
Finance Committee

HI 732

Brief Description: Creating a carbon pollution tax on fossil fuels to fund a reduction in the state sales tax, a reduction in the business and occupation tax on manufacturing, and the implementation/enhancement of the working families' sales tax exemption.

Brief Summary of Bill

- Establishes a new carbon tax levied on the carbon content of fossil fuels sold or used in the state and on the carbon content inherent to electricity consumed within the state.
- Reduces the business and occupation tax rate to 0.001 percent for manufacturing activities and for the wholesaling and retailing of commercial airplanes.
- Reduces the state retail sales tax to 5.5 percent over a two-year period.
- Increases the remittance for individuals that qualify for the working families tax exemption.

Hearing Date: 2/19/16

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Background:

Initiatives to the Legislature.

Article II, Section 1, of the Washington State Constitution authorizes the initiative process, allowing the people to place a proposition on the ballot or to submit the proposed law to the Legislature. If an initiative to the Legislature is certified, the Legislature has one of the following three options:

1. adopt the initiative as proposed, in which case it becomes law without a vote of the people;
2. reject or refuse to act on the proposed initiative, in which case the initiative must be placed on the ballot at the next state general election; or

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3. approve an alternative to the proposed initiative, in which case both the original proposal and the Legislature's alternative must be placed on the ballot at the next state general election.

Current Federal and Washington Regulation of Greenhouse Gasses.

The United States Environmental Protection Agency (EPA) and state Department of Ecology (ECY) identify carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, and sulfur hexafluoride as greenhouse gases (GHGs) as a result of their capacity to trap heat in the Earth's atmosphere.

Under the federal Clean Air Act, carbon dioxide and other GHGs are regulated as an air pollutant and are subject to several air regulations administered by the EPA. These federal Clean Air Act regulations include a requirement that facilities and fuel suppliers whose associated annual emissions exceed 25,000 metric tons of carbon dioxide equivalent report their emissions to the EPA.

At the state level, carbon dioxide and other GHGs are regulated by the ECY under the state Clean Air Act. This state law requires facilities and other sources whose emissions exceed 10,000 metric tons of carbon dioxide equivalent each year to report their annual emissions to the ECY, or to local air authorities that implement the state Clean Air Act. Liquid motor vehicle and aircraft fuel suppliers that supply fuel whose combustion would exceed that same 10,000-ton volumetric threshold must also report their annual emissions. In addition, in January of 2016, the ECY issued a draft rule under the authority of the state Clean Air Act to limit GHGs from certain stationary sources and fuel sources.

Apart from reporting and other regulations under the state and federal clean air acts, several other state laws and programs explicitly address GHG emissions. State law prohibits Washington utilities from investing in or making a long-term financial commitment to sources of electricity whose generation exceeds a GHG emission performance standard of 1,100 pounds of GHGs per megawatt-hour, or a separate standard for natural gas generation as determined by the Department of Commerce. State law also establishes limits for statewide GHG emission levels for 2020, 2035, and 2050, although it is not specified how the state must achieve those limits, nor does the law require emission reductions to be achieved by particular entities or types of entities.

Business and Occupation Tax.

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. A B&O tax is imposed on manufacturing businesses equal to 0.484 percent of the gross income of the business; a few specific types of manufacturing are subject to a lower preferential rate. A manufacturer is one who undertakes activities of a commercial or industrial nature applying labor or skill to materials so that a different or useful substance or article of personal property is produced for sale or use.

Retail Sales Tax.

Retail sales taxes are imposed on retail sales of most articles of tangible personal property, digital products, and some services. A retail sale is a sale to the final consumer or end user of the property, digital product, or service. If retail sales taxes were not collected when the user acquired the property, digital products, or services, then use taxes apply to the value of property,

digital product, or service when used in this state. The state, most cities, and all counties levy retail sales and use taxes. The state sales and use tax rate is 6.5 percent; local sales and use tax rates vary from 0.5 percent to 3.1 percent, depending on the location.

Working Families Tax Exemption.

In 2008, the Legislature enacted a working families' tax exemption in the form of a state sales tax remittance, equal to a percentage of the federal earned Income Tax credit (EITC). Persons eligible for the credit must file a federal income tax return, receive and EITC, and have resided in Washington for more than 180 days in the year that the exemption is claimed. Eligible persons must pay the sales tax in the year for which the exemption is claimed. The exemption for taxes paid in the prior year is \$50 or equal to 10 percent of the EITC, whichever is greater. For any fiscal period, the working families' tax exemption must be approved in the state Omnibus Appropriations Act.

The Department of Revenue (DOR) determines eligibility based on information provided by the applicant, and through audit, administrative records, and verification of Internal Revenue Service (IRS) records. The DOR may use the best data available to process the remittance. The timeframe for the DOR to receive verified federal EITC data from the IRS is 18 months. The state Omnibus Appropriations Act must specify funding to be used for the ongoing administrative costs of the program.

Summary of Bill:

Carbon Tax: Rates, Exemptions and Credits.

Beginning July 1, 2017, a tax of \$15 per metric ton is levied on the carbon content of fossil fuels sold or used in the state and the carbon content inherent in electricity consumed in the state. The carbon content is calculated by the DOR using resources such as the United States energy information administration, or the United States environmental protection agency that provide the carbon dioxide content measurements for fossil fuels. "Carbon content inherent in electricity" is defined as carbon dioxide generated by the production of electricity from fossil fuels. Fossil fuels include coal, petroleum products, natural gas and other forms of solid, liquid or gaseous fuel derived from these types of products.

The rate of tax is increased to \$25 per metric ton beginning July 1, 2018. The tax rate increases every year thereafter by 3.5 percent plus inflation. The tax rate may not exceed a rate of \$100 per metric ton, converted into 2016 dollars when adjusted by inflation using the consumer price index.

A reduction or refund is authorized for the use of fossil fuels if it can be demonstrated that the use did not contribute to increasing atmospheric carbon dioxide concentration, for example, by qualified sequestration. The right to a reduction or refund is not transferrable and may not be banked.

The carbon tax is imposed only once and at the time and place of the first taxable event within the state. If a person pays the tax imposed on fuel that is consumed in the generation of electricity, the electricity generated is not subject to the tax.

A credit for any similar taxes paid to another state is authorized for any person taxable with respect to electricity consumed in the state. The credit may not exceed the tax liability due with respect to the consumption of that electricity.

The tax on electricity must be imposed on the consumer of electricity. If the seller of electricity is located within the state, the seller is obligated to collect and remit the tax on behalf of the consumer. If the seller fails to collect the tax imposed, or collects the tax but fails to remit, the seller is liable for the amount of the tax.

The following are exempt from the carbon tax:

- fossil fuels brought into the state by a fuel supply tank of a motor vehicle, vessel, locomotive or aircraft;
- fuel that is prohibited from taxation under the state or federal Constitution; and
- fuel intended for export outside the state.

The carbon tax is phased-in for the following uses of fossil fuels:

- diesel, biodiesel or aircraft fuel purchased and used solely for agricultural purposes;
- fuel purchased for the purpose of public transportation;
- fuel purchased for private, nonprofit transportation providers;
- fuel purchased by the Washington state ferry system for use in a state-owned ferry; and
- fuel purchased for school buses.

The tax rate is phased-in as follows:

- 5 percent of the carbon tax rate, for the 2017-2019 biennium;
- 10 percent of the carbon tax rate, for the 2019-2021 biennium; and
- continues to increase by five percent, biennially, until it reaches 100 percent, effective July 1, 2055.

Carbon Tax: Administration and Reporting.

The DOR is responsible for administration of the carbon tax. This includes a requirement that the DOR and the DOL adopt rules related to the implementation of the carbon tax. The DOR is also responsible for any tax rate adjustments, and the development of forms and reports taxpayers are required to submit. The DOR's general administrative provisions apply to the carbon tax.

Utilities and users of electricity not generated in state or acquired from a qualifying utility must file monthly with DOR a fuel mix disclosure report together with the tax calculated based on the calculated tax tables provided by DOR. If a utility or electricity user reports electricity products with no declared resources or fails to provide the sources of the resources, DOR must assume the carbon content inherent in the electricity to be one metric ton of CO₂ per megawatt hour.

Refineries must file with DOR monthly a fuel use report similar to EPA's greenhouse gases tool report, along with the tax calculated based the tax tables provided by DOR. A utility, electricity user, or refinery that does not have the information required for a fuel mix disclosure or fuel use report may file an interim report based on estimates with an estimated payment, and may file a final report at a later date. Interests and penalties on underpayments applies.

In addition, the DOR must submit an annual report to the Legislature and Governor until 2027, with biennial reports thereafter, that includes the following:

- the total carbon tax collected;
- the total revenue loss from the reduction of the B&O tax, state retail sales tax and the WFTE;
- the revenue loss from the phase-in for specific uses of fossil fuels;
- the costs associated with the administration of the carbon tax; and
- the overall net revenue gain or loss from the tax policy changes of the initiative.

Business and Occupation Tax.

The B&O tax rate for manufacturing activities is reduced to 0.001 percent. In addition, the B&O tax rate for the wholesaling and retailing of commercial airplanes, or components of commercial airplanes, is reduced to .001 percent if the airplane or components are manufactured by the seller.

Retail Sales and Use Tax.

Beginning July 1, 2017, the state retail sales and use tax rate is reduced to 6.0 percent. Beginning July 1, 2018 the retail sales and use tax rate is further reduced to 5.5 percent.

Working Families Tax Exemption.

Beginning in 2017, the remittance amount for the WFTE is 15 percent of the federal EITC or \$100, whichever is greater. Beginning in 2018, and every year thereafter, the exemption is 25 percent of the federal EITC or \$100, whichever is greater.

The definition of eligible low-income person is modified. The requirement that an individual be granted the federal EITC is removed and instead an eligible individual that claims the federal EITC is eligible for the WFTE if all other eligibility requirements are met.

Appropriation: None.

Fiscal Note: Available.