

SENATE BILL REPORT

SB 5539

As Reported By Senate Committee On:
Environment, Energy & Water, February 23, 2001

Title: An act relating to tax credits for new facilities that provide electricity for direct service industrial customers.

Brief Description: Establishing tax credits for new facilities that provide electricity for direct service industrial customers.

Sponsors: Senators Honeyford, Eide, Patterson, Fraser, Regala, Hale, Oke and Winsley; by request of Governor Locke.

Brief History:

Committee Activity: Environment, Energy & Water: 2/1/01, 2/23/01 [DPS-WM].
Ways & Means: 3/6/01.

SENATE COMMITTEE ON ENVIRONMENT, ENERGY & WATER

Majority Report: That Substitute Senate Bill No. 5539 be substituted therefor, and the substitute bill do pass and be referred to Committee on Ways & Means.

Signed by Senators Fraser, Chair; Regala, Vice Chair; Eide, Hale, Jacobsen, McDonald, Morton and Patterson.

Staff: Andrea McNamara (786-7483)

SENATE COMMITTEE ON WAYS & MEANS

Staff: David Schumacher (786-7474)

Background: Direct Service Industrial customers (DSIs) are a category of large industrial customers (primarily aluminum smelters and pulp mills) that historically have contracted with the federal Bonneville Power Administration (BPA) for the direct delivery of electricity. Aluminum companies utilize large amounts of electricity, not just to power their operations but also as an element in the production of their products. DSIs were given their direct contracting authority by Congress several decades ago to support the war effort and encourage economic development in the region.

The state collects business and occupation (B&O) taxes from businesses in Washington at a rate of 0.484 percent of gross receipts for manufacturing and extracting operations. B&O proceeds are deposited into the state general fund. DSI's are subject to the B&O tax.

The state also imposes a public utility tax (PUT) on light and power businesses and gas distribution businesses based on gross receipts earned in the generation, production and distribution of electricity and the distribution of natural or manufactured gas. The rates are

3.873 percent for electricity and 3.852 percent for gas. State PUT revenues are deposited into the state general fund. Cities may also impose a local public utility tax at a rate of up to 6 percent (or higher if approved by voters). Local PUT revenues are used as general fund sources by the cities that impose them. Utilities typically pass these state and local public utility taxes directly on to their customers.

As a result of their status as DSI's, these companies do not pay state or local utility taxes on the electricity they purchase directly from BPA. In addition to purchasing power from BPA, some DSI's obtain a portion of their electricity directly from the wholesale market or from out-of-state entities. These transactions are also exempt from state and local public utility taxes.

The natural/manufactured gas use tax (known as the brokered natural gas– tax) is imposed directly on customers who bypass in-state utilities and obtain natural gas directly from out-of-state producers or brokers for their own use. This brokered natural gas is exempt from general state and local sales and use taxes and is instead subject to a special use tax. The state tax rate is equal to the state public utility tax rate on non-brokered natural gas (3.852 percent). The city tax rate is equal to the city public utility tax rate on natural gas. These tax revenues are general fund revenues.

Summary of Substitute Bill: A new tax credit/deferral program is established for direct service industrial customers (DSIs) who install their own gas-fired generating facilities or who purchase electricity from new gas-fired generating facilities owned by others.

Three different tax incentive options are included in the program, depending on the ownership and operation of the new generating facilities: business and occupation (B&O) tax credits; brokered natural gas tax deferrals; and public utility tax (PUT) credits. All credits and deferrals take effect on July 1, 2004, and are available for five years.

Employment requirements are included so that any of the credits/deferrals are only available if the DSI maintains employment levels equal or greater than the average of the previous five years. Future reductions in employment levels will result in commensurate reductions in the available credit/deferral. A repayment schedule based on employment levels reductions is specified.

B&O Tax Credit. A credit is available against the B&O tax for DSIs that purchase gas for use in their own generating facilities from a gas company that pays the PUT. The amount of the credit is the same as the amount of the PUT paid by the gas company providing the gas.

Brokered Natural Gas Tax Deferral/Exemption. A deferral is available against the brokered natural gas tax paid by a DSI on the first five years' worth of gas used to generate electricity at a facility owned by the DSI. A five-year repayment schedule is specified, but the deferral need not be repaid if employment conditions are met.

Public Utility Tax Credit. A credit is available against the public utility tax paid by an electricity generator that sells electricity to a DSI from a new gas-fired generating facility if certain conditions are met: (1) there must be a contract whereby the DSI purchases electricity

from the generator for at least ten years; (2) the generator passes on the amount of the credit to the DSI; and (3) the DSI is responsible for any repayment if all requirements are not met.

In order to qualify for the tax relief, any DSI that is reselling or remarketing BPA power between January 1, 2000 and October 1, 2001, must use the proceeds for curtailment expenses, including payment of laid off or idled workers, and expenses related to securing future power supplies and enhancing operations in Washington.

If a portfolio diversification requirement is enacted in legislation during the 2001 session, credits/deferrals are only available to companies that also meet the requirements of that legislation.

Substitute Bill Compared to Original Bill: The substitute makes three clarifications and adds one new requirement. It clarifies that a subsidiary of a DSI is eligible for the tax credit as if it were a DSI (so long as it is more than 50 percent owned by the DSI). It also clarifies how employment levels will be measured for the purposes of meeting the continued employment requirements (five year average annual). It also clarifies that DSIs are only eligible for one of the three alternative tax incentive options. The substitute adds a new requirement for DSIs to qualify for the tax incentive: for any DSI that is reselling or remarketing BPA power between January 1, 2000, and October 1, 2001, they must use the proceeds for curtailment expenses (including payment of idled or laid-off workers), and expenses related to securing future power supplies and enhancing operations in Washington (including new nonfederal power and new conservation/ efficiency measures, or environmental benefits).

Appropriation: None.

Fiscal Note: Available.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Testimony For: DSIs do not have a secure allocation of BPA power in the future, and it is in the whole region's interest for the DSIs to become independent of BPA as soon as possible. DSIs are exploring many options to keep their operations viable in Washington. A full and permanent closure of the Goldendale aluminum plant would devastate that community, resulting in an additional 18-25 percent unemployment on top of the existing 9 percent unemployment rate, and the loss of a significant number of students (and associated state funding) for the local public schools.

Testimony Against: Any tax break should be linked to a requirement for permanent independence from BPA and should require mitigation of carbon dioxide emissions created by the new gas-fired generating facilities. An independent study conducted for BPA shows that the region would be better off without the DSIs. The diversion of significant amounts of gas to DSI combustion turbine projects may create a gas shortage in the region and drive gas prices up to other consumers.

Testified: Gerry Miller, Goldendale Aluminum Co. (pro); Dana Peck, Klickitat County (pro); Carl Conroy, Goldendale School Bd (pro); Mark Peterson, Don Henwing, USWA #8147 (pro); Harold Hill, Klickitat PUD (pro); Sandi Swarthout, Alcoa (pro); Danielle

Dixon, NW Energy Coalition (con); Donna Ewing, League of Women Voters (con); Tim Boyd, Industrial Customers of NW Utilities (amend.); Craig Engelking, Sierra Club (con); Dave Danner, Governor's Policy Office.