

# HB 1658

## Bill Analysis

March 4, 1999

**Brief Description:** Modifying electrical service taxes.

**Bill Sponsors:** Representative Thomas.

### Brief Summary of Bill

- Major tax restructuring for electrical services. Shifts towards a greater reliance upon consumption taxes and less reliance upon business taxes. Several tax changes made.

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### Background:

#### *About Taxes Generally*

Sales tax is imposed on retail sales of most items of tangible personal property and some services. Sales tax is paid by the consumer but collected and forwarded to the Department of Revenue by the seller.

Use tax is imposed on the use of an item in this state, when the acquisition of the item or service has not been subject to sales tax. Consumers are responsible for paying use tax to the Department of Revenue.

Washington's major business tax is the business and occupation (B&O) tax. The B&O tax is imposed on the gross receipts of business activities conducted within the state without any deduction for the costs of doing business. Some key B&O tax rates are:

Manufacturing & wholesaling	0.484 percent
Retailing	0.471 percent

Public and privately-owned utilities, and certain other businesses, are subject to the public utility tax instead of the business and occupation (B&O) tax. Like the B&O tax, the public utility tax is applied to the gross receipts of the business. The principal difference between the B&O tax and public utility tax is a higher rate schedule applied under the public utility tax.

Cities also impose taxes on the gross receipts of business activities conducted within the cities without any deduction for the cost of doing business. City gross receipts taxes are often called city B&O taxes, but cities (like the state) impose higher gross receipts tax rates on utilities. These taxes with higher rates that are imposed on utilities are often called city utility taxes.

Counties have no authority to impose gross receipts taxes.

*How Electricity Is Taxed*

State tax rates are uniform throughout the state. Local tax rates vary from location to location. Combining state and local taxes together, the table indicates the highest current excise tax rates for electricity.

**Highest Current Rates of Excise Taxation**

<b>Tax</b>	<b>Electricity</b>
Retail Sales & Use	0.0%
Gross Receipts (B&O)	0.0%
Gross Receipts (public utility)	3.873%
<b>STATE TAX SUB-TOTAL</b>	<b>3.873%</b>
Retail Sales & Use (for general funds)	0.0%
Retail Sales & Use (for dedicated funds)	0.0%

Gross Receipts ( <i>only cities may impose</i> )	6.0%*
LOCAL TAX SUB-TOTAL	6.0%
<b>GRAND TOTAL</b>	<b>9.873%</b>

\*A city's gross receipts tax may exceed six percent with voter-approval.

As the table indicates, the state imposes a 3.873 percent gross receipts tax on light and power businesses. There are some tax deductions allowed. A light and power business may deduct any revenues earned from wholesale transactions or from sales of exported power. Light and power businesses that serve less than seventeen customers per mile of line may also deduct 30 to 50 percent of the wholesale amount paid for power.

City tax deductions are not necessarily the same as state deductions. Each city determines if any deductions are allowed. City taxes generally apply only to the gross receipts earned by a light and power business that sells power to customers located within the city. A city that operates its own municipal utility, however, taxes the full gross receipts of its municipal utility, regardless of whether the power was sold to customers located inside or outside of the city's boundaries.

State and city gross receipts taxes are imposed on light and power businesses. Although the Bonneville Power Authority (BPA) is a light and power business, it is also a federal agency and exempt from state and local taxes. Therefore, power sold by the BPA is untaxed.

State and city taxes apply to in-state light and power businesses. On the other hand, out-of-state businesses that sell power to Washington consumers are only subject to tax if the out-of-state business has some sort of nexus or direct connection to the state. For example, an out-of-state light and power business that has some employees located in Washington would be taxable, but an out-of-state business with no employees based in Washington nor any other direct connection to the state is not subject to tax.

If large commercial or industrial consumers of electricity purchase electricity from an out-of-state light and power business that have no connection to Washington, then no state or city taxes are paid on the value of the electricity. It is possible, however, that a local light and power business would deliver this out-of-state electricity to the commercial or industrial customer by wheeling the electricity over its power distribution lines. In this case, the local light and power business would pay state and city taxes on revenues earned from the wheeling fees that it charges to transport the power. The value of the electricity itself, however, is untaxed.

**Summary of Bill:**

Combining state and local taxes together, the table illustrates the highest rates of excise taxation

for electrical services. The table assumes that cities opt to impose a new electric sales and use tax. However, cities are not required to adopt an electric sales and use tax, as explained below under the header, *City tax changes*. –

### Highest Rates of Excise Taxation

Tax	Electrical Service
Retail Sales & Use	3.0%
Gross Receipts (B&O)	0.471%
Gross Receipts (public utility)	0.0%
STATE TAX SUB-TOTAL	3.471%
Retail Sales & Use (for general funds)	5.8%
Retail Sales & Use (for dedicated funds)	1.1%**
Gross Receipts ( <i>only cities may impose</i> )	0.2%*
LOCAL TAX SUB-TOTAL	5.7%
<b>GRAND TOTAL</b>	<b>10.571%</b>

\*Cities may impose a gross receipts tax at a rate higher than 0.2 percent rate with voter approval. However, a city must tax businesses making retail sales of electrical services at the same rate that a city taxes businesses making retail sales of tangible personal property.

\*\*Local governments have authority to impose up to 1.8 percent in dedicated sales taxes for purposes such as transit or criminal justice, but no local govt. is using its full taxing authority. The highest current rate is 1.1 percent.

#### *State Tax Changes*

The 3.873 percent state public utility tax imposed on light and power businesses is repealed. Replacing this tax is a new 3 percent state sales and use tax on electrical services. Additionally, businesses providing electrical services become subject to state B&O taxes at regular rates:

Manufacturing & wholesaling	0.484 percent
Retailing	0.471 percent

The tax changes are designed to be revenue neutral for the state. Although the total state excise tax rate declines from 3.873 percent to 3.471 percent, there is an expansion in the tax base so that the total amount of revenues collected remains the same. The tax base expansion is due to the fact that B&O taxes would apply at regular rates. There are no B&O tax deductions allowed for revenues earned from sales at wholesale or from sales of exported power.

The wholesaling B&O tax does not apply, however, to energy exchanges. Energy exchanges involve one electrical business providing electricity, or the rights thereto, to another electrical business. These transactions are not subject to tax, as long as the exchanges are for equivalent rights or amounts of electricity.

Light and power businesses that generate electricity are engaged in manufacturing, and the manufacturing B&O tax applies to the value of all electricity generated in-state. If the electricity is sold in-state, however, then any wholesaling or retailing B&O taxes paid may be credited against the manufacturing B&O tax liability. If the electricity is exported out-of-state, then a credit is allowed for similar taxes paid to other states or their political sub-divisions. Manufacturing tax is owed on any remaining balance after available credits have been taken.

### *City Tax Changes*

Cities have three tax options. First, a city may restructure its taxes by adopting up to a 5.8 percent electric sales and use tax and up to a 0.2 percent gross receipts tax for a total excise tax rate of 6.0 percent. Second, a city may choose the status quo, keeping its public utility gross receipts tax that may be as high as 6.0 percent and even higher, if voter-approved. Third, a city may adopt up to a 5.8 percent electric sales and use tax and keep its gross receipts tax that may be as high as 6.0 percent and even higher, if voter approved. A city choosing the third option must credit any electric sales and use taxes paid against its public utility gross receipts tax. This credit mechanism prevents an increase in the overall rate of taxation. Additionally, any city choosing the second or third options must subject its public utility gross receipts tax to voter referenda every six years.

Under the second and third options, a city whose municipal electrical utility provides service to out-of-city consumers may keep its public utility gross receipts taxes and continue to tax revenues associated with out-of-city sales. Nonetheless, if a neighboring city or county imposes a local electric sales and use tax, then the city operating the municipal utility must provide a credit for the neighboring city or county's electric sales and use tax against its gross receipts tax. This credit mechanism prevents double taxation.

### *County Tax Changes*

Under the new tax structure counties gain local option taxing authority. A county may impose up to a 5.8 percent electric sales and use tax on electrical services. This county tax applies only in unincorporated areas.

### *About Local Dedicated Sales Tax Revenues*

Under the tax restructuring both cities and counties may impose up to a 5.8 percent electric sales and use tax to raise revenues for general fund purposes. Additionally, special sales tax levies for dedicated purposes such as transit, the RTA, or criminal justice are permitted. Since electrical services have not been previously subject to sales and use taxes, these dedicated sales

and use tax levies that are imposed on top of the state and local electric sales and use taxes will result in new revenues to cities and counties for purposes such as transit, the RTA, and criminal justice.

*Purchases of Electricity from Out-of-State or from the BPA Subject to Use Tax*

By replacing state and city gross receipts taxes with a new electric sales and use tax, out-of-state purchases or purchases from tax-exempt entities become subject to state and local use taxes. Specifically, when a large industrial or commercial customer buys electricity from an out-of-state light and power business, the customer must pay use tax to the Department of Revenue if sales tax has not been paid. Similarly, if a customer buys electricity from a federal agency such as the BPA that is not required to collect state and local sales taxes, then the customer must pay use tax on the purchase of electricity from the BPA to the Department of Revenue.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** January 1, 2000.