

HOUSE BILL REPORT

SSB 6369

As Passed House:

March 6, 2006

Title: An act relating to excise tax exemptions for water services provided by small water systems.

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

Sponsors: By Senate Committee on Ways & Means (originally sponsored by Senators Haugen, Mulliken and Rasmussen).

Brief History:

Committee Activity:

Finance: 2/20/06, 2/23/06 [DP].

Floor Activity:

Passed House: 3/6/06, 96-1.

Brief Summary of Substitute 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.

HOUSE COMMITTEE ON FINANCE

Majority Report: Do pass. Signed by 8 members: Representatives McIntire, Chair; Hunter, Vice Chair; Orcutt, Ranking Minority Member; Ahern, Condotta, Ericks, Hasegawa and Santos.

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'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.

Testimony For: There are not many big public water systems in Island County. Many struggle with issues like saltwater intrusion. Every dollar that can be saved is used in

improving the systems to make the drinking water quality better. Many urban residents do not understand how difficult it is to keep up the quality of the potable water supply in small districts. The federal government mandates are burdensome yet necessary. Camano Island's largest system serves only 300 households.

This bill reestablishes some tax relief that was provided to small water systems through mid-2004. The previous exemption resulted in a number of success stories. The new proposal is consistent and requires that 90 percent of the value of the relief be spent on infrastructure. These systems have elected commissioners. There is an accountability section to ensure objectives are met.

Penn Cove Water and Sewer District provides service to 181 homes with a total population of 450 persons. Most of the residents are retired, military, or otherwise lower income. We had to replace the entire water system due to Department of Health mandates at a cost of \$1.6 million in 1998, and the ongoing assessments on our residents to pay for this are a constant burden. Small systems are subject to the same requirements as larger systems, but have a much smaller customer base. During the previous exemption, we spent hundreds of hours to improve our system in various ways, using the cost savings to install an emergency generator, upgrade level controls, and improve the mineral removal process.

Potable drinking water through public and private water systems has been the biggest contributor to public health since the dawn of man. A little money goes a long way in terms of keeping everybody healthy.

The Clinton Water District provides water to the community that is the Ferry Landing on Whidbey Island. Our commissioners have boldly taken on the enormous task of ensuring that the infrastructure meets the needs of the changing population. We have installed \$2 million of improvements, including a new filtration facility. This would not have been possible without the previous exemption. This improvement is very large in magnitude for a district that doesn't have the economies of scale of a city distribution system. Compliance with the state's code is expensive. Passing this bill is one way to reward commissions of the systems of small communities for showing leadership on these issues.

In January, I wrote a \$12,000 check to the Department of Revenue to cover our public utility tax costs for the year. This amount is equal to 25 percent of our capital budget funds for the year. We have only 1.6 full-time equivalent employees, and our system has just 725 connections. About \$77,000 of a recent \$300,000 improvement came from savings that were attributable in part to the previous exemption.

There are 17 different public utility districts (PUDs) that provide water service. In some cases, the PUDs inherited shoddy systems that had been privately developed when state and federal oversight was not as good. The PUDs are often the white hat that come in to fix these private systems. While we were not part of the previous exemption, we would be part of this one, for those districts that serve small customer bases.

Testimony Against: None.

Persons Testifying: Senator Haugen, prime sponsor; Dean Thiem, Penn Cove Water & Sewer District; Mike Helland and Maury Hood, Clinton Water District; Joe Daniels, Washington Association of Sewer and Water Districts; and Bill Stauffacher, Washington Public Utilities Association.

Persons Signed In To Testify But Not Testifying: None.