

HOUSE BILL REPORT

HB 1346

As Reported By House Committee On:

Energy & Utilities
Finance

Title: An act relating to use tax on electricity.

Brief Description: Imposing use tax on electricity.

Sponsors: Representatives B. Thomas and Crouse; by request of Department of Revenue.

Brief History:

Committee Activity:

Energy & Utilities: 2/5/97, 2/25/97 [DPS];

Finance: 3/6/97, 3/10/97 [DPS(EN)].

HOUSE COMMITTEE ON ENERGY & UTILITIES

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 12 members: Representatives Crouse, Chairman; DeBolt, Vice Chairman; Mastin, Vice Chairman; Poulsen, Ranking Minority Member; Morris, Assistant Ranking Minority Member; Bush; Cooper; Honeyford; Kessler; Mielke; Mulliken and B. Thomas.

Staff: Margaret Allen (786-7110).

Background: Pressure has been mounting both inside and outside the region to open the electricity industry to market-based pricing and retail competition. Bills have been introduced in Congress to restructure the industry, and the sale of the Bonneville Power Administration (BPA) has once again been proposed. A few states, such as California, New Hampshire, and Pennsylvania, recently passed legislation restructuring their electricity industry; numerous other states are studying restructuring issues or experimenting with customer choice programs.

In 1996, the governors of Washington, Oregon, Idaho, and Montana convened for a comprehensive review of the Northwest's energy system. The final report submitted by the review steering committee in December contains several recommendations regarding competition and customer choice in the electricity marketplace, including a recommendation that by July 1, 1999, all retail electric utilities (public and investor-

owned) allow customers the option to choose their electricity suppliers. The local utility would be obligated to carry the power from the supplier to the customer, but the customer could buy the power itself from an alternative supplier. A transition board is now working on a strategic plan for implementing the recommendations.

In the meantime, some Washington utilities already are allowing at least some customers to choose their provider of electricity.

State Public Utility Tax. The state's primary tax on businesses is the business and occupation tax. However, for light and power businesses, the state instead levies a public utility tax on the gross income received by the business. The state public utility tax rate for light and power businesses is 3.873 percent.

Cities are authorized to levy a tax on the gross income received by utilities, at a rate not exceeding 6 percent unless city voters approve a higher rate.

Sales and Use Taxes. Sales tax is imposed on most items of tangible personal property. The state sales tax rate is 6.5 percent and is applied to the selling price of the article. In addition, local sales taxes are applied to all sales subject to the state sales tax.

Sales tax applies when items are purchased at retail in the state. A use tax is imposed on the use of an item in this state when the item's acquisition was not subject to sales tax. Use tax applies to items purchased from sellers who do not collect sales tax, items acquired from out of state, and items produced by the person using the item. The use tax is equal to the sales tax rate.

Sales and use taxes do not apply to sales for which utilities are taxed under the public utility tax laws.

Depending on the connection (or nexus) of the electricity broker or generator to the state, electricity purchased from an out-of-state source might not be subject to public utility, business and occupation, sales, or use taxes.

BPA Sales. Since the BPA is a federal entity, BPA power sales are not subject to state or local taxation. While most of the federal power marketed by the BPA is sold wholesale, BPA is authorized to sell directly to some end users, including federal agencies in the region, public bodies (defined to include states, counties, municipalities, agencies, and political subdivisions), and DSI.

A direct service industrial customer (DSI) is an industrial customer that contracts with BPA for the purchase of power for direct consumption. However, only industrial customers with contracts to purchase power from the BPA on December 5, 1980 (the date of the Pacific Northwest Electric Power Planning and Conservation

Act), may purchase directly from the BPA rather than a utility. The DSIs are primarily aluminum and chemical plants. Some industrial customers qualify as a DSI for part, but not all, of their electricity loads.

Collection. In some instances, an agency collects taxes on behalf of other entities and is compensated out of the revenues collected for doing so. For example, the Department of Revenue collects local sales and use taxes, and is authorized by statute to deduct a percentage amount, as provided by contract but not to exceed two percent for the department's administration and collection expenses.

Initiative 601. Approved by voters in November 1993, Initiative 601 requires two-thirds approval by the Legislature for any action raising state revenue or requiring a revenue-neutral tax shift.

Summary of Substitute Bill: A new use tax is imposed on the privilege of consuming electricity in the state, with a rate equal to the state public utility tax on light and power businesses. Cities are authorized to impose a new tax for the privilege of consuming electricity in the city, with a rate equal to the city tax on electrical energy businesses.

Value. The value of the electricity to which the state or city use taxes would apply is the amount the purchaser pays, or agrees to pay, the seller of the electricity. The value does not include amounts paid to a utility to transport the electricity if those amounts are covered by the public utility taxes.

Exemptions. All power purchased by a DSI will be exempt from the new state and local use taxes, regardless of where or from whom the power is purchased. For an industrial customer that qualifies as a DSI for part, but not all, of its load, that portion that did not qualify as DSI load as of December 5, 1980 will be ineligible for the exemption. A DSI's successor-in-interest will be entitled to the exemption to the extent the energy is consumed at production sites that were subject to the exemption, or would have been subject to the exemption had the exemption been in place, prior to or at the time the successor company acquired the DSI or the DSI facilities.

Electricity consumed by a company able to import electricity into the state over the company's own transmission facilities as of August 1, 1997, will be exempt from the taxes, regardless of where the electricity is actually purchased. Electricity consumed by the company's successor-in-interest (in whole or in part) will also be exempt, to the extent the power is consumed at production sites that were subject to the exemption, or would have been subject to the exemption had the exemption been in place, prior to or at the time the successor company acquired all or part of the original company.

The new state and city use taxes do not apply to the consumption of electricity generated by a person for the person's own use. Those circumstances include if the person owns or leases all or a portion of the generating facility, or has other financial arrangements with the owner of the facility that are comparable to an ownership or lease interest. In addition, the state use tax will not apply if the seller has paid the state public utility tax, and the local use tax will not apply if the seller has paid the local public utility tax on the electricity.

All electricity purchased by public bodies will be subject to the taxes, regardless of where or from whom purchased.

Credits. A credit is allowed against the new state use tax for gross receipts taxes similar to Washington's public utility tax that are paid by the seller or buyer of the electricity to another state, and any foreign country, or to a political subdivision of another state or foreign country.

A credit is allowed against the new local use tax for taxes similar to Washington's local public utility tax or equivalent that are paid by the seller or buyer of the electricity to another state or to a political subdivision of another state.

Collection. The Department of Revenue (DOR) may contract with the utility wheeling the power for collection of the taxes, but the utility need not agree to do so. A contract between the DOR and a utility must provide compensation to the utility for its expenses incurred in collecting the taxes, in an amount not to exceed 2 percent of the taxes collected.

Beyond the kilowatt hours of energy delivered and the name of the person to whom it is delivered, the wheeling utility is required in its quarterly reports to provide any nonproprietary information held by the utility that is essential to the DOR in collecting the tax. The utility is authorized to require the person on whose behalf the electricity is wheeled to compensate the utility for costs incurred in making the quarterly reports to the DOR.

Information in the quarterly reports is not subject to public disclosure.

Electric utilities are not required to file the quarterly reports if the seller of electricity is licensed, incorporated, certified, or registered to do business in Washington to sell electricity at retail in the state. In that case, the DOR may require the seller to file the reports.

Substitute Bill Compared to Original Bill: In the original bill, the exemption for DSIs applied only to power purchased from the BPA, and there was no mention of partial DSIs and successors to DSIs. There was no exemption for a company able to import electricity into the state over the company's own transmission lines. Also, the

electricity public bodies purchased from the BPA were exempted from the taxes. The circumstances under which electricity would be considered to have been generated by a person for the person's own use were not specified.

The original bill also provided a tax credit only for public utility taxes paid by the seller to another state.

The substitute bill modified and expanded collection provisions, and exempted information in quarterly reports from public disclosure.

The substitute bill also eliminated statements in the original bill stating that nothing in either section meant electricity is tangible personal property, defined wheeling, and made technical changes.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill takes effect on August 1, 1997.

Testimony For: This bill gives equity to in-state and out-of-state providers. It is in the state's interests that competition be based on the cost of providing service. It protects state and local revenues, while maintaining the status quo in terms of who pays and who doesn't.

Testimony Against: This bill does too much, too soon. Until the electricity industry is deregulated, this bill is unnecessary. The reporting requirements are too open-ended, and may require utilities to divulge proprietary information.

Testified: (Pro) Representative Brian Thomas, prime sponsor; Jim Hedrick, Department of Revenue; and Deb Ross, Department of Community, Trade and Economic Development. (With Concerns) Stan Finkelstein, Association of Washington Cities; Collins Sprague, Washington Water Power; and Aaron Jones, Washington Rural Electric Coop Association. (No Position) Teresa Osinski, Washington Utilities and Transportation Commission; Enid Layes, Industry Customers of Northwest Utilities; Mike Tracy, Puget Power; and Ron Newbry, PacifiCorp.

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill by Committee on Energy & Utilities be substituted therefor and the substitute bill do pass. Signed by 15 members: Representatives B. Thomas, Chairman; Carrell, Vice Chairman; Mulliken, Vice Chairman; Dunshee, Ranking Minority Member; Dickerson, Assistant Ranking

Minority Member; Boldt; Butler; Conway; Kastama; Mason; Morris; Pennington; Schoesler; Thompson and Van Luven.

Staff: Linda Brooks (786-7153).

Summary of Recommendation of Committee on Finance Compared to Recommendation of Committee on Energy & Utilities: No new changes were recommended.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill takes effect on August 1, 1997.

Testimony For: The substitute bill levels the playing field for in-state producers of power. Currently, a power customer may buy electricity out-of-state, wheel the electricity into Washington, and pay no tax on the power since it comes from an out-of-state source. Combined state and local public utility tax rates may be as high as 10 percent, so buying out-of-state power has an immediate 10 percent price advantage. By enacting this substitute bill, the Legislature eliminates the 10 percent price advantage that out-of-state power producers have over in-state power producers. A use tax will not only protect state tax revenues from erosion but also local tax revenues, since many municipalities levy their own local utility taxes.

Concerns: Direct service industries (DSI) have traditionally bought their power from the Bonneville Power Association (BPA). The DSI purchase tax-exempt power from BPA, because Washington cannot levy taxes on federal agencies. Under the provisions of this substitute bill, a DSI customer may buy power from any power supplier and pay no public utility tax or use tax. In other words, each DSI will be able to shop for the best power rates and need not buy from BPA to obtain tax-exempt power.

Giving the DSI the ability to buy tax-exempt power from any supplier means that power rates might increase for BPA's remaining customers. The BPA has incurred significant costs in meeting environmental goals to improve fish migration past its dams and in paying off bonds for abandoned nuclear power projects. The DSI should share in these added costs that face BPA's ratepayers. On the other hand, if the Legislature grants DSI use tax and public utility tax exemptions on power purchased from any supplier, then other major BPA customers such as operators of deep well irrigation systems should receive similar tax exemptions.

Testimony Against: None.

Testified: (Pro) Collins Sprague, Washington Water Power; Victoria Lincoln, Association of Washington Cities; and Sharon Kanareff, Intalco Aluminum. (With Concerns) Aaron Jones, Washington Rural Electric Cooperative Association; and Jim Hedrick, Department of Revenue.