices used in the process of experimentation to develop a new or improved pilot model, plant process, product, formula, invention or similar property

### ***Deferred Taxes***

Taxes are deferred under this program if the business uses the investment project for qualified research and development or pilot scale manufacturing during the year in which the investment is certified as operationally complete, and the next seven calendar years.

If the investment project is used for any other reason at any time during the calendar year in which the investment is certified as operationally complete, or during the next seven calendar years, the deferred taxes must be repaid immediately according to a prorated schedule. Interest will be assessed on the payments. The sales or use taxes on machinery or equipment used in manufacturing that could have qualified for the Manufacturers' Sales/Use Tax Exemption at the time of purchase or first use do not have to be repaid.

### ***Application***

The *High Technology Application for Sales and Use Tax Deferral* is available on our web site at <http://dor.wa.gov> under Forms or by calling 1-800-647-7706.

A project that has received any sales/use tax deferral under this or any other deferral program is not eligible for further deferral under this program. A research and development facility can get additional deferral certificates to upgrade to pilot scale manufacturing. Businesses may have more than one project that may qualify for deferral under any of these programs.

The Department of Revenue must approve or deny applications within 60 days. If approved, a Tax Deferral Certificate is issued to the business to provide to vendors and contractors at the time of purchase. If denied, the business may appeal the decision to the Department's Appeals Division.

### ***Use of Deferral Certificate***

The deferral certificate allows vendors and contractors to sell to approved business without charging retail sales tax. Sales and use tax may be deferred on three kinds of expenditures:

1. Qualified buildings;
2. Qualified machinery and equipment; and
3. Labor and services rendered in the planning, installation and construction of the project.

The purpose of the program is to relieve manufacturing firms, undertaking qualified investment projects in eligible areas, of the obligation to pay tax on the retail construction services. However, it is not a comprehensive sale and use tax exemption. The deferral does not extend to prime construction contractors or subcontractors. It does not relieve contractors or subcontractors of their obligation to pay tax on the purchase or rental of tools, equipment, and supplies that are not incorporated into the final project, even though the ultimate cost of the tax is passed on to the person making the investment.

### ***Annual Survey***

An Annual Survey providing substantial information about the business, employees, and employee benefits and wages must be filed with the Department of Revenue by **March 31** of each year for eight years after the qualifying project is operationally complete. The *Annual Survey for Tax Deferral Program for High Technology Businesses* is available on our web site at <http://dor.wa.gov> under Forms or by calling 1-800-647-7706.

### ***Audit of the Project***

When your application is approved, a deferral certificate will be issued using the estimates from your application. Upon completion of the project, an auditor will verify that you are performing qualified activities at this facility. They will also verify that the approved percentage of your structure and 100 percent of the machinery and equipment are eligible for deferral. The auditor may adjust the allowable deferral based on his or her findings.

To minimize inconvenience and the time it takes to complete an audit, please have the following records for the audit period available for your meeting with the auditor:

- Purchase invoices (i.e., accounts payable, receipts)
- Supporting documentation for the construction, such as construction contracts; and
- Original Sales and Use Tax Deferral Certificate.

Although most audits can be completed with the above records, additional documents may be required during the audit.

### ***Reporting/Documentation***

- Applications must be filed with the Department of Revenue **BEFORE**:
  - a building permit is issued under the building code, or
  - machinery and/or equipment is acquired.
- Annual survey must be filed by March 31<sup>st</sup> of the following year
  - Available online at <http://dor.wa.gov> under FORMS, Annual Survey
- No electronic filing requirement

The expiration date of this program is currently July 1, 2010.

### ***Laws and Rules***

RCW 82.63 - Tax deferrals for high technology businesses

WAC 458-20-24003 - Tax incentives for high technology businesses

WAC 458-20-268 – Annual surveys for certain tax adjustments

*Chapter 5*  
**Biotechnology Product & Medical Device Manufacturers  
Sales & Use Tax Deferral Program**

The Biotechnology Product & Medical Device Manufacturers Sales & Use Tax Deferral is available for investments in construction or renovation of structures, or machinery and equipment used for biotechnology product or medical device manufacturing.  
(See RCW 82.75)

*Important Definitions*

“**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.

“**Medical device**” is 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:

- Recognized in the national formulary, or the United States pharmacopeia, or any supplement to them;
- 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
- Intended to affect the structure or any function of the body of man or other animals, and 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.

*Requirements*

Applications for the deferral/waiver program must be **received and approved** by the Department of Revenue prior to starting construction or possessing machinery or equipment in Washington. The application is available on our web site at <http://dor.wa.gov> under Forms or by calling 1-800-647-7706.

The Department will approve or deny applications within 60 days of receipt. When an application is approved, we will issue a sales and use tax deferral certificate for state and local sales and use taxes.

**Note:** Certificates will not be issued for investment projects that have already received a deferral under the Rural County or High Technology Deferral Programs. (RCW 82.60 & 82.63)

**“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 of the project.

The lessor or owner of a qualified building may be eligible for a deferral **provided:**

- Underlying ownership of the buildings, machinery, and equipment vests exclusively in the same person; or
- Lessor by written contract agrees to pass the full amount of the economic benefit of the deferral to the lessee, and the lessee agrees in writing to complete the Annual Survey and maintain documentary evidence that this has taken place.

**“Initiation of construction”** is the date that a building permit is issued under the building code adopted under RCW 19.27.031. “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 building’s foundation.

**“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, including:

- 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 if the facilities are an essential or an integral part of a factory, plant, or laboratory used for biotechnology product manufacturing or medical device manufacturing.

If a building is used partly for biotechnology product manufacturing or medical device manufacturing and partly for other purposes, the applicable tax deferral will be determined by apportionment of the construction costs under Department rules.

**“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 including:

- Computers
- Software
- Data processing equipment
- Laboratory equipment
- Manufacturing components such as belts, pulleys, shafts, and moving parts

- Molds, tools, and dies
- Operating structures
- Equipment used to control or operate the machinery

### *Use of Deferral Certificate*

The deferral certificate allows vendors and contractors to sell to approved business without charging retail sales tax. Sales and use tax may be deferred on three kinds of expenditures:

1. Qualified buildings;
2. Qualified machinery and equipment; and
3. Labor and services rendered in the planning, installation and construction of the project.

The purpose of the program is to relieve biotechnology product and medical device manufacturing firms, undertaking qualified investment projects, of the obligation to pay tax on the retail construction services. However, it is not a comprehensive sale and use tax exemption. The deferral does not extend to prime construction contractors or subcontractors. It does not relieve contractors or subcontractors of their obligation to pay tax on the purchase or rental of tools, equipment, and supplies that are not incorporated into the final project, even though the ultimate cost of the tax is passed on to the person making the investment.

### *Annual Survey*

Eligible businesses must file an **Annual Survey** detailing employee information by **March 31** following the year in which the investment project is operationally complete and/or audited and the following seven years. The project must remain an eligible investment project for an eight year period in order for all deferred taxes to be waived. See WAC 458-20-268 (Annual surveys for certain tax adjustments) for more information on the requirements to file annual surveys.

### *Audit of the Project*

When your application is approved, a deferral certificate will be issued using the estimates from your application. Upon completion of the project, an auditor will verify that you are performing qualified activities at this facility. They will also verify that the approved percentage of your structure and 100 percent of the machinery and equipment are eligible for deferral. The auditor may adjust the allowable deferral based on his or her findings.

To minimize inconvenience and the time it takes to complete an audit, please have the following records for the audit period available for your meeting with the auditor:

- Purchase invoices (i.e., accounts payable, receipts)
- Supporting documentation for the construction, such as construction contracts; and
- Original Sales and Use Tax Deferral Certificate.

Although most audits can be completed with the above records, additional documents may be required during the audit.

***Reporting/Documentation***

- Applications must be **received and approved** by the Department of Revenue prior to starting construction or possessing machinery or equipment in Washington.
- Annual Survey must be filed by March 31 of the following year
- No electronic filing requirement.

The expiration date of this program is January 1, 2017.

***Laws & Rules***

RCW 82.75 - Tax deferrals for biotechnology and medical device manufacturing businesses.

WAC 458-20-xxx – Tax incentives for biotechnology product and medical device manufacturers.

WAC 458-20-268 - Annual surveys for certain tax adjustments.

*Chapter 6*  
**Aerospace Industry Tax Incentives**

**Reduced B&O Tax Rate for Manufacturers of  
Commercial Aircraft & Component Parts**

RCW 82.04.260(11) provides a comprehensive tax incentive program for persons engaged in manufacturing commercial airplanes and manufacturers of component parts of commercial airplanes. Although the bill is effective December 1, 2003, some incentives are not available for use until a later date. Additionally, several incentives apply to manufacturers of commercial airplanes *and* manufacturers of component parts of commercial airplanes, while other incentives apply only to manufacturers of commercial airplanes.

***Important definitions***

“**Commercial airplane**” means an airplane certified by the Federal Aviation Administration (FAA) for transporting persons or property, and any military derivative of such an airplane.

“**Component**” means a part or system certified by the FAA for installation or assembly into a commercial airplane.

***Business and Occupation Tax Rate Decrease***

The business and occupation (B&O) tax rate for manufacturers and processors for hire of commercial airplanes or component parts of commercial airplanes will decrease as outlined below. The rate will apply to both the manufacturing activity and the subsequent sale of the manufactured product by the manufacturer. The manufacturer is also eligible for the multiple activities tax credit (MATC). Persons who qualify for this B&O tax rate decrease should report the income under the new Aerospace B&O tax classification on the excise tax return.

<b>Period</b>	<b>Rate</b>
December, 1, 2003 - September 30, 2005	.00484
October 1, 2005 - June 30, 2007	.004235 (reduction of 12.5%)
July 1, 2007 * - June 30, 2024	.002904 (reduction of 40.0%)

\* The reduction to the .002904 B&O tax rate provided in this legislation takes effect on the later of July 1, 2007, or when final assembly of a superefficient airplane has begun.

***Reporting / Documentation***

- No Application
- Annual Report must be filed by March 31<sup>st</sup> following any calendar in which incentive is taken. (WAC 458-20-267, Annual Report instructions)

## **B&O Tax Credit for Pre-Production Development Expenditures for Aircraft Manufacturing**

**Effective December 1, 2003**, RCW 82.04.4461 provides a B&O tax credit equal to 1.5% of *qualified preproduction development expenditures* used in manufacturing commercial airplanes or component parts of commercial airplanes by manufacturers and processors for hire of commercial airplanes or component parts of commercial airplanes.

- The credit can accrue for expenditures made on and after December 1, 2003, but cannot be used until July 1, 2005.
- The credit should be reported under the Credits section of the excise tax return for periods starting July 1, 2005.
- The credit cannot exceed B&O taxes due for any reporting period. However, the credit can be carried over from one period to another within the same calendar year.
- Unused credit accrued from December 1, 2003, through June 30, 2005, may be carried over until used.
- Unused credit accrued after June 30, 2005, cannot be carried over beyond the calendar year in which it is accrued.
- Credit may not be claimed for expenditures for which a credit is claimed under RCW 82.04.4452 (High Technology Research and Development B&O tax).

### ***Reporting/Documentation***

- Pre-approval is not required from the Department of Revenue to use the credit.
- An *Aerospace Credit Affidavit for Preproduction Spending* must be filed with the Department for each reporting period a credit is taken. The affidavit is available on our web site at <http://dor.wa.gov> under Forms.
- *Annual report* must be filed by March 31<sup>st</sup> of the year following any year in which a credit is claimed. (See WAC 458-20-267, Annual report for instructions)
- Report B&O credit under *Credit* section on excise tax return.

### ***Laws & Rules***

- RCW 82.04.4461 - Credit — Preproduction development spending.
- RCW 82.32.545 - Annual report for airplane manufacturing tax preferences
- WAC 458-20-267 - Annual reports for certain tax adjustments

## **B&O Tax Credit for Property/Leasehold Tax Paid on Aerospace Manufacturing Facilities**

Effective December 1, 2003, RCW 82.04.4463 provides a B&O tax credit for property taxes paid on qualifying property used in manufacturing commercial airplanes or component parts of commercial airplanes. The credit is claimed on the excise tax return and cannot be claimed until after the property taxes on the qualifying property have been paid.

### ***Definitions***

The following definitions are important to understanding who qualifies for the B&O tax credit.

“**Commercial airplane**” means an airplane certified by the Federal Aviation Administration (FAA) for transporting persons or property, and any military derivative of such an airplane.

“**Component**” means a part or system certified by the FAA for installation or assembly into a commercial airplane.

### ***Qualifying Property***

The B&O tax credit may apply for property taxes paid on new buildings and land upon which the buildings are located, property taxes attributable to an increase in assessed value due to a renovation or expansion, and for property taxes paid on machinery and equipment exempt from sales and use tax under the machinery and equipment (M&E) exemption. The conditions for each type of property are listed below:

#### **New Buildings and Land**

- The new buildings must be built on or after December 1, 2003.
- The new buildings must be used in manufacturing commercial airplanes or component parts.
- Property taxes on the land upon which the new buildings are built may be claimed as part of the credit.

#### **Renovation or Expansion of Buildings**

- The renovation or expansion must be made on or after December 1, 2003.
- The renovated or expanded buildings must be used in manufacturing commercial airplanes or component parts.

#### **Machinery and Equipment**

- The machinery and equipment must be acquired on or after December 1, 2003.
- The machinery and equipment must be exempt from sales and use tax under the RCW 82.08.02565 or 82.12.02565 M&E sales and use tax exemption.
- The machinery and equipment must be used to manufacture commercial airplanes or their component parts.

### ***Claiming the B&O Tax Credit***

The B&O tax credit must be claimed on the excise tax return, and cannot be claimed until the property taxes on the qualifying property have actually been paid. Property taxes for each year are generally paid in two installments: the first installment is due by April 30 and the second installment is due by October 31. Taxpayers have the option of paying the full amount of taxes by April 30. Property taxes generally cannot be paid before February 15 of the year they are due.

For qualifying property purchased, expanded or renovated in 2004, the first year the credit may be claimed was 2005.

Information you receive from the county assessor and the county treasurer will help you in determining the amount of property tax eligible for the credit. In the year you purchase, renovate or expand qualifying property, the county assessor will value the qualifying property and send you a valuation notice. (If machinery and equipment is treated as personal property, it will be listed in a separate valuation notice). The following year the county treasurer will send you a tax statement for the same property identifying the tax rate and the taxes due on the property. In the case of new buildings, land and qualifying machinery and equipment, the amount of the B&O tax credit is equal to the value of the qualifying property set forth in the valuation notice multiplied by the tax rate set forth in the tax statement. In the case of qualifying renovation or expansion, the credit is equal to the increase in value attributable to the renovation or expansion multiplied by the tax rate set forth in the tax statement. The Department is developing additional guidance on how to determine the increase in value attributable to the renovation or expansion. When this guidance is completed, it will be available on the Department of Revenue's web site at <http://dor.wa.gov>.

If your B&O tax obligation is less than the property taxes paid on qualifying property, the credit may carry forward one year but may not be carried over a second year. B&O tax refunds will not be granted in lieu of a credit for property taxes paid. The credit may be claimed through June 30, 2024.

### ***Documentation***

You must maintain documentation in your records to substantiate your claim for this credit. The credit is subject to audit by the Department of Revenue. Information needed for verification and for calculation of the amount of credit can be found on several documents such as: the Assessor's Notice of Value or Change of Value, the Assessor's Notice of New Construction Value, a property tax billing statement from the County Treasurer's Office, a cancelled check from payment of property taxes, the Assessor's Parcel number, and information from building permits or invoices.

### ***Annual Reporting Requirements***

A person who claims this credit must submit an **annual report** to the Department of Revenue detailing employment, wages, and employer-provided health and retirement benefits per job at the manufacturing site. The report is due by March 31 following the year in which the credit is taken. (WAC 458-20-267, Annual report instructions.)

## **Sales & Use Tax Exemption for Aerospace Manufacturer Computer Costs**

RCW 82.08.975 and RCW 82.12.975 provide a retail sales and a use tax exemption for computer hardware, software, and computer peripherals when purchased by manufacturers and processors for hire of commercial airplanes or component parts of commercial airplanes. The exemption also applies to charges for labor and services related to the installation of qualifying computer hardware, software, and computer peripherals.

- The exemption applies to computer equipment not otherwise eligible for the manufacturing machinery and equipment (M&E) exemption.
- Qualifying equipment must be used **primarily** in the design, development, and engineering of commercial airplanes or component parts of commercial airplanes.
- The purchaser must provide the vendor with a completed *Buyers' Retail Sales Tax Exemption Certificate*, checking the appropriate box in Section 5 of this certificate. This form can be found at the Department of Revenue's web site at <http://dor.wa.gov> under Forms.
- Purchasers who paid sales tax on qualifying exempt purchases on or after December 1, 2003, should submit an exemption certificate and refund request directly to the vendor.

### **Definitions**

**“Commercial Airplane”** means an airplane certified by the Federal Aviation (FAA) for transporting persons or property or any military derivative of such an airplane.

**“Component”** means a part or system certified by the FAA for installation or assembly into a commercial airplane.

**“Primarily”** means greater than 50% of the equipment's capacity or total time the equipment is used.

**“Computer Peripherals”** include keyboards, monitors, mouse devices, and other devices that operate outside the computer *excluding* cables, conduit, wiring, and similar property.

*Chapter 7*  
**Non-Manufacturer Aerospace Tax Incentives**

**Sales/Use Tax Exemption on Certain Computer Equipment**

**B&O Tax Credit on Preproduction Development Expenditures  
&  
Reduced B&O Tax Rate for FAR Part 145 Repair Stations**

Persons who develop, design, and engineer, but do not manufacture commercial airplanes or component parts of commercial airplanes, are eligible for a **sales and use tax exemption** for certain computer equipment purchases and a business and occupation (**B&O**) **tax credit** based on certain preproduction development expenditures. Similar programs were previously available only to aerospace manufacturers and processors for hire. These two programs expire July 1, 2024.

The preferential B&O tax rate for FAR part 145 repair stations has been changed to 0.002904. The expiration date has been extended to December 31, 2012.

***Sales and Use Tax Exemption***

Purchases and installation of computer hardware, peripherals, or software, used to develop, design, and engineer commercial airplanes or component parts of commercial airplanes by persons who develop, design, and engineer, but do not manufacture such items, are eligible for a sales and use tax exemption.

To take advantage of the sales tax exemption, the buyer must provide the seller with a completed *Buyers' Retail Sales Tax Exemption Certificate*. The certificate is available on our web site at <http://dor.wa.gov> under Forms.

***B&O Tax Credit***

Persons who develop, design, and engineer, but do not manufacture commercial airplanes and component parts, are eligible for a B&O tax credit on qualified preproduction development expenditures made after July 1, 2006.

- The credit is equal to the amount of qualified preproduction development expenditures incurred, multiplied by the rate of 1.5 percent.
- The credit must be taken against taxes due for the same calendar year in which the qualified preproduction development expenditures are incurred. **Credits may not be carried over.**
- The credit for each calendar year may not exceed the amount of B&O tax due. Refunds will not be granted in the place of a credit.

- The credit may not be claimed for expenditures for which a credit is claimed under RCW 82.04.4452 (High Tech B&O credit) or RCW 82.04.4461 (Aerospace Manufacturer Preproduction Expenditure B&O credit).

### ***Important Definitions***

“**Qualified preproduction development expenditures**” means operating expenses, including wages, compensation of a proprietor or a partner in a partnership (as determined by the Department), benefits, supplies, and computer expenses, directly incurred in qualified preproduction development by a person claiming the B&O tax credit.

It does not include amounts paid to a person other than a public education or research institution to conduct qualified preproduction development. It also does not include capital costs and overhead, such as expenses for land, structures, or depreciable property.

“**Qualified preproduction development**” means preproduction development performed within Washington in the field of aeronautics.

“**Aeronautics**” means the study of flight and the science of building and operating commercial aircraft.

“**Preproduction development**” means research, design, and engineering activities performed in relation to the development of a product, product line, model, or model derivative, including prototype development, testing, and certification. It includes the discovery of technological information, the translating of technological information into new or improved products, processes, techniques, formulas, or inventions, and the adaptation of existing products and models into new products or new models, or derivatives of products or models.

It does not include manufacturing activities or other production-oriented activities. The term does not 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.

### ***Reporting/Documentation***

- File tax returns electronically; and
- File an Annual Survey\* detailing employee information by March 31 of each year. (See WAC 458-20-268 – Annual survey for certain tax adjustments.)

\* This is a different form from the *Annual Report*, which must be filed by aerospace manufacturers who take advantage of RCW 82.04.4463 and other aerospace tax incentive programs.

### ***Laws & Rules***

RCW 82.04.4487 - Credit -- Commercial aircraft -- Qualified preproduction development expenditures.

RCW 82.08.981 - Exemptions (sales tax) — Development, design, and engineering of commercial airplanes

RCW 82.12.981 - Exemptions (use tax) — Development, design, and engineering of commercial airplanes.

WAC 458-20-268 – Annual surveys for certain tax adjustments

### **FAR Part 145 Repair Stations**

The preferential B&O tax rate for FAR part 145 repair stations has changed to .002904 from .0027 and has been extended to December 31, 2012. The .275 rate was scheduled to expire June 30, 2006.

***Available to:***

Persons certified by the Federal Aviation Administration (FAA) to perform repair and maintenance on commercial airplanes under FAR Part 145

***Qualifying Activity:***

Performing repair and maintenance on commercial airplanes

***Reporting/Documentation:***

- No application
- Electronic filing of all documents required
- **Annual Survey\*** must be filed by March 31st following the year in which the credit is taken. (See WAC 458-20-268 – Annual Surveys.)

\* This is a different form from the *Annual Report*, which must be filed by aerospace manufacturers who take advantage of RCW 82.04.4463 and other aerospace tax incentive programs.

***Laws & Rules***

RCW 82.04.250(3) - Tax on retailers

WAC 458-20-268 – Annual surveys for certain tax adjustments

*Chapter 8*  
**Food Processing Tax Incentives**

**B&O Tax Exemption for Manufacturing Fresh Fruits & Vegetables**

RCW 82.04.4266 states the business and occupation (B&O) tax no longer applies to the value of canning, preserving, freezing, processing, or dehydrating fresh fruits and vegetables or to wholesale sales by the persons performing these activities when the sales are to purchasers who transport the goods out of this state in the ordinary course of business. This exemption is **effective July 1, 2005**.

Prior to July 1, 2005, persons engaged in these activities were subject to B&O tax at the rate of 0.138 percent.

Instate wholesale sales to persons who **do not** transport the goods out of this state in the ordinary course of business remain subject to the wholesaling classification of the B&O tax at the rate of 0.484 percent.

***Annual Survey Requirements***

Each person claiming the tax exemption shall report information to the Department of Revenue by filing an annual survey. The survey is due by March 31 of the year following the calendar year in which a tax exemption is taken. A survey form (REV 81 1014) is available on our web site at <http://dor.wa.gov> under the Forms link.

***Laws & Rules***

RCW 82.04.4266 - Exemptions — Fruit and vegetable businesses  
RCW 82.32.610 – Annual survey  
WAC 458-20-268 – Annual surveys for certain tax adjustments

**Processing Plants and Cold Storage Warehouses Tax Incentives**

The legislation also provides tax incentives for the construction or expansion of a fresh fruit or vegetable processing plant and construction or expansion of a cold storage warehouse. These incentive programs will become effective July 1, 2007. The Department of Revenue will issue detailed information about these programs as the effective date draws closer. (RCW 82.74)

## **B&O Tax Exemption for Manufacturing Dairy Products**

Persons manufacturing dairy products are exempt from the business and occupation (B&O) on the value of products and gross proceeds on dairy products **sold to buyers who transport the goods, in the ordinary course of business, out of Washington**. The person claiming the tax exemption must maintain documentation that the goods were transported out of the state by the purchaser. This B&O tax exemption is **effective July 1, 2006** and will expire July 1, 2012 at which time, the activities will be subject to B&O tax at the 0.00138 rate.

Instate wholesale sales to persons who **do not transport the goods out of this state**, in the ordinary course of business, remain subject to the Wholesaling classification of the B&O tax at the 0.00484 rate.

### ***Dairy Product and Manufacturing Defined***

For this tax exemption, “**dairy product**” means dairy products that as of September 20, 2001 are identified in 21 C.F.R., milk and cream (chapter 1, parts 131), cheeses and related cheese products (133), and frozen desserts (135), including by-products from the manufacturing of the dairy products such as whey and casein.

The term “**manufacturing**” means manufacturing as defined in RCW 82.04.120.

### ***Reporting/Documentation***

- Required to electronically file all returns, surveys, and any other forms and information required. To sign up for E-file go to our web site at **<http://dor.wa.gov>**.
- Annual survey due by March 31 of the year following the calendar year in which a tax exemption is taken.

### ***Laws & Rules***

RCW 82.04.4268 - Exemptions — Dairy product businesses

RCW 82.32.610 - Annual survey requirements

WAC 458-20-268 – Annual surveys for certain tax adjustments

## **Processing Plants and Cold Storage Warehouses Tax Incentives**

There are also tax incentives for the construction or expansion of dairy product processing plants and cold storage warehouses. These incentive programs will become **effective July 1, 2007**. The Department of Revenue will issue detailed information about these programs as the effective date draws closer. (RCW 82.74)

## **B&O Tax Exemption for Manufacturing Seafood Products**

Persons manufacturing seafood products are exempt from the business and occupation (B&O) tax when the seafood products remain in a raw, frozen, or raw salted state at the end of the manufacturing process. The tax exemption includes the value of products from manufacturing seafood and gross proceeds on seafood products **sold to buyers who transport the goods, in the ordinary course of business, out of Washington**. Persons claiming the tax exemption must maintain documentation that the goods were transported out of the state by the purchaser. (Engrossed House Bill 3159)

This tax exemption is **effective July 1, 2006** and expires July 1, 2012 at which time, the activities will be subject to B&O tax at the 0.00138 rate. Instate wholesale sales to persons who **do not transport the goods out of Washington**, in the ordinary course of business, remain subject to the Wholesaling classification of the B&O tax at the 0.00484 rate.

### ***Reporting/Documentation***

- Required to electronically file all returns, surveys, and any other forms and information required. To sign up for E-file go to our web site at **<http://dor.wa.gov>**.
- Annual survey due by March 31 of the year following the calendar year in which a tax exemption is taken.

### ***Laws & Rules***

RCW 82.04.4269 - Exemptions — Seafood product businesses

RCW 82.32.610 – annual survey

WAC 458-20-268 – Annual survey for certain tax adjustments

## **Deferral/Waiver: Processing Plants and Cold Storage Warehouses**

There are also tax incentives for the construction or expansion of seafood manufacturing plants and cold storage warehouses. These incentive programs will become **effective July 1, 2007**. We will issue information about these programs as the effective date draws closer. The Department of Revenue will issue detailed information about these programs as the effective date draws closer. (RCW 82.74)

## **Beef Processors – B&O Tax Relief for Processors Impacted by the Ban on American Beef Products**

RCW 82.04.4336 establishes that the deduction from the business and occupation (B&O) tax for certain businesses impacted by the ban on American beef products will expire on December 31, 2007, or when Japan, Korea, and Mexico all lift their bans on importation of United States beef, whichever occurs first.

The original legislation Substitute House Bill 2929, Chapter 235, Laws of 2004 temporarily provided Washington's beef processors with a deduction from the measure of business and occupation tax for:

- Slaughtering cattle **if** the slaughtered cattle are sold at wholesale.
- Breaking or processing perishable beef products **if** the products are slaughtered and sold at wholesale by the taxpayer.
- Wholesale sales of perishable beef products derived from cattle slaughtered by the taxpayer.
- Processing nonperishable beef products **if** the products come from cattle slaughtered by the taxpayer and sold at wholesale.
- Wholesale sales of nonperishable beef products derived from cattle slaughtered by the taxpayer.

The deduction does not apply if the resulting beef products are sold at retail. "Beef products" is defined by RCW 82.04.4336 to be the carcass, parts of carcass, meat, and meat by-products, derived exclusively from cattle and containing no other ingredients.

### ***Reporting/Documentation***

- For tax reporting purposes the deduction is reported on the deduction detail sheet as an "other" deduction. In the space provided for an explanation taxpayers should write "beef ban."
- No application or pre-approval required
- No annual survey or report required

### ***Laws & Rules***

RCW 82.04.4336 - Deductions — Cattle and beef products

## ***Chapter 9*** **Biofuel Industry Tax Incentives**

### **Manufactures of Biodiesel Fuel, Alcohol Fuel, Biodiesel Feedstock, and Wood Biomass Fuel**

#### **Reduced B&O Tax Rate**

#### **Property and Leasehold Tax Exemptions**

Effective July 1, 2003, RCW 82.04.260, RCW 84.36.635, and RCW 84.36.640 provide significant tax benefits for persons who manufacture biodiesel fuel, alcohol fuel, biodiesel feedstock, and wood biomass fuel. The benefits include property and leasehold excise tax exemptions and a lower B&O tax rate for persons manufacturing these products.

#### ***Important definitions***

**Biodiesel Fuel** means a mono alkyl ester of long chain fatty acids derived from vegetable oils or animal fats for use in compression-ignition engines and meets the American Society of Testing and Materials specification D 6751. ***Taxpayers must maintain certification from a testing lab that their biodiesel meets the ASTM standard***

**Biodiesel Feedstock** means oil that is produced from an agricultural crop for the sole purpose of ultimately producing biodiesel fuel.

**Alcohol Fuel** means any alcohol made from a product other than petroleum or natural gas that is used in combination with gasoline or other petroleum products for use as a fuel in motor vehicles or farm implements.

**Wood Biomass Fuel** means pyrolytic liquid fuel or synthesis gas-derived liquid fuel, used in internal combustion engines, and produced from wood, forest, or field residue, or from dedicated energy crops, and does not include any wood pieces that contain chemical preservatives.

#### ***B&O Tax Rate Reduction***

The tax rate for manufacturers of biodiesel fuel, biodiesel feedstock, alcohol fuel, and wood biomass fuel has been reduced from 0.484% to 0.138%. The value of such products should be reported on Line 5 of the Combined Excise Tax Return. The lower rate does not apply to the manufacture of biodiesel fuel **blends** or wood biomass fuel **blends**. (RCW 82.04.260)

Please note that such fuels remain subject to the Special Fuels tax, RCW 82.38 when sold for the propulsion of motor vehicles upon the road and highways of this state. For detailed information about this tax, contact the Department of Licensing, Fuel Tax Division at <http://www.dol.wa.gov/>

***Property Tax and Leasehold Excise Tax Exemption***

RCW 84.36.635 and RCW 84.36.640 both provide that qualifying real and personal property is exempt or partially exempt from property tax and leasehold excise tax.

**Qualifying** real and personal property must be operational and must be used primarily for manufacturing alcohol, biodiesel or wood biomass fuels. Qualifying property includes buildings, machinery and equipment, other personal property and land associated with the manufacture of these products, but not the land used to grow crops. The buildings and equipment must be new and not have existed before July of 2003.

For manufacturing facilities that produce other products in addition to biodiesel, alcohol, or wood biomass fuels or biofeedstock, the property exemption will be computed on a ratio based on the annual value of the biodiesel, alcohol or wood biomass fuels or biodiesel feedstock as compared to the annual value of all other products produced.

Application for the exemption must be made by November 1. Application for property tax exemption is made through the local county assessor. Application for leasehold excise tax exemption is made through the Department of Revenue. No claims for exemption may be filed after December 31, 2009.

***Laws & Rules***

RCW 82.04.260(1)(e)&(f) – Tax on manufacturers.

RCW 84.36.635 - Property used for the manufacture of alcohol fuel or biodiesel fuel.

RCW 84.36.640 - Property used for the manufacture of wood biomass fuel.

## **B&O Tax Deduction for Sales of Biodiesel Fuel**

### **Sales & Use Tax Exemption for Equipment used to Sell Biodiesel Fuel**

**Effective July 1, 2003**, 2SHB 1241, Chapter 63, Laws of 2003 and EHB 2146, Chapter 339, Laws of 2003, provide significant tax benefits for persons who distribute and/or make retail sales of biodiesel fuel, or alcohol fuel, wood biomass fuel.

The laws also provide benefits for persons who invest in machinery and equipment, including delivery vehicles, used directly for the retail sale of biodiesel, alcohol, and wood biomass fuel *blends*.

#### ***Important definitions***

**Biodiesel Fuel** means a mono alkyl ester of long chain fatty acids derived from vegetable oils or animal fats for use in compression-ignition engines and meets the American Society of Testing and Materials specification D 6751. ***Taxpayers must maintain certification from a testing lab that their biodiesel meets the ASTM standard.***

**Alcohol Fuel** means any alcohol made from a product other than petroleum or natural gas that is used in combination with gasoline or other petroleum products for use as a fuel in motor vehicles or farm implements.

**Wood Biomass Fuel** means any pyrolytic liquid fuel or synthesis gas-derived liquid fuel, used in internal combustion engines, and produced from wood, forest, or field residue, or from dedicated energy crops, and does not include any wood pieces that contain chemical preservatives.

**Biodiesel Fuel Blend** and **Wood Biomass Fuel Blend** mean fuel that contains at least **20%** biodiesel fuel or wood biomass fuel by volume.

**Alcohol Fuel Blend** means fuel that contains at least 85% alcohol fuel by volume.

**Distribution** means any of the activities specified in RCW 82.36.020(2).

#### ***B&O Tax Deduction***

Income received from the distribution or retail sale of biodiesel fuel, wood biomass fuel, or alcohol fuel that contains at least 85% alcohol by volume may be deducted from the measure of B&O tax.

Only income attributable to the pure biodiesel fuel, wood biomass fuel, or alcohol fuel portion of the product sold may be deducted. This amount may be computed based on the percentage of the product by volume that is pure biodiesel, wood biomass, or alcohol fuel multiplied by the price of the product by volume. Thus, for example, if fuel is 50% biodiesel and sells for \$1.50 per gallon, the vendor may deduct \$0.75 from gross income for each gallon sold. Alcohol fuel must be at least 85% alcohol for any portion of sale to qualify for the deduction.

Please note that such fuels remain subject to the Special Fuels tax, RCW 82.38 when sold for the propulsion of motor vehicles upon the road and highways of this state. For detailed information about this tax, contact the Department of Licensing, Fuel Tax Division <http://www.dol.wa.gov/>

### ***Retail Sales Tax and Use Tax Exemptions***

The purchase of machinery and equipment and the construction of facilities used directly for the retail sale of biodiesel fuel blend, alcohol fuel blend, and wood biomass fuel blend are exempt from retail sales tax and use tax.

The purchase of fuel delivery vehicles and labor and service charges related to such vehicles are exempt from retail sales tax and use tax provided 75% of the fuel distributed by them is biodiesel fuel blend, alcohol fuel blend, and wood biomass fuel blend. Persons taking the exemptions must provide the vendor with a properly completed *Buyers' Retail Sales Tax Exemption Certificate* to document the tax exempt nature of the sale. Persons taking the deduction and the exemptions must also keep records necessary to verify their eligibility. The exemption certificate is available on our web site at <http://dor.wa.gov> under the Forms link.

### ***Laws & Rules***

RCW 82.04.4334 - Deductions — Sale or distribution of biodiesel or alcohol fuels.

RCW 82.04.4335 - Deductions — Sale or distribution of wood biomass fuel.

RCW 82.08.955 - Exemptions — Sales of machinery, equipment, vehicles, and services related to biodiesel or alcohol fuel blend.

RCW 82.12.955 - Exemptions — Use of machinery, equipment, vehicles, and services related to biodiesel or alcohol fuel blend.

RCW 82.08.960 - Sales of machinery, equipment, vehicles, and services related to wood biomass fuel blend.

RCW 82.12.960 - Exemptions — Use of machinery, equipment, vehicles, and services related to wood biomass fuel blend

## **Chapter 10**

# **Aluminum Smelting Industry Tax Incentives**

Aluminum smelter tax incentive program:

- Lowers the B&O tax rate for aluminum smelters to 0.2904 percent.
- Provides a B&O tax credit for property taxes paid,
- Provides an exemption from the state portion of retail sales tax and use tax on tangible personal property and all construction at an aluminum smelter
  - A person claiming an exemption must pay the tax and may then take a credit equal to the state share of retail sales tax paid. The person must submit information, in a form and manner prescribed by the department, specifying the amount of qualifying purchases or acquisitions for which the exemption is claimed and the amount of exempted tax.
- Provides an exemption from the natural gas use tax.

### ***Reporting/Documentation***

- Annual report due by March 31<sup>st</sup> following any year in which a tax incentive is claimed or used. The report is available on our web site at <http://dor.wa.gov> under Forms link. (See WAC 458-20-267, Annual reports for instructions.)

In addition, B&O tax and public utility tax credits are available for persons supplying energy to aluminum smelters, provided that the economic benefit of the credits are passed on to the smelter in the form of lower energy prices. *Effective July 1, 2004.*

### ***Laws & Rules***

RCW 82.04.2909 - Tax on aluminum smelters. (expires January 1, 2012.)

RCW 82.04.4481 - Credit — Property taxes paid by aluminum smelter.

RCW 82.08.805 – Exemptions (sales tax) — Tangible personal property used at an aluminum smelter.

RCW 82.12.022(5) - Natural or manufactured gas — Use tax imposed — Exemption.

RCW 82.32.570 - Smelter tax incentives — Goals — Annual report.

WAC 458-20-267 – Annual reports for certain tax adjustments

## **Chapter 11**

# **Miscellaneous Manufacturing Tax Incentives**

### **Reduced B&O Tax Rate for Manufacturing Timber/Wood Products**

Effective July 1, 2006, RCW 82.04.260(12), provides a new business and occupation (B&O) tax rate for timber harvesting and certain manufacturing and/or processing activities.

This law does not affect persons who are eligible for the B&O tax exemption for small harvesters. See section below on small timber harvesters.

#### ***B&O Tax Rate Reduction***

Effective July 1, 2006, the B&O tax rate is reduced for the following activities:

- Extracting timber or extracting timber for-hire;
- Manufacturing or processing timber into timber products or wood products;
- Manufacturing or processing timber products into other timber products or wood products; and
- Selling at wholesale:
  - timber extracted by the seller;
  - timber products manufactured by the seller from timber or other timber products; and
  - wood products manufactured by the seller from timber or timber products.

#### ***Timber products are:***

- Logs, wood chips, saw dust, wood waste, and similar products obtained wholly from the processing of timber
- Pulp
- Recycled paper products

#### ***Wood products are:***

- Paper and paper products
- Dimensional lumber
- Engineered wood products such as particle board, oriented strand board, medium density fiber board, and plywood
- Wood doors
- Wood windows

The reduced B&O tax rate will be phased in as follows:

Rate	Time Period
0.004235	July 1, 2006 to June 30, 2007
0.002904	July 1, 2007 to July 1, 2024

The reduced tax rate expires on July 1, 2024.

### ***Reporting/Documentation***

- Required to file all tax returns and the annual survey using our E-file system.
- An annual survey must be completed by March 31 of each year following the year in which you take advantage of the reduced tax rate. (See WAC 458-20-268 – Annual surveys for certain tax adjustments.)

If you do not file your tax returns and the annual survey electronically, you forfeit the reduced rate for the calendar year covered by the survey, and additional tax and interest will be assessed. Once you use our E-file system to file your excise tax returns, we will notify you electronically that you **must** E-file the annual survey each calendar year that you take advantage of the reduced tax rate.

### ***B&O Tax Surcharge***

Businesses reporting under the reduced B&O tax rate are also subject to a surcharge of .00052, effective July 1, 2007. The surcharge funds activities for improving and protecting banks of a natural course of water on non-federal Washington forest lands designated in the 1999 forest and fish report. When surcharge receipts reach \$8 million during a biennium, it will be suspended. The surcharge is also subject to suspension or adjustment depending on amounts appropriated by the federal government to support tribal participation.

We will provide electronic reminders to businesses that file their tax returns via E-file about the surcharge in June 2007, as well as when the surcharge will be suspended, adjusted, or reinstated.

### ***Multiple Activities Tax Credit (MATC)***

Businesses that engage in any combination of activities listed above as qualifying for the reduced B&O tax rate remain eligible for the Multiple Activities Tax Credit (MATC). The tax due and credit amount will be calculated at the new rate. You can take the credit within the E-file application when you file on-line. Beginning July 2007, the MATC will include the B&O tax surcharge rate.

### ***B&O Exemption for Small Harvesters Continues***

Small timber harvesters are exempt of B&O tax. A small timber harvester is a person who within a calendar year:

- Extracts or extracts for others less than two million board feet of timber for sale or for commercial or industrial use; and
- Receives gross income from such sales of extracted timber of less than \$100,000 per year.

Small harvesters must register with the Department's Forest Tax Section even if they qualify for the B&O exemption for small harvesters.

***Laws & Rules:*** RCW 82.04.260(12) - Tax on manufacturers and processors

## **Reduced B&O Tax Rate for Solar Energy System Manufacturers & Wholesalers**

Effective October 1, 2005, RCW 82.04.294, provides incentives to support the renewable energy industry in Washington State.

### ***Special Business and Occupation Tax Rate***

A lower business and occupation (B&O) tax rate is provided for manufacturers, processors for hire, or wholesalers of solar energy systems using photovoltaic modules or silicon components of these systems **effective October 1, 2005**. The B&O rate is lowered from 0.484 percent to 0.2904 percent (.002904). The expiration date for this reduced rate is June 30, 2014.

### ***Reporting/Documentation***

**Annual Report** due by March 31 of the year following any year in which the lower B&O tax rate is taken. The form (Form REV 81 1015), is available on our web site at **<http://dor.wa.gov>** under the Forms link.

If a person fails to submit an annual report by the due date, the amount of taxes reduced for the previous calendar year becomes due and payable.

### ***Laws & Rules***

RCW 82.04.294 - Tax on manufacturers or wholesalers of solar energy systems.

RCW 82.32.620 - Annual report

WAC 458-20-267 – Annual reports for certain tax adjustments

**Chapter 12**  
**Semiconductor Industry**  
***(Contingent on \$ 1 billion investment project)***

**Reduced B&O Rate for Manufacturing Semiconductor Materials**

Firms that manufacture materials used in the production of semiconductors are subject to B&O tax at a rate of 0.275 percent, instead of the normal manufacturing rate of 0.484 percent. The lower tax rate lasts for a period of 12 years from the effective date. The reduced tax rate is contingent upon commencement of commercial operations by a new semiconductor microchip fabrication facility with an investment in new buildings and equipment amounting to at least \$1 billion. At this time, the contingency has not been met. The tax rate will become effective when the condition is met . (RCW 82.04.240(2))

RCW 82.04.2404 also offers a reduced B&O tax rate for firms that manufacture materials used in the production of semiconductors. Under this incentive, the reduced tax rate is contingent upon the siting, expansion, or renovation, and commercial operation of a significant semiconductor materials fabrication facility or facilities in the state of Washington with an investment in new buildings and equipment amounting to at least \$350 million.

**B&O Tax Credit for New Jobs Created by Semiconductor Firms**

RCW 82.04.448 provides for a B&O tax credit for persons engaged in the business of manufacturing semiconductor materials. For the purposes of this section "semiconductor materials" has the same meaning as provided in RCW 82.04.240(2). This credit is contingent on an investment of \$1 billion in new buildings and equipment for a semiconductor microchip fabrication facility and is not currently effective.

The credit shall equal three thousand dollars for each employment position used in manufacturing production that takes place in a new building exempt from sales and use tax under RCW 82.08.965 and 82.12.965. A credit is earned for the calendar year a person fills a position. Additionally a credit is earned for each year the position is maintained over the subsequent consecutive years, up to eight years. Those positions that are not filled for the entire year are eligible for fifty percent of the credit if filled less than six months, and the entire credit if filled more than six months.

Person taking the credit are required to file an **Annual report** by March 31st following any year in which a credit is claimed. See RCW 82.32.535 for information on the report.

## **B&O Tax Exemption for Manufacturing Semiconductor Microchips**

RCW 82.04.426 provides a B&O tax exemption for any person in respect to the manufacturing of semiconductor microchips.

This exemption is contingent on an investment of \$350 million and is currently not in effect

## **Sales & Use Tax Exemption for Semiconductor Facility Construction**

RCW 82.08.965 and RCW 82.12.965 provide a sales and use tax exemption for charges made for labor and services rendered in respect to the constructing of new buildings used for the manufacturing of semiconductor materials, to sales of tangible personal property that will be incorporated as an ingredient or component of such buildings during the course of the constructing, or to labor and services rendered in respect to installing, during the course of constructing, building fixtures not otherwise eligible for the exemption under the M&E sales and use tax exemption (RCW 82.08.02565(2)(b)). The exemption is available only when the buyer provides the seller with an exemption certificate in a form and manner prescribed by the department. The seller shall retain a copy of the certificate for the seller's files.

To be eligible the manufacturer or processor for hire must be the requirements outlined in RCW 82.08.965.

The exemption is contingent on a \$1 billion investment in a semiconductor facility and is not currently in effect.

## **Sales & Use Tax Exemption for Semiconductor Gasses & Chemicals**

RCW 82.08.970 and RCW 82.12.970 provide a sales and use tax exemption on purchases of gases and chemicals used by a manufacturer or processor for hire in the manufacturing of semiconductor materials. This exemption is limited to gases and chemicals used in the manufacturing process to grow the product, deposit or grow permanent or sacrificial layers on the product, to etch or remove material from the product, to anneal the product, to immerse the product, to clean the product, and other such uses whereby the gases and chemicals come into direct contact with the product during the manufacturing process, or uses of gases and chemicals to clean the chambers and other like equipment in which such processing takes place. For the purposes of this section, "semiconductor materials" has the same meaning as provided in RCW 82.04.240(2).

The exemption is contingent on a \$1 billion investment in a semiconductor manufacturing facility and is not currently in effect.

A person taking the exemption is required to file an **Annual report** by March 31<sup>st</sup> following any year in which an exemption is taken. (RCW 82.32.535)

No application is necessary for the tax exemption.

### **Sales & Use Tax Exemption for Semiconductor Gasses & Chemicals**

RCW 82.08.9651 & 82.12.9651 provide a sales and use tax exemption on purchases of gases and chemicals used by a manufacturer or processor for hire in the manufacturing of semiconductor materials. This exemption is limited to gases and chemicals used in the production process to grow the product, deposit or grow permanent or sacrificial layers on the product, to etch or remove material from the product, to anneal the product, to immerse the product, to clean the product, and other such uses whereby the gases and chemicals come into direct contact with the product during the production process, or uses of gases and chemicals to clean the chambers and other like equipment in which such processing takes place. For the purposes of this section, "semiconductor materials" has the meaning provided in RCW 82.04.2404.

The exemption is contingent on a \$350 million investment in a semiconductor manufacturing facility and is not currently in effect.

A person taking the exemption is required to file an **Annual report** by April 30th following any year in which a tax exemption is taken. (RCW 82.32.5351)

No application is necessary for the tax exemption.

### **Property Tax Exemption for Semiconductor Equipment**

Machinery and equipment exempt under RCW 82.08.02565 or 82.12.02565 (M&E exemption) used in manufacturing semiconductor materials at a building exempt from sales and use tax and in compliance with the employment requirement under RCW 82.08.965 and 82.12.965 are tax exempt from property tax. "Semiconductor materials" has the same meaning as provided in RCW 82.04.240(2).

A person seeking this exemption must make application to the county assessor, on forms prescribed by the department.

A person receiving an exemption must file an **Annual report** by March 31st following any year in which a tax exemption is taken. (RCW 82.32.535.)

This exemption is contingent on a \$1 billion investment in a semiconductor manufacturing facility and is not currently in effect.