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**Finance Committee**

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**SSB 6369**

**Brief Description:** Providing excise tax exemptions for water services provided by small water systems.

**Sponsors:** Senators Haugen, Mulliken and Rasmussen.

**Brief Summary of Bill**

- Exempts water-sewer, irrigation, and public utility districts that provide water services to small customer bases from the public utility tax and business and occupation tax.
- Provides goals for the exemption.
- Requires districts that receive the exemption to file an annual report to the Department of Revenue regarding the use of the tax savings.

**Hearing Date:**

**Staff:** Mark Matteson (786-7145).

**Background:**

*Water systems and federal requirements.* The Washington State Department of Health statistics indicate that, at the end of 2005, there were over 17,000 water systems in Washington. Water systems may be run by any one of a number of entities, including municipalities, special purpose districts, other governmental entities, associations, and private investors.

Water systems serving at least 25 persons or 15 connections must meet the federal Safe Drinking Water Act requirements. The Safe Drinking Water Act requires water testing for more than 100 different types of contaminants. If tests indicate the presence of contaminants, then additional testing, treatment and system upgrades may be required. A water system using surface water as its source must also filter the water. Fulfilling water testing, filtration, and treatment obligations imposes costs on water systems. The cost per customer in meeting these obligations can be high for small systems, since small systems must spread costs over a smaller customer base and cannot realize economies of scale.

*Excise taxation of water systems.* Public and privately-owned utilities, including water distribution businesses, are subject to the state public utility tax (PUT). The PUT is applied to the gross receipts of the business. For water distribution businesses, the applicable tax rate is 5.029 percent. Revenues are deposited to the state general fund.

The business and occupation (B&O) tax is Washington State's major business tax. The tax is imposed on the gross receipts of business activities conducted within the state. Revenues are deposited to the state general fund. A business may have more than one B&O tax rate, depending on the types of activities conducted. Firms that provide services are generally taxed at a rate of 1.5 percent.

Neither the PUT nor the B&O tax permits deductions for the costs of doing business, such as payments for raw materials and wages of employees. Nonetheless, a number of exemptions, credits, deductions, and other preferences have been enacted for specific types of business activities under the PUT and B&O tax statutes. For example, an exemption exists for public utilities for which the gross income is \$2,000 per month or less. Many small water systems qualify for this exemption.

In 1997, the Legislature enacted legislation that exempted certain businesses from paying public utility and B&O taxes on amounts received for water services. The legislation, which was further amended in 1998, applied to:

1. Water-sewer districts and irrigation districts that:
  - a. Serve fewer than 1,500 connections; and
  - b. charge a residential water rate exceeding 125 percent of the average statewide water rate.
2. Water systems owned or operated by a satellite system management agency that:
  - a. Serve fewer than 200 connections; and
  - b. charge a residential water rate exceeding 125 percent of the average statewide water rate.

A water system or irrigation district claiming one of these tax exemptions was required to supply proof to the Department of Revenue (DOR) that at least 90 percent of the value of the tax exemptions would be used to repair, equip, upgrade, or maintain the system. The tax exemptions expired on July 1, 2004.

Data from the DOR indicates that approximately 58 districts or businesses that provide water services took the exemption on an annual basis, resulting in a total taxpayer savings of about \$230,000 annually.

*Reporting requirements for taxpayers taking incentives.* In recent years, a number of tax incentives have been enacted with certain reporting requirements. The principal components of these provisions are reporting requirements and enforcement mechanisms. For example, aluminum smelters that take certain incentives must provide an annual report with details about employment, wages, and health benefits. If such smelters fail to submit the report, the business must pay back the value of the incentive. As part of the enactment of recent incentives, the Legislature has also required that the fiscal committees of the Legislature report periodically on the effectiveness of the program.

### **Summary of Bill:**

The exemptions that existed through fiscal year 2004 under the PUT and the B&O tax for water-sewer districts and irrigation districts that provide water services to small customer bases are reenacted with modifications and extended indefinitely. The exemptions are extended to include public utility districts that provide water services to small customer bases.

Goals are provided for the exemption program: To provide assistance to small public water systems that are most in need in order to make necessary repairs; and to allow these systems to comply with state and federal mandates associated with clean drinking water.

Water services providers that participate in the exemption program are required to submit a report to the DOR annually. The report must detail the specific capital improvements that were made using the tax savings attributable to the exemptions. The report content is not subject to confidentiality requirements and may be disclosed to the public. During any year, if a business fails to submit a report, all tax savings attributable to the exemptions for the year are due.

The fiscal committees of the Legislature are required to report to the Legislature on the effectiveness of the exemptions by December 2010.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill contains an emergency clause and takes effect immediately.