

HOUSE BILL REPORT

HB 1381

As Reported by House Committee On:
Technology & Economic Development

Title: An act relating to encouraging job retention and creation in rural economies through the transparent and accountable extension of aluminum smelter tax preferences.

Brief Description: Concerning encouraging job retention and creation in rural economies through the transparent and accountable extension of aluminum smelter tax preferences.

Sponsors: Representatives Buys, Lytton, Van Werven, Blake, Wilcox, Condotta, Nealey and Morris.

Brief History:

Committee Activity:

Technology & Economic Development: 2/3/15, 2/17/15 [DPS].

Brief Summary of Substitute Bill

- Extends the reduced business and occupation (B&O) tax rate for aluminum smelter manufacturing and wholesaling until January 1, 2022.
- Extends the B&O tax credit for property taxes paid on an aluminum smelter through 2022.
- Extends the credit against retail sales and use tax liability for the state portion of sales and use taxes paid by an aluminum smelter on property and labor and services associated with the property, until January 1, 2022.
- Extends the exemption for an aluminum smelter from paying the brokered natural gas use tax on gas delivered to it through a pipeline until January 1, 2022.
- Establishes performance metrics for the tax preference, based on smelter employment, electricity prices, aluminum prices, and changes in reported profitability of the smelters.
- Requires repayment of all or a portion of tax preference amounts saved, triggered by certain changes in employment or average wages at the smelter.
- Requires a financial statement of profitability and affidavit to be submitted annually to the Department of Revenue and used by the Joint Legislative Audit and Review Committee in assessing the tax preferences' performance.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

HOUSE COMMITTEE ON TECHNOLOGY & ECONOMIC DEVELOPMENT

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 7 members: Representatives Morris, Chair; Tarleton, Vice Chair; Fey, Hudgins, Ryu, Santos and Wylie.

Minority Report: Without recommendation. Signed by 5 members: Representatives DeBolt, Assistant Ranking Minority Member; Harmsworth, Magendanz, Nealey and Young.

Minority Report: Do not pass. Signed by 1 member: Representative Smith, Ranking Minority Member.

Staff: Jasmine Vasavada (786-7301).

Background:

In 2004 the Legislature enacted a package of incentives for the aluminum manufacturing industry, an electricity-intensive industry, with the stated intent of keeping smelters operating in the state during a time when electricity costs were high and aluminum prices were falling. The incentives were originally scheduled to expire on January 1, 2007, but have been renewed multiple times, and are now scheduled to expire in 2017. Tax incentives for the aluminum smelter industry include business and occupation (B&O) tax credits and rate reductions, sales and use tax credits, and a brokered natural gas use tax exemption.

Business and Occupations Tax Credits and Rate Reductions.

The B&O tax is Washington'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. Until January 1, 2017, manufacturers of aluminum are subject to a B&O tax rate reduced from 0.484 percent to 0.2904 percent.

An aluminum smelter that is a direct service industrial customer (DSI) may take a credit against B&O tax liability for property taxes levied through 2016. A DSI is an industrial customer that contracts with the Bonneville Power Administration (BPA) for the purchase of power for direct consumption. Only industrial customers with contracts to purchase power from the BPA on December 5, 1980, the date of the federal Pacific Northwest Electric Power Planning and Conservation Act, may purchase directly from the BPA rather than a utility. Of the two DSIs remaining in the state, one is an aluminum smelter.

Sales and Use Tax Credits.

Until January 1, 2017, aluminum smelters may take a credit against retail sales and use tax liability for the amount of the state portion of sales and use taxes paid on tangible property and labor and services associated with the property.

Public Utility Tax and Brokered Natural Gas.

Public and privately-owned utilities are subject to the state Public Utility Tax (PUT). The PUT is applied to the gross receipts of the business. If the supplier of natural or manufactured gas that is consumed within the state is not subject to the state PUT, the natural or manufactured gas that is consumed within the state is subject to the state brokered natural

gas use tax. "Brokered natural gas" (BNG) means natural gas purchased by a consumer from a source out of the state and delivered to the consumer in this state. Use taxes for BNG are imposed at the location where the gas is burned by the taxpayer or stored in a facility of the taxpayer for later consumption. Revenues are deposited to the State General Fund. An aluminum smelter is exempt from paying the brokered natural gas use tax on gas delivered to it through a pipeline until January 1, 2017.

Joint Legislative Audit and Review Committee.

The Citizen Commission for Performance Measurement of Tax Preferences (Commission) was established in 2006 as a seven-member Commission that includes, as a non-voting member, the Chair of the Joint Legislative Audit and Review Committee (JLARC). The Commission develops a schedule to review nearly all tax preferences at least once every 10 years. The Commission also schedules preferences with expiration dates for reviews in the year before the tax preference expires. Tax preference reviews are conducted by the JLARC according to the schedule established by the Commission. For each tax preference, the JLARC provides recommendations to continue, modify, schedule for future review, or terminate the preference. The Commission reviews and comments on the JLARC report. The Commission has selected the four aluminum industry tax preferences for a performance review by the JLARC staff in 2015.

Summary of Substitute Bill:

Tax incentives for the aluminum industry are extended for five years. The business and occupation (B&O) tax credit for the amount of property taxes paid by a direct service industrial customer for property reasonably necessary for the purposes of an aluminum smelter is extended through 2022. The following tax incentives are extended until January 1, 2022:

- the reduced B&O rate from 0.484 percent to 0.2904 percent for manufacturers of aluminum;
- the sales and use tax credit against the state portion of the tax for personal property, construction materials, and labor and services performed on buildings and property at an aluminum smelter; and
- the exemption from the brokered natural gas use tax on gas delivered through a pipeline.

The Department of Revenue (DOR) may adopt rules for the administration and enforcement of the tax preference.

Repayment of Tax Preference Amounts Saved.

If certain changes in employment or wages occur at an aluminum smelter before July 1, 2025, tax preference amounts saved must be repaid. Taxes that would have otherwise been due and payable on or after August 1, 2015, must be repaid if employment positions at the smelter decline, as compared to the reported average of the five prior calendar years. Such decline is determined by data reported to the Employment Security Department:

1. Employment decline by 10 percent and up to 50 percent requires proportional repayment, of 10 percent to 40 percent of tax preference amounts saved.

2. Employment decline by 50 percent or more requires repayment of all tax preference amounts saved.

All tax preference amounts saved must be repaid if the average wage at the smelter in the previous calendar year is less than \$50,000. If a requirement to repay tax preferences is triggered, the person claiming the tax preference is disqualified from claiming any tax preference in future years.

Tax Preference Performance Statement.

A Tax Preference Performance Statement provides that the goal of the incentives is to promote and preserve employment within the state's aluminum manufacturing industry. Aluminum smelters must file with the DOR each year an annual report and a "certified statement of profitability." The certified statement of profitability is a financial statement reporting the gross income, gross profit, operating profit, and net profit of the aluminum smelter, together with an affidavit by the person claiming the tax preference, attesting that the financial statement was prepared in accordance with generally accepted accounting principles.

In addition to filling out an annual report, aluminum smelters must complete an annual survey. The survey includes the amount of tax preference claimed, which is not confidential and may be publicly disclosed. The survey also includes employment, wage, and benefit information for each of the facilities in Washington at which the exemption is claimed, but this information is treated as confidential taxpayer information. The DOR must provide the annual report, certified statement of profitability, and annual survey information to the Joint Legislative Audit and Review Committee (JLARC).

The JLARC is directed to measure the effectiveness of the exemptions by evaluating changes in certain performance metrics. These metrics state that the effectiveness of the exemption will be measured based on:

- changes in statewide employment and wages for the two largest aluminum manufacturing firms in Washington;
- changes in price of aluminum on the London metal exchange;
- firm-wide changes in alumina price index and spot pricing as a percent of third-party shipments for the largest aluminum manufacturing firm operating in Washington;
- changes in Bonneville Power Administration contracted power prices of the largest aluminum manufacturing firm operating in Washington; and
- changes in the profitability of aluminum smelters, as indicated on the certified financial statements of profitability.

Substitute Bill Compared to Original Bill:

Repayment of Tax Preference Amounts Saved.

The substitute bill removes a requirement in the original bill to repay up to three years of tax preference amounts saved, if an aluminum smelter closes. Instead, the substitute bill requires:

- pro-rated repayment of tax preference amounts saved, for taxes that would have otherwise been due and payable on or after August 1, 2015, if employment positions at the smelter decline, as reported to the Employment Security Department and as compared to the reported average of the five prior calendar years. Repayments must

be made as follows: (1) employment decline by 10 percent and up to 50 percent requires repayment of 10 percent to 40 percent of tax preference amounts saved; and (2) employment decline by 50 percent or more requires repayment of all tax preference amounts saved; and

- repayment of all tax preference amounts saved, for taxes otherwise due and payable on or after July 1, 2015, if the average wage at the smelter in the previous calendar year is less than \$50,000.

These repayment obligations apply only to changes in employment or wages that occur at an aluminum smelter before July 1, 2025. A person is disqualified from claiming a tax preference in future years, once a requirement to repay tax preference amounts has been triggered.

Certified Statement of Profitability.

The person claiming the tax preference must submit to Department of Revenue, along with the annual report, a "certified statement of profitability," which is a financial statement reporting the gross income, gross profit, operating profit, and net profit of the aluminum smelter, together with an affidavit attesting that the financial statement was prepared in accordance with generally accepted accounting principles.

Tax Preference Performance Statement and Annual Reporting.

Legislative findings are changed to provide that the intent of the Legislature is to assist smelters that are temporarily unprofitable in achieving profitability. One performance metric the Joint Legislative Audit and Review Committee (JLARC) uses in determining the success of the tax preferences is changed, and a new performance metric is added. The JLARC must consider changes in statewide employment at the two largest in-state smelters, rather than only at the largest. The JLARC must also consider changes in the profitability of aluminum smelters, as reported in the certified statements of profitability.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill takes effect August 1, 2015.

Staff Summary of Public Testimony:

(In support) Smelters provide a significant number of union-wage jobs to surrounding communities. In 1997 there were 10 facilities representing 10,000 jobs; today there are two locations, with roughly 1,100 jobs. The value of employee wages and benefits is greater than \$100 million, and each aluminum smelter job supports additional indirect employment. In 2013 average wage and benefits for both plants was more than 1.5 times the state average, and the two plants contributed \$500 million to the gross state product.

An aluminum smelter is also an energy sink that can help stabilize the grid, taking spikes off the grid before there is damage, by sinking the energy into a potline. Smelters help achieve statewide policy goals of integrating renewables. Aluminum can be part of the long-term

sustainable future of the economy, due to its high strength-to-weight ratio. Industry reports that 75 percent of aluminum ever manufactured remains in use. It is like a battery, in that once it is created, it only takes small amounts of energy to recycle it. Electricity is the biggest ingredient in aluminum, and when electricity prices skyrocket, it is unable to be manufactured here.

When these tax preferences were originally established, metrics and an expiration date were included. Aluminum is a global commodity and smelters must be able to compete on a global scale. The local plant needs to be able to demonstrate to the parent company that it remains economically viable. Today, there is a glut in the market due to overproduction in China, and metals prices have taken a big hit. Smelters need assistance to make it through these circumstances.

Alcoa has shared many financial records with legislative leaders, and pays all its local taxes. Since 2004 management and labor have worked together to make it through hard times, and then renegotiated when things improved. The smelters are a vital cornerstone of local economies, contributing to schools, counties, fire districts, and charitable organizations. Thirty percent of aluminum from one of the smelters is shipped to customers here in the Pacific Northwest. Smelters are part of the in-state supply chain for Boeing.

(Opposed) None.

Persons Testifying: Representative Buys, prime sponsor; Ryan Spiller, Jens Lee, Kelley Woodard, Raina Clark, and Kathryn Mitchell, Alcoa; Larry Stenseth and Filmon Ali, Machinists Union; Ann Cline, Ferndale Chamber of Commerce; Shiloh Schauer, Wenatchee Valley Chamber of Commerce; Jim Richardson, Wenatchee Valley College; Guy Occhiogrosso, Bellingham Chamber of Commerce; and Toni Larson, Whatcom Business Alliance.

Persons Signed In To Testify But Not Testifying: None.