

EVALUATION OF TAX INCENTIVES

Analysis of Biotechnology Sales Tax Program

A Report to the Legislature

Washington State Department of Revenue
Cindi L. Holmstrom, Director

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STATE OF WASHINGTON
DEPARTMENT OF REVENUE
OFFICE OF THE DIRECTOR

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November 16, 2009

TO: Tom Hoemann, Secretary
Washington State Senate

Barbara Baker, Chief Clerk
Washington State House of Representatives

FROM:  Cindi L. Holmstrom, Director

SUBJECT: EVALUATION OF BIOTECHNOLOGY SALES TAX INCENTIVE

This report contains analysis of the sales tax deferral/exemption program for facilities that manufacture biotechnology products and certain medical devices. It was prepared in response to the requirement in RCW 82.32.645(7). Pursuant to Section 24 of Chapter 518, Laws of 2009, the report is being submitted to your offices in electronic format.

The sales tax deferral/exemption program was established in 2006. Already it has helped to encourage the construction and operation of biotechnology facilities in this state. Four projects have benefited from the incentive to date and more than \$4.1 million in investment can be attributed to this program. The amount of state and local sales tax foregone for the four projects totals \$364,000. An estimated 58 new jobs are attributable to the four projects.

The report was prepared by Van Huynh and Don Taylor, Tax Policy Specialists in our Research Division, under the direction of Kathy Oline, Assistant Director. Please contact Kathy at (360) 570-6076 if you have any questions concerning the analysis.

Attachments

cc: Christine Gregoire, Governor
Members, Senate Economic Development, Trade and Innovation Committee
Members, Senate Ways and Means Committee
Members, House Finance Committee
Members, House Technology, Energy and Communications Committee

CHAPTER ONE

EXECUTIVE SUMMARY

This report is submitted to the Legislature pursuant to RCW 82.32.645(7). It contains the results of an evaluation of the retail sales tax deferral/exemption for facilities that manufacture biotechnology products or certain medical devices. This program was adopted in 2006 and is codified in chapter 82.75 RCW. This chapter provides a brief synopsis of the result of the study conducted during 2009 by the Department of Revenue.

RCW 82.32.645(7) requires that the Department report to the Legislature on the utilization of this tax incentive program. The statute specifies that the report must measure the number of new manufacturers of biotech products or medical devices established in Washington, the dollar amount of the investment in these plants, and the number of new jobs at these facilities. In addition, the report must analyze the wages paid and the employee benefits provided, in comparison with wages and benefits paid in other manufacturing jobs and in other industries.

Through 2008, four projects have been certified as operationally complete upon final audit by the Department. Data for these projects were reported in annual surveys submitted by the participants in 2009. (One additional project has been certified as complete in 2009, but the data will not be reported until the 2010 survey.)

Each of the projects was an expansion for an existing in-state business, so no new firms have yet been attracted to the state as a result of the tax incentive. The total investment for these projects has amounted to \$4.1 million. The amount of state sales tax related to this investment was \$266,000; the impact on local governments is \$98,000. Assuming that the four projects continue to meet program requirements, this is the amount of sales tax that will be foregone due to the incentive program so far. An estimated 58 new jobs are associated with these four projects; so far 55 of them have been filled.

CHAPTER TWO

OVERVIEW OF TAX INCENTIVE PROGRAM

This tax incentive provides a deferral or outright exemption from state and local retail sales tax for facilities engaged in manufacturing biotechnology products or certain medical devices. This program was adopted in 2006 (Chapter 178, Laws of 2006), effective July 1, 2006, and is presently scheduled to expire on January 1, 2017.

The term biotechnology includes the development of products based on the science of biology, microbiology, molecular or cellular biology, biochemistry, or biophysics; it includes DNA techniques, genetics and other bioprocesses that use living organisms. Eligible products include viruses, serums, antibodies, proteins, toxins, vaccines, and blood and blood derivatives which are used in the prevention, treatment, or cure of diseases or injuries in humans or animals.

Medical devices must be intended for use in the diagnosis, treatment, prevention, or cure of diseases in humans or animals, or they must affect the structure or function of human or animal bodies. They must be recognized in the national formulary or the U.S. pharmacopeia. Devices do not include drugs, and they must not operate through chemical actions within the body or be metabolized to achieve their intended purposes.

The tax incentive program offers a deferral of state and local retail sales tax for construction or renovation of qualified manufacturing facilities and the purchase of related machinery and equipment. If participants maintain program requirements, the deferred tax does not need to be repaid, thereby making the deferral an outright exemption. Specifically, to avoid repayment of the deferred sales tax, the firm must file annual surveys, the project must be audited and certified as complete by the Department, and the facility must be operated for its intended purpose for at least the succeeding seven years after completion and final audit by the Department.

Firms must apply for the deferral/exemption, and the Department must issue a certificate prior to construction taking place. Leased facilities are eligible for the program if the lessor agrees in writing to pass on the benefit of the deferral/exemption to the lessee. Eligible facilities includes structures used for actual manufacturing activities, as well as laboratories for product and process development, related offices, space devoted to quality control, and warehouses for storage of raw materials and finished products if the warehouse facilities are an integral part of the production plant. Qualified equipment includes machinery that is necessary for actual manufacturing of biotechnology products or medical devices, as well as computers and software, laboratory equipment, and equipment which controls the machinery.

CHAPTER THREE

UTILIZATION AND IMPACT OF THE PROGRAM

The information presented in this chapter is based on data from tax deferral applications and annual accountability surveys submitted to the Department by incentive participants. Where applicable, information from the Washington Employment Security Department and the Washington State Economic and Revenue Forecast Council was also used.

Only investment projects that were certified as "operationally complete" by the Department in 2008 were used in the analysis below. Though there was at least one project certified as "operationally complete" in 2009, it is excluded from the analysis below because its first annual survey is not due until March 31, 2010.

During 2008, four projects were certified as "operationally complete" by the Department. Two of these projects are located in Snohomish County and the other two are in King County. These projects involved business expansion. None of the participants were new businesses.

The total amount of investment (cost) of these projects approved for deferral was \$4.1 million; this represents \$364,000 in retail sales taxes. The tax amount is the combined state and local sales/use taxes and is the amount that will eventually be forgiven if participants meet the use requirements (biotechnology product or medical device manufacturing).

The incentive participants together employed 478 people during calendar year 2008. The participants indicated that during calendar year 2008 they created a total of 58 employment positions in Washington. Of these, 55 were filled, at the time of hire, by Washington residents. This 13.8 percent job growth is exceptional given that over this same period, manufacturing employment in Washington declined and total employment in the state was almost unchanged¹.

The status of all their employees was as follows:

Full-time:	95.7%
Part-time:	2.5%
Temporary:	1.9%
Total	100.0%

¹ Washington State Economic and Revenue Forecast Council, September 2009

The percentage of employees in different salary bands was as follows:

\$60,000 or more:	57.1%
\$30,000 to \$59,999:	42.1%
<u>Less than \$30,000:</u>	<u>0.8%</u>
Total	100.0%

In addition to high salaries, all incentive participants offered medical, dental, and retirement benefits. The following table compares benefits offerings of participants to firms in all manufacturing and all industries in Washington.

Table 3.1
Percentage of Washington Firms That Offered Benefits in 2008

	Participants	All Manufacturing ²	All Industries ³
Medical	100%	73.6%	56.5%
Dental	100%	50.5%	37.4%
Retirement	100%	46.3%	37.7%

CONCLUSION

In summary, it appears that so far, the intent and primary legislative goals of this tax incentive program have been met.

Firms that took advantage of this incentive program expanded, created new employment positions, paid their employees well, and offered medical, dental, and retirement benefits. While it is unlikely that the deferral program alone caused this positive outcome, it certainly was an incentive and an asset to firms that participated in the program.

Other goals of this incentive program have also been met. Based on responses from participants, so far none of their business activities have been moved out of state. This satisfies the legislative goal of retaining Washington commercial operations (e.g. manufacturing) in the life sciences.

Finally, the incentive participants reported a total of one patent and one trademark granted to them in 2008. Both were in the field of biotechnology.

^{2,3} Washington State Employment Security Department, *Washington Employee Benefits Survey of 2009*