

# HOUSE BILL REPORT

## HB 1592

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**As Reported By House Committee On:**  
Finance

**Title:** An act relating to tax exemptions for small water districts and systems.

**Brief Description:** Providing tax exemptions for small water districts and systems.

**Sponsors:** Representatives Bush, Kastama, Mulliken, Regala, K. Schmidt, McDonald, Lantz, Robertson, Chandler, Poulsen, Talcott, Backlund, McMorris, Thompson, O'Brien, Linville, Dunn and Sheldon.

**Brief History:**

**Committee Activity:**

Finance: 2/19/97, 3/10/97 [DPS].

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### HOUSE COMMITTEE ON FINANCE

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 14 members: Representatives B. Thomas, Chairman; Carrell, Vice Chairman; Mulliken, Vice Chairman; Dunshee, Ranking Minority Member; Dickerson, Assistant Ranking Minority Member; Boldt; Butler; Conway; Kastama; Mason; Pennington; Schoesler; Thompson and Van Luven.

**Staff:** Linda Brooks (786-7153).

**Background:** According to a 1994 report by the Department of Health, Washington has over 14,000 water systems. About 200 of these systems serve over 85 percent of the state's population. In contrast, 10,000 of the state's water systems serve only 2 percent of the state's population. Most small water systems are privately owned.

All water systems serving at least 25 persons or 15 connections must meet 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/or treatment obligations poses particular challenges for small water systems. Compliance can impose high costs on households served by small systems, since small systems cannot take advantage of economies of scale and must spread costs over a small customer base.

In Washington, the Department of Health enforces federal and state safe drinking water standards. In 1993 the department formed a "Drinking Water 2000" task force to review the state's drinking water program. In response to the task force's report, the Legislature passed a bill in 1995 implementing some of the task force's recommendations. The bill covers several topics and the following is only a partial list of its provisions:

- requires a certified operator for every water system that serves 100 or more connections. A smaller system may also require a certified operator, if it uses surface water, or ground water under the direct influence of surface water, as a water source.
- establishes a water supply advisory committee to advise the Department of Health on the organization, functions, service delivery methods, and funding of the drinking water program. (This advisory committee issued a report to the Legislature on the adequacy of current and prospective funding for the drinking water program in November 1996.)
- requires new water systems to be operated by a satellite system management agency (SMA) whenever possible. The Department of Health is responsible for certifying a SMA as qualified to assume operation and/or ownership of an existing or proposed water system. To obtain certification, a SMA must demonstrate financial integrity and operational competence. Satellite system management agencies may operate one or more water systems. The Department of Health has set a goal of having at least one SMA in each county but that goal has not yet been attained.
- creates a drinking water assistance account in the state treasury for the purpose of receiving federal funds made available for safe drinking water.

Some of the provisions enacted by the Legislature in 1995, such as the creation of the drinking water assistance account, were in anticipation of Congressional action. Congress did reauthorize the federal Safe Drinking Water Act (SDWA) in 1996. The federal re-authorization of the SDWA gives states more flexibility in regulating water systems. The federal law also authorizes the creation of a state revolving loan fund to finance projects needed to bring water systems into compliance. Congress appropriated \$1.275 billion for fiscal year 1997 for the state revolving loan fund, and Washington's share of the appropriation is expected to be about \$30 million. This federal money will be deposited into the drinking water assistance account created by the Legislature in 1995.

Money in the drinking water assistance account is expected to be used for a drinking water revolving loan program. In Washington, local governments have been able to borrow from the Public Works Trust Fund to finance water system improvements.

However, private water systems cannot borrow from the Public Works Trust Fund. Under the new drinking water revolving loan program, both public and private water systems will be able to borrow.

In Washington public- and privately-owned utilities, and certain other businesses, are subject to the public utility tax instead of the business and occupation (B&O) tax. Like the B&O tax, the public utility tax is applied to the gross receipts of the business. The principal difference between B&O and public utility taxes is rates. Water distribution businesses (essentially all water systems) pay a public utility tax of 5.029 percent on gross receipts. This 5.029 percent rate is higher than the 1.75 percent B&O tax rate that applies to non-utility services. Although many businesses subject to the public utility tax are also subject to regulation by the Utilities and Transportation Commission, there is no direct connection between regulatory status and tax status.

If a public utility business is exempted from public utility tax, then the utility becomes subject to the B&O tax. A second exemption from the B&O tax must also be explicitly provided, if the intent is to exempt a utility business from both public utility and B&O taxes.

**Summary of Substitute Bill:** The following water distribution businesses are exempted from public utility and B&O taxes through July 1, 2003:

- water districts that:
  - (1) serve fewer than 1,500 connections; and
  - (2) charge water rates in excess of 125 percent of the average statewide rate .
  
- water systems that:
  - (1) are owned and/or operated by a satellite system management agency;
  - (2) serve fewer than 200 connections; and
  - (3) charge water rates in excess of 125 percent of the average statewide rate.

Eligible water distribution businesses are either water districts or water systems managed by a satellite management agency. Municipal water systems, public utility district systems, and irrigation district systems are not eligible for these tax exemptions.

The Department of Health will estimate a statewide average residential water rate by July 1 of each year. The Department of Health may use rate information provided in surveys and reports produced by the Association of Washington Cities, an association of elected officials, or other municipal associations to estimate a statewide average residential rate. The residential water rate serves as a criterion for determining eligibility for these tax exemptions. However, if a water district or system qualifies

for the exemptions, then a district's or system's total gross receipts, including receipts from its commercial customers, are exempt from public utility tax and B&O tax.

**Substitute Bill Compared to Original Bill:** The original bill would have required the Department of Health to collect rate information on every water system in the state and to compute an average county water rate for each county based on actual rate information. The substitute bill requires the Department of Health to compute one average: a statewide residential water rate. The Department of Health is also permitted to estimate the statewide average residential rate in lieu of computing an actual average. In estimating an average statewide residential rate, the Department of Health may rely upon surveys and publications produced by the Association of Washington Cities, an association of elected officials, or other municipal associations.

**Appropriation:** None.

**Fiscal Note:** Requested on March 11, 1997 (substitute bill).

**Effective Date of Substitute Bill:** Ninety days after adjournment of session in which bill is passed.

**Testimony For:** The tax exemptions will assist small systems to upgrade their infrastructure. Some systems need significant upgrades. For example, the Valley Water District has discovered that telephone conduit and wooden pipes were sometimes used in the original construction of its water systems, and the district must replace the conduit and wooden pipes with modern piping. Modernizing is expensive, and small districts must be careful to control their costs. Many customers of small water systems live on fixed incomes and sharply rising water rates affect them. Water districts are not taxing districts. User fees pay for the operation of water systems.

Water districts may be particularly hard hit by natural disasters. For example, the Valley Water District lost 10 percent of its customers due to recent flooding. With service cut to those customers, water rates for remaining customers must increase to cover the same fixed costs over a smaller customer base.

**Testimony Against:** None.

**Testified:** (Pro) Representative Bush, prime sponsor; James Morgan, Valley Water District; Ted Miller; Joe Daniels, Washington State Association of Sewer/Water Districts.