

HB 2425

Bill Analysis

January 22, 1998

Brief Description: Modifying telecommunication and energy taxes.

Bill Sponsors: B. Thomas and Thompson.

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Background: Telecommunication, gas, and electrical services are taxed differently as follows:

Electricity: Light and power businesses engaged in the generation or distribution of electricity pay a state public utility tax of 3.873 percent on their gross receipts. Both public and privately-owned light and power business pay this state public utility tax instead of paying 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 the B&O tax and public utility tax is a higher rate schedule applied under the public utility tax. There are certain allowable deductions to the state public utility tax, including deductions for some costs in serving rural areas and for revenues earned from wholesale transactions.

Out-of-state firms that import electricity pay no taxes, because only in-state firms are subject to public utility tax. Similarly, in-state firms that export electricity pay no tax on the value of the exported power, because they are allowed to deduct revenues earned on exports from their gross receipts.

In addition to state taxes, cities are also allowed to impose a gross receipts tax on a light and power business. A city's tax rate cannot exceed 6 percent of gross receipts, unless voters approve a higher rate. Most cities tax a light and power businesses' gross receipts that are earned from making sales of electricity to consumers located within their cities. Municipal utilities are an exception. Cities operate nineteen municipal utilities. These cities generally tax the full gross receipts of their utilities, even though some of the gross receipts might be earned by selling electricity to out-of-city consumers.

Counties have no authority to impose gross receipts taxes on light and power businesses nor on any other type of business.

Gas: Gas distribution businesses pay a state public utility tax of 3.852 percent on their gross receipts. Again, there are some allowable deductions, such as a deduction for revenues earned on wholesale transactions between gas distribution businesses. Although the public utility tax does not apply to revenues earned from sales of imported gas, the state brokered natural gas tax imposes a use tax of 3.852 percent on the value of imported gas. If the out-of-state gas distribution business does not collect the use tax, then the Washington consumer purchasing the gas from out-of-state is responsible for remitting the use tax due to the Department of Revenue.

In terms of local taxes, counties cannot impose a gross receipts tax on gas distribution businesses but cities may. A city's tax rate cannot exceed 6 percent of gross receipts, unless voters approve a higher rate. Although there are nineteen cities operating their own municipal electrical utilities, it appears that the City of Ellensburg may be the only city operating its own gas distribution utility. As in the case of the state public utility tax, a city's gross receipts tax does not apply to revenues earned from sales of imported gas. A city may impose, however, a city brokered natural gas tax at the same rate as its gross receipts tax.

Telecommunications: The retail sales and use tax applies to sales of telephone services. The state tax rate is 6.5 percent. In addition, local sales taxes apply. For most cities, their effective local sales tax rate is 0.85 percent. Most counties impose a 1.0 percent sales tax, with the 1.0 percent rate applying in unincorporated areas and a 0.15 percent rate applying in incorporated areas. Additional local sales taxes might be imposed for special purposes such as transit or criminal justice. Adding state, city, county, and other local taxes together, the total retail sales tax ranges from 7.0 to 8.6 percent, depending on location.

The retail sales tax applies to all telephone services except residential phone service. For example, residential customers located in areas served by US West presently pay a basic service charge of \$10.50/month (soon to increase to \$12.50/month), and this charge is not subject to sales tax. Everyone, including residential customers, pays sales taxes, however, on charges for interstate and intrastate long distance calls.

The retail sales tax is levied directly on the consumer. In addition to sales tax, the state also imposes B&O taxes on telephone businesses. The B&O rates are a 0.471 percent rate on retail revenues and a 0.484 percent rate on wholesale revenues.

In addition to state B&O taxes, telephone businesses also pay city gross receipts taxes. Generally, a city may impose up to a 6.0 percent gross receipts tax on a telephone business's gross receipts and an even higher rate with voter approval. Nonetheless, there are some restrictions. Cities cannot tax receipts from interstate long distance toll charges. Interstate

toll receipts are greater than intrastate toll receipts. Cities are also limited in their ability to tax network access charges.

Maximum Rates of Taxation - Electricity, Gas & Telecommunications: Considering taxes imposed both on consumers and businesses, the following represents the maximum amount of state and local taxes associated with electrical, gas, and telephone services. Total taxes are lower in cities that do not use their full taxing authority, in unincorporated areas where counties have no authority to levy gross receipts taxes, and in areas where the retail sales tax is below the maximum rate of 8.6 percent.

Electricity	9.873%
Gas	9.852%
Telephone	15.071%

Internet Service Providers: Internet service providers are subject to a state 1.75 percent service B&O tax, lowering to 1.5 percent on July 1, 1998. Legislation enacted last year prohibits cities from imposing new taxes or fees specific to Internet service providers, but cities may impose gross receipts taxes that should not exceed 0.2 percent in most cases. This prohibition against new taxes and fees lasts through July 1, 1999.

Cable Television: Cable television businesses are subject to a state 1.75 percent service B&O tax, lowering to 1.5 percent on July 1, 1998. In regards to local governments, the federal 1996 Telecommunications Act limits local cable TV franchise fees to no more than 5 percent. Franchise agreements signed before 1996 might contain higher rates, however, and those higher rates continue in effect until the agreements expire. In addition to franchise fees, many cities impose gross receipts taxes on cable TV. Adding franchise fee rates and gross receipts tax rates together, the highest city rate appears to be 17 percent.

Summary of Bill: Electrical, gas, and telecommunication services are taxed the same.

Repealed Taxes Include:

- State public utility taxes levied on light & power and gas distribution businesses;
- Regular retail sales tax as it applies to telephone services; and
- State and city brokered natural gas taxes.

Optional:

- Cities may repeal their current gross receipts taxes that range up to 6%, but repeal is optional.

Telecommunication & Energy (T&E) Sales and Use Tax: Replacing the repealed taxes is a T&E sales and use tax on electrical, gas, and telephone services. The T&E sales tax rates are:

3.0 %	State tax.
Up to 5.5%	Local option tax for cities or counties.

Since the T&E sales tax is also a use tax, consumers purchasing imported electricity are responsible for remitting use tax to the Department of Revenue, if sales tax has not been collected. Also, unlike the retail sales tax, the T&E sales tax applies to residential telephone service.

State B&O Taxes: Additionally, businesses providing electrical, gas, or telephone services become subject to state B&O taxes at regular rates as follows:

0.471%	State tax on gross receipts from retailing activities.
0.484%	State tax on gross receipts from wholesaling or manufacturing activities.

The wholesaling B&O tax (0.484%) does not apply, however, to energy exchanges. Energy exchanges involve one electrical business providing electricity, or the rights thereto, to another electrical business. These transactions are not subject to tax, as long as the exchanges are for equivalent rights or amounts of electricity.

The manufacturing B&O tax applies to the value of all electricity generated in-state. If the electricity is sold in-state, however, then any wholesaling or retailing B&O taxes paid may be credited against the manufacturing B&O tax liability. If the electricity is exported out-of-state, then a credit is allowed for similar taxes paid to other states or their political subdivisions. Manufacturing tax is owed on any remaining balance after available credits have been taken.

City Gross Receipts Tax: Cities adopting the T&E tax structure may also impose a gross receipts tax at the following rate:

0.200%	City tax on a business's gross receipts.
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Maximum Rates of Taxation - Electricity, Gas, & Telecommunications: Considering taxes imposed both on consumers and businesses, the following represents the maximum amount of state and local taxes associated with electrical, gas, and telephone services under the T&E tax restructuring. These maximum rates apply uniformly throughout the state.

Electricity	9.171%
Gas	9.171%
Telephone	9.171%

Regarding Cities: Cities have three choices. First, a city may adopt up to a 5.5 percent T&E sales and use tax and up to a 0.2 percent gross receipts tax under the T&E tax restructuring. Second, a city may choose the status quo, keeping its gross receipts tax that may be as high as 6.0 percent and even higher, if voter-approved. Third, a city may adopt up to a 5.5 percent T&E sales and use tax and keep its gross receipts tax that may be as high as 6.0 percent and even higher, if voter approved. A city choosing the third option must credit any T&E sales and use taxes paid against its gross receipts tax. This credit mechanism prevents an increase in the overall rate of taxation. Additionally, any city choosing the second or third options must subject its gross receipts tax to voter referenda every six years.

Under the second and third options, a city whose municipal electrical utility provides service to out-of-city consumers may keep its gross receipts taxes and continue to tax revenues associated with out-of-city sales. Nonetheless, if a neighboring city or county imposes a local T&E sales tax, then the city operating the municipal utility must provide a credit for the neighboring city or county's T&E sales tax against its gross receipts tax. This credit mechanism prevents double taxation.

Cities selecting the first option are allowed a total tax rate of 5.7 percent. Although this 5.7 percent is lower than a 6.0 percent gross receipts tax, there is a tax base expansion. This 5.7 percent tax rate applies to interstate toll revenues, whereas a gross receipts tax levied in excess of 0.2 percent under the second and third options does not apply to interstate toll revenues.

Regarding Counties: Under the T&E tax restructuring counties gain local option taxing authority. A county may impose up to a 5.5 percent T&E sales and use tax on electrical, gas, and telephone services. A county tax applies in unincorporated areas.

Internet Study Commission: No changes are made to how Internet service providers are taxed, but a special study commission is created. The commission will review whether or not services provided on the Internet compete directly with services provided by telecommunication companies and other types of businesses that are subject to higher rates of taxation.

Cable Television: Cities may impose franchise fees and gross receipts taxes on cable television businesses, but the combined fee and tax rates cannot exceed 8 percent of gross receipts on or after the year 2004.

Appropriation: None.

Fiscal Note: Requested.

Effective Date: January 1, 1999.