Individual State Agency Fiscal Note

Bill Number: SB 5901	Bill Title: AN ACT Relating to economic development tax incentives for targeted counties	Agency: 140 Department of Revenue

Part I: Estimates

[ ] No Fiscal Impact

Estimated Cash Receipts to:

Fund	Fiscal Year 2022	Fiscal Year 2023	2021-2023 Total	2023-25 Biennium	2025-27 Biennium
GF-State Retail Sales Tax		1,090,000	1,090,000	750,000	230,000
Performance Audit Retail Sales Tax					
Total		1,090,000	1,090,000	750,000	230,000

Estimated Expenditures from:

	Fiscal Year 2022	Fiscal Year 2023	2021-2023 Total	2023-25 Biennium	2025-27 Biennium
FTE Staff Years	.1	.67	.39	.1	.1
Fund					
GF-State 001	93,400	73,700	167,100	24,600	24,600
Total	93,400	73,700	167,100	24,600	24,600

The revenue and expenditures estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.

Check applicable boxes and follow corresponding instructions:

[X] If fiscal impact is greater than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.

[ ] If fiscal impact is less than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).

[ ] Capital budget impact, complete Part IV.

[ ] Requires new rule making, complete Part V.

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Part II: Narrative Explanation

II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

CURRENT LAW:

DEFERRAL
There are no sales and use tax deferral programs specific to qualifying manufacturing projects in counties with less than 650,000 population.

WAREHOUSE REMITTANCE
Certain warehouses and grain elevators are eligible for an exemption in the form of a remittance of the state retail sales and use tax paid on purchases of machinery and on materials and labor for construction of these facilities (RCW 82.08.820 and 82.12.820). The remittance does not include local sales and use taxes.

Warehouses more than 200,000 square feet in size receive an exemption equal to:
- 100% of the state retail sales and use taxes paid on construction, and
- 50% of the state retail sales and use taxes paid on equipment, including materials handling and racking equipment.

Grain elevators receive an exemption of state retail sales and use taxes paid based on capacity of the facility:
- 50% exemption with bushel capacity of 1 million, but less than 2 million, and
- 100% exemption with bushel capacity of 2 million or more.

PROPOSALS:

DEFERRAL
The bill creates a new sales and use tax deferral for qualified investment projects located in counties with population less than 650,000. The Department of Revenue (Department) must publish a list of qualifying counties by July 1, 2022, and update the list every even-numbered year thereafter.

The total state and local sales and use tax for eligible deferrals is limited to $400,000 per eligible investment project per person.

The applicant must apply to the Department prior to initiating the construction of the eligible project. The application must be made to the Department and include information regarding the location of the investment project, applicant's average employment in the state for prior year, estimated or actual new employment and wages related to the project, estimated or actual costs, time schedule for completion and operation, and other information required by the Department. The Department must rule on the application within 60 days and issue a sales and use tax deferral certificate for state and local taxes for each eligible project. The Department may not accept applications for the deferral after June 30, 2032.

The Department must keep a running total of all deferrals granted for each fiscal biennium.

The deferral certificate recipient must begin meaningful construction on an eligible investment project within two years of receiving a deferral certificate unless construction is delayed due to circumstances beyond the recipient’s control. Lack of funding is not considered beyond the recipient’s control. If the recipient does not begin meaningful construction within one year, the issued deferral certificate is invalid, and taxes deferred are due immediately. Meaningful construction means an active construction site, where excavation of a building site, laying of a structure foundation, or other tangible signs of construction are taking place and that clearly show a progression in the construction process at the location designated by the taxpayer in the application for deferral.

The taxes deferred need not be repaid if the recipient utilizes the qualified project for qualified manufacturing or research and development operation for the seven years following project completion date. If project is not operationally complete within five years or not utilized for qualifying purposes for the seven years immediately following the project certified as operationally complete, then the deferred taxes are due immediately based on the following schedule:

Year in which qualifying activities cease	Percent of deferred tax due
1	100.0%
2	87.5%
3	75.0%
4	62.5%
5	50.0%
6	37.5%
7	25.0%
8	12.5%

The Department must assess interest at the rate provided for delinquent taxes, but not penalties, retroactively to the date the investment project was no longer eligible for tax deferral.

Persons receiving the benefit of the deferral are required to file an annual tax performance report beginning the year following the year in which the project is operationally complete and continue filing for the next seven years.

WAREHOUSE REMITTANCE
The bill limits the state sales and use tax remitted under the warehouse credit to a maximum $400,000 for the construction or expansion of a warehouse or grain elevator.

For warehouses built in a qualifying county, the warehouse must be at least 100,000 square feet. Existing warehouses located in a qualifying county need to add at least 100,000 square feet additional space when expanding to qualify for the warehouse credit. Qualifying county is defined as a county with less than 650,000 population.

Persons receiving the benefit of the warehouse remittance are required to file an annual tax performance report beginning the first calendar year following the year the warehouse or distribution center is operationally complete and continue filing for the next two years.

The warehouse remittance expires July 1, 2032.

EFFECTIVE DATE:
This bill takes effect on July 1, 2022.

II. B - Revenue Impact

ASSUMPTIONS:
- Eligible deferrals are limited to $400,000 total state and local sales and use tax per eligible investment project per person. A person is only allowed to defer up to $400,000 in total state and local sales and use tax.
- Projects are operationally complete within in one year of when the Department received the application.
- This estimate uses national level investment in fixed assets data that has been adjusted to reflect Washington State investment levels.
- To estimate the local government impacts, this estimate uses the statewide average local tax rate for the qualifying counties for Fiscal Year 2021 of 2.094%.
- The growth for qualifying project costs mirrors the annual growth for non-residential investment in R&D and private investment in industrial facilities for the United States as reflected in the November 2021 IHS Markit forecast.

- Based on Office of Financial Management's April 2021 population data, 36 of the 39 counties qualify for the new deferral program.
- The qualifying counties are as follows:

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

- The qualifying counties remain eligible until the deferral expires.
- The Department begins accepting applications July 1, 2022, and has 60 days to review. This results in nine months of impacted collections in Fiscal Year 2023. The Department may not accept deferral applications after June 30, 2032.
- The maximum amount of state sales and use tax remittance allowed for the construction or expansion of a warehouse or grain elevator is $400,000.
- The bill allows new construction or expansions of warehouses 100,000 square feet or larger in qualifying counties.
- Based on the current warehouse remittance program and smaller warehouses becoming eligible under the proposal, the Department estimates eight newly constructed or expanded warehouses per fiscal year.
- Materials and handling costs continue to qualify for the warehouse remittance program.
- This estimate assumes the Department is able to implement this proposal by July 1, 2022.

DATA SOURCES:
- Department of Revenue, warehouse remittance and deferral data
- Office of Financial Management, April 2021 population data
- IHS Market, Non-residential investment in R&D and private investment in industrial facilities forecast, November 2021
- Bureau of Labor Statistics, employment data
- Bureau of Economic Analysis, fixed asset data

POTENTIAL LITIGATION:
Legislation creating new exemptions and deferrals for construction projects presents a risk that the federal government or federal contractors will seek to re-litigate Washington v. United States. This risk increases with each additional exemption or deferral that the state enacts.

The Department’s legal counsel at the Attorney General’s Office has opined that the federal contractor risk applies to all exemptions and deferrals of construction activity, not just construction projects of the type that the federal government is likely to engage in. It also applies even if the exemption or deferral applies to federal construction projects as well as non-federal construction projects.

Sales/use tax exemptions pose the greatest legal risk because they plainly treat the beneficiaries of the exemption more favorably than federal contractors are treated. Sales/use tax deferrals also pose a significant legal risk. Each such exemption or deferral increases the likelihood that the federal government or federal contractors will seek to re-litigate Washington v. United States in which they would claim that Washington now discriminates against federal contractors.

If a legal challenge to a deferral or exemption were successful, in addition to lost future revenues, refunds potentially would be owed under the statutory period (current year plus four previous years). Each year approximately $90 million is collected on federal government contracting. If refunds were included as part of a potential court decision, the revenue impact could reach nearly $500 million.

REVENUE ESTIMATES:
This bill increases state revenues by an estimated $1.1 million in the nine months of impacted collections in Fiscal Year 2023, and by $430,000 in Fiscal Year 2024, the first full year of impacted collections.

This bill also decreases local revenues by an estimated $520,000 in the nine months of impacted collections in Fiscal Year 2023, and by $730,000 in Fiscal Year 2024, the first full year of impacted collections.

TOTAL REVENUE IMPACT:

State Government (cash basis, $000):
FY 2022 - $ 0
FY 2023 - $ 1,090
FY 2024 - $ 430
FY 2025 - $ 320
FY 2026 - $ 200
FY 2027 - $ 30

Local Government, if applicable (cash basis, $000):
FY 2022 - $ 0
FY 2023 - ($ 520)
FY 2024 - ($ 730)
FY 2025 - ($ 770)
FY 2026 - ($ 810)
FY 2027 - ($ 860)

II. C - Expenditure Impact

ASSUMPTIONS:
- This legislation will affect 25 taxpayers applying for the warehouse remittance and will affect 20 taxpayers with new deferral applications each year.
- Persons receiving the benefit of the deferral or warehouse remittance are required to file an annual tax performance report.
- Expenditures include the cost to implement the new tax preference.

FIRST YEAR COSTS:
The Department will incur total costs of $93,400 in Fiscal Year 2022. These costs include:

Labor Costs – Time and effort equates to 0.1 FTEs.
- Set up, program, and test computer system changes.

Object Costs - $79,200.
- Computer system changes including contract programming.

SECOND YEAR COSTS:
The Department will incur total costs of $73,700 in Fiscal Year 2023. These costs include:

Labor Costs – Time and effort equates to 0.67 FTEs.
- Amend one administrative rule.
- Provide revenue impact data for fiscal notes for tax-related initiatives.
- Test and verify computer systems for new deferral.

- Annual review of tax performance report.
- Create a Special Notice and identify publication and information that need to be created or updated on the Department's website.
- Respond to tax ruling requests, email inquiries, and more difficult call backs from the telephone information center.

ONGOING COSTS:
Ongoing costs for the 2023-2025 Biennium equal $24,600 and include similar activities described in the second-year costs. Time and effort equate to 0.1 FTE.

Part III: Expenditure Detail

III. A - Expenditures by Object or Purpose:

	Fiscal Year 2022	Fiscal Year 2023	2021-2023 Total	2023-25 Biennium	2025-27 Biennium
Salaries and Wages	9,000	45,200	54,200	16,400	16,400
Benefits	3,200	16,200	19,400	6,000	6,000
Personal Service Contracts	79,200		79,200		
Supplies & Material	1,300	7,900	9,200	2,000	2,000
Office Equipment	700	4,400	5,100	200	200
Total	93,400	73,700	167,100	24,600	24,600

III. B - FTE Detail:

Job Classification	Salary	FY 2022 FTEs	FY 2023 FTEs	2021 - 2023 Total	2023 - 2025	2025 - 2027
EMS BAND 4	122,633		.01	.01		
IT SYS ADM-JOURNEY	89,916	.1		.05		
MGMT ANALYST4	70,956		.11	.06		
TAX INFO SPEC 4	64,332		.3	.15		
TAX POLICY SP 2	72,756		.01	.01		
TAX POLICY SP 3	82,344		.22	.11	.1	.1
TAX POLICY SP 4	88,644		.01	.01		
WMS BAND 3	104,295		.01	.01		
Total		.1	.67	.41	.1	.1

III. C - Expenditures by Program (optional):

	Fiscal Year 2022	Fiscal Year 2023	2021-2023 Total	2023-25 Biennium	2025-27 Biennium
Total					

Part IV: Capital Budget Impact

None.

Part V: New Rule Making Required

Should this legislation become law, the Department will use the expedited process to amend WAC 458-20-182 Rule, titled: "Warehouse businesses". Persons affected by this rule-making would include manufacturers in certain counties.

Revenue Impact Detail

			First Biennium		Second Biennium		Third Biennium	
FUND	SOURCE	CODE	1st YEAR	2nd YEAR	3rd YEAR	4th YEAR	5th YEAR	6th YEAR
GF-State	Retail Sales Tax	0101		1,090,000	430,000	320,000	200,000	30,000
Total				1,090,000	430,000	320,000	200,000	30,000
OTHER								
Performance Audit	Retail Sales Tax	0101						
Total								
Net				1,090,000	430,000	320,000	200,000	30,000

Revenue Impact - by Biennium

FUND	SOURCE	CODE	1st Biennium	2nd Biennium	3rd Biennium
GF-State	Retail Sales Tax	0101	1,090,000	750,000	230,000
Total			1,090,000	750,000	230,000
OTHER					
Performance Audit	Retail Sales Tax	0101			
Total					
Net			1,090,000	750,000	230,000