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ETA 3187.2016

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“Operationally Complete” and Tax Deferral Projects

Scope

This Excise Tax Advisory (ETA) clarifies what “operationally complete” means when used in the following Chapters of the Revised Code of Washington (RCW):

- Chapter 82.60 RCW (Tax Deferrals for Investment Projects in High Unemployment/Rural Counties);
- Chapter 82.63 RCW (Tax Deferrals for High Technology Businesses);
- Chapter 82.74 RCW (Tax Deferrals for Fruit and Vegetable Businesses); and
- Chapter 82.75 RCW (Tax Deferrals for Biotechnology and Medical Device Manufacturing Businesses).

Tax Deferrals

Washington State law provides a retail sales and use tax deferral for businesses engaged in certain qualifying activities that file an appropriate application. If approved, the Department will issue a retail sales and use tax deferral certificate (certificate) to an applicant for each eligible investment project. The recipient may use the certificate for deferring retail sales and use tax when making eligible purchases from vendors. Once an eligible project is operationally complete, the recipient is required to notify the Department.

When is a Project Operationally Complete?

With respect to the tax deferrals referenced in this ETA, a project is “operationally complete” when the project is capable of being used for its intended purpose as described in the deferral application.

Example 1:

JD Company’s deferral application states that a manufacturing facility is being constructed and JD Company intends to manufacture widgets. The operationally complete date is the date that the constructed building and manufacturing equipment

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can be used to manufacture widgets.

Importance of Identifying the “Operationally Complete” Date

Identifying the date an eligible investment project (project) becomes operationally complete is important for a number of reasons:

- The recipient of a deferral certificate is required to notify the Department when the investment project is operationally complete.
 - The Department, after receipt of the required notice, will verify both the date the project became operationally complete and the amount of qualifying deferred sales and use tax through an audit.
 - The certificate recipient must begin filing annual tax incentive surveys beginning with the year the project becomes operationally complete.
 - A deferral recipient risks losing part or all of the tax deferral benefit if the recipient does not timely file the survey(s) because the operationally complete date was not accurately identified – even if the Department has not yet been notified by the recipient or has not completed its audit of the project.
 - The date the project becomes operationally complete is the date on which the project’s deferral period (e.g., an eight-year deferral period) begins.
 - The certificate may not be used after the project becomes operationally complete.
 - Improper use of a deferral certificate by the recipient for purchases that are not eligible for deferral is subject to assessment of tax, interest, and, possibly, penalties.
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Filing the First Annual Tax Incentive Surveys

A deferral recipient must complete and file an annual tax incentive survey with the Department beginning the year immediately following the year in which the project is operationally complete. Failure to file this annual survey timely will result in 12.5% of the deferred tax being immediately due, regardless of whether the recipient has notified the Department or the Department has yet to complete its audit of the project.

Example 2:

JD Company’s project becomes operationally complete in June 2016. JD Company must file its first tax incentive survey for calendar year 2016, which is due April 30, 2017.

More than One Manufacturing Line

A taxpayer receives a deferral certificate for an investment project that includes a building or building expansion, and multiple planned manufacturing lines. Is the investment project operationally complete when one manufacturing line is capable of being used even though more manufacturing lines in the same project are planned?

- Once a finished product can be manufactured from any one or more of the completed manufacturing lines, the investment project is considered operationally complete. This is true even though the application shows that more manufacturing lines are planned.

Note: Machinery and equipment qualifying for the exemptions under RCW 82.08.02565 and RCW 82.12.02565 would remain exempt regardless of the deferral period.

Example 3:

The purpose of an investment project stated in a tax deferral application is to build a manufacturing plant to produce smart phones. There are three proposed manufacturing lines and each manufacturing line will produce smart phones. The manufacturing lines will be completed at different times. The investment project is operationally complete when the first manufacturing line is complete and the project is capable of being used for its intended purpose – to produce smart phones.

- If a finished product cannot be completed from one manufacturing line, then the investment project is not operationally complete until all manufacturing lines necessary to build the finished product are completed.

Example 4:

XYZ Company's tax deferral application states that XYZ intends to build a manufacturing facility to produce magnetic resonance imaging machines (MRI). There will be three separate manufacturing lines, two of which will produce components for the MRI machine and the third will produce the actual MRI machine. All three lines are necessary to produce a finished MRI machine.

The project is operationally complete when the project is capable of being used for its intended purpose, which is the production of MRI machines. Thus, the project is operationally complete when all three manufacturing lines are complete and MRI machines can be produced.

**Use of
Investment
Project for
Non-qualifying
Purpose**

What if the investment project is capable of being used for its qualifying intended purpose, but instead is used for a non-qualifying purpose?

The applicant must state on the deferral application the intended qualifying purpose of the investment project (e.g. what the building and/or equipment will be used for). Once the project is operationally complete, the applicant must notify the Department. The Department will determine the amount of deferred taxes, taxes due on non-qualifying purchases, and whether the project is being used for a qualifying purpose. If the Department determines that the building and/or equipment are not being used for a qualifying purpose, the remaining deferred taxes are immediately due and payable according to each deferral's repayment schedule.

Example 5:

The intended purpose of a qualifying investment project is to manufacture guitar picks. The building is capable of being used to manufacture guitar picks, but the demand for guitar picks has dropped. The applicant (manufacturer) for the deferral intends to use the building to manufacture guitar picks once demand increases.

However, in the meantime, the manufacturer rents the building to an '80s cover band, which uses the building for rehearsals.

- The building is capable of being used for its qualifying purpose, which is to manufacture guitar picks. Therefore, the project is operationally complete.
- Because the building is not being used for a qualifying purpose, deferred taxes are immediately due and payable.

Note: If instead the building is used to manufacture guitar picks for three years and then used for a non-qualifying purpose, the remaining deferred taxes would be immediately due and payable based on the deferral's repayment schedule.
