
Finance Committee

HB 2199

Brief Description: Creating business and occupation and public utility tax exemptions for certain amounts received as the result of receipt, generation, purchase, sale, transfer, or retirement of allowances, offset credits, or price ceiling units under the climate commitment act.

Sponsors: Representatives Orcutt, Fitzgibbon, Reed, Doglio and Leavitt.

Brief Summary of Bill

- Authorizes a business and occupation tax and a public utility tax exemption from amounts received from the receipt, generation, purchase, sales, transfer of allowances, offset credits, or price ceiling units under the 2021 Climate Commitment Act.

Hearing Date: 1/23/24

Staff: Tracey Taylor (786-7152).

Background:

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. Businesses must pay the B&O tax even though they may not have any profits or may be operating at a loss.

A taxpayer may have more than one B&O tax rate, depending on the types of activities conducted. Major B&O tax rates are 0.471 percent for retailing; 0.484 percent for manufacturing, wholesaling, and extracting; and 1.5 percent (businesses with taxable income of

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less than \$1 million) or 1.75 percent (businesses with taxable income of \$1 million or more) for services and activities not classified elsewhere. Several preferential rates also apply to specific business activities.

In addition, a taxpayer may be eligible to utilize other tax preferences, including credits and deductions, to reduce their tax liability. For example, a taxpayer engaging in activities subject to different B&O tax rates may be eligible for a Multiple Activities Tax Credit. A taxpayer may also be eligible for a small business credit that will either eliminate or reduce their B&O tax liability. In general, the small business credit is \$70 per month for service businesses and \$35 per month for all other businesses, multiplied by the number of months in the reporting period. The amount of the credit available phases out based on the business's gross receipts.

Public Utility Tax.

The gross income derived from the operation of publicly and privately owned utilities is subject to the public utility tax (PUT), unless otherwise exempt. The PUT is imposed in lieu of B&O tax and is applied only on sales to consumers. Other income of the utility, such as retail sale of tangible personal property, is subject to the B&O tax. There are six different PUT rates, depending on the specific utility activity. The rates are:

- 3.852 percent on telegraph companies, distribution of natural gas, and the collection of sewage;
- 3.8734 percent on the generation or distribution of electrical power;
- 0.642 percent on urban transportation and watercraft vessels under 65 feet in length;
- 1.926 percent on motor transportation, railroads, railroad car companies, and all other public service businesses;
- 5.029 percent on the distribution of water; and
- 1.3696 percent on log transportation.

A taxpayer who engages in one or more businesses subject to a PUT is fully exempt from the tax if their total gross income is \$2,000 or less per a month. Any taxpayer that has a total gross income greater than \$2,000 per month does not receive an exemption or deduction under this provision.

A business does not have to file an excise tax return for a PUT if the business does not owe other taxes or fees to the Department of Revenue (DOR) and has annual gross proceeds of less than \$24,000.

Tax Preferences.

State law provides for a range of tax preferences that confer reduced tax liability upon a designated class of taxpayer. Tax preferences include tax exclusions, deductions, exemptions, preferential tax rates, deferrals, and credits. Currently, Washington has over 650 tax preferences, including a variety of sales and use tax exemptions. Legislation that establishes or expands a tax preference must include a Tax Preference Performance Statement (TPPS) that identifies the public policy objective of the preference, as well as specific metrics that the Joint Legislative Audit and Review Committee (JLARC) can use to evaluate the effectiveness of the preference.

All new tax preferences automatically expire after 10 years unless an alternative expiration date is provided.

Climate Commitment Act Overview.

Under the 2021 Climate Commitment Act (CCA), in order to ensure that greenhouse gas (GHG) emissions are reduced consistent with the state's 2030, 2040, and 2050 emissions limits, the Department of Ecology (Ecology) must implement a cap on GHG emissions from covered entities and a program to track, verify, and enforce compliance through the use of compliance instruments, which include allowances or eligible offset credits. The Cap-and-Invest Program (Program) commenced on January 1, 2023.

The Program:

- establishes annual allowance budgets that limit emissions from covered entities;
- defines those entities covered by the Program (covered entities), those entities that may voluntarily opt into coverage under the Program (opt-in entities), and other persons that participate in auctions or allowance markets by purchasing, holding, selling, or voluntarily retiring compliance instruments (general market participants);
- provides for the distribution of emissions allowances at no-cost to certain covered entities, or by purchase at an auction;
- provides for offset credit as a method for meeting compliance obligations;
- defines the compliance obligations of covered entities;
- provides for the transfer of allowances and recognition of compliance instruments, including those issued by jurisdictions with which Washington may have linkage agreements in the future; and
- provides monitoring and oversight of the sale and transfer of allowances.

Climate Commitment Act Allowance Auctions, Compliance Obligations, and Enforcement.

Except for directly distributed, no-cost allowances allocated to certain entities, allowances must be distributed via allowance auctions. Auctions are open to covered entities, opt-in entities, and general market participants that are registered entities in good standing. Covered entities and opt-in entities may not buy more than 10 percent of the allowances offered during a single auction. General market participants may not buy more than 4 percent of the allowances offered during a single auction and may not in aggregate own more than 10 percent of the total number of allowances issued in a calendar year.

Certain entities, including emissions-intensive trade-exposed (EITE) facilities, receive directly distributed, no-cost allowances from Ecology. Owners or operators of EITE facilities that are required to participate in the Program must receive an allocation of allowances at no cost as follows:

- for the first compliance period beginning in 2023, the annual allocation of allowances must equal the facility's baseline carbon intensity, under which emissions are measured relative to facility production, as established using 2015 through 2019 data, multiplied by the EITE facility's actual production for each calendar year of the compliance period;
 - for facilities using a mass-based approach, the allocation of allowances must equal

the facility's mass-based baseline established using 2015 through 2019 data, unless there were abnormal circumstances during those years. Facilities may use a mass-based baseline if it is not able to feasibly determine a carbon intensity benchmark based on its unique circumstances. In general, a facility may not switch from using a mass-based baseline to a carbon intensity baseline;

- for the second compliance period beginning in 2027, the annual allocation of no-cost allowances is reduced to 97 percent of first compliance period allocations (for mass-based facilities); or 3 percent below the first compliance period benchmark; and
- for the third compliance period beginning in 2031, the annual allocation of no-cost allowances is 94 percent of first compliance period allocations (for mass-based facilities) or 3 percent below the second compliance period benchmark.

For electricity, the covered entity that must satisfy a compliance obligation is specified in statute and in rule, and includes first jurisdictional deliverers of electricity, which include importers of electricity. The CCA specifies eight types of persons whose activities may qualify the person as an electricity importer. Imported electricity does not include electricity imports of unspecified electricity that are netted by exports of unspecified electricity to any jurisdiction with which Washington has not linked, by the same entity within the same hour. An unspecified source of electricity is defined as electricity that, at the time of entry into a transaction to procure electricity, is not a specified facility, unit, or asset controlling supplier that is permitted to be claimed as the source of electricity delivered. First jurisdictional deliverers of electricity are covered entities that must participate in the CCA if their imported electricity has associated cumulative annual emissions exceeding 25,000 tons of carbon dioxide equivalent (CO₂e).

All covered and opt-in entities are required to submit compliance instruments in a timely manner to meet their compliance obligations and must comply with all requirements for monitoring, reporting, holding, and transferring emission allowances. If a covered or opt-in entity does not submit sufficient compliance instruments to meet its compliance obligation by the specified transfer dates, a penalty of four allowances for every one compliance instrument that is missing must be submitted to Ecology within six months. When a covered or opt-in entity reasonably believes that it will be unable to meet a compliance obligation, the entity must immediately notify Ecology. Upon receiving notification, Ecology must issue an order requiring the entity to submit the appropriate penalty allowances. If a covered or opt-in entity fails to submit the appropriate penalty allowances, Ecology must issue an order or a penalty of up to \$10,000 per day per violation, or both. During the first compliance period, Ecology may reduce the amount of a penalty owed by either adjusting the monetary amount or the number of penalty allowances that must be submitted.

Offset Credits.

Ecology must adopt, by rule, protocols for establishing offset projects and securing offset credits. The protocols adopted by Ecology must align with specified policies, including policies identifying the role of the forest products sector in carbon sequestration.

Offset projects must:

- provide direct environmental benefits to the state or be located in a jurisdiction with which the state has entered into a linkage agreement;
- result in GHG emission reductions or removals that:
 - are real, permanent, quantifiable, verifiable, and enforceable; and
 - are in addition to GHG emission reductions or removals otherwise required by law and other GHG emission reductions or removals that would otherwise occur; and
- have been certified by a recognized registry after the effective date of the CCA or within two years prior to the effective date of the CCA.

In adopting protocols governing offset projects and covered and opt-in entities' use of offset credits, Ecology must:

- take into consideration standards, rules, or protocols for offset projects and offset credits established in other states, provinces, and countries with programs comparable to the Program;
- encourage opportunities for the development of offset projects in the state by adopting offset protocols that may include protocols that make use of aggregation or other mechanisms to reduce transaction costs related to the development of offset projects and that support the development of carbon dioxide removal projects; and
- adopt a process for monitoring and invalidating offset credits, as necessary to ensure quality control.

The use of offset credits by covered entities is limited to specified percentages of their compliance obligations:

- During the first compliance period, 5 percent of a covered entity or opt-in entity's compliance obligation may be satisfied by offset projects, plus an additional 3 percent may be satisfied by offset projects on on federally recognized tribal land.
- Beginning in the second compliance period, 4 percent of a covered entity or opt-in entity's compliance obligation may be satisfied by offset projects, plus an additional 2 percent may be satisfied by offset projects located on federally recognized tribal land.

Program allowance budgets must be set so that the use of offsets does not prevent the achievement of state emission limits. In setting annual allowance budgets, Ecology must reduce the number of allowances in the budget in an amount equivalent to offset use, or according to a similar methodology that Ecology may adopt by rule.

Initiative 2117.

Initiative 2117 was filed in 2023 as an Initiative to the Legislature. The Secretary of State has certified the Initiative and it was referred to the House Committee on the Environment and Energy on January 17, 2024. Initiative 2117 would repeal the CCA, and prohibit state agencies from implementing any type of carbon tax credit trading, if the Initiative is approved by the voters in the November 2024 general election.

Summary of Bill:

A B&O and PUT tax exemption is authorized for amounts received from the receipt, generation, purchase, sale, transfer, or retirement of allowances, offset credits, or price ceiling units under the CCA. This exemption is both retroactive and prospective.

This act is exempt from the requirements of a TPPS, a JLARC review, and an automatic 10 year expiration.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains an emergency clause and takes effect on April 1, 2024.