

HOUSE BILL ANALYSIS

HB 1411

Title: An Act relating to telecommunications and energy taxes.

Brief Description: Relating to telecommunication and energy taxes.

Sponsors: Representatives Thomas

HOUSE COMMITTEE ON TECHNOLOGY, TELECOMMUNICATIONS & ENERGY

Meeting Date: February 10, 1999

Bill Analysis Prepared by: Linda Brooks, (786-7153)

Background:

About Taxes Generally: Sales tax is imposed on retail sales of most items of tangible personal property and some services. Sales tax is paid by the consumer but collected and forwarded to the Department of Revenue by the seller.

Use tax is imposed on the use of an item in this state, when the acquisition of the item or service has not been subject to sales tax. Consumers are responsible for paying use tax to the Department of Revenue.

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. Some key B&O tax rates are:

Manufacturing & wholesaling	0.484	percent
Retailing	0.471	percent

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 the B&O tax and public utility taxes is a higher rate schedule applied under the public utility tax.

Cities also impose taxes on the gross receipts of business activities conducted within the cities without any deduction for the cost of doing business. City gross receipts taxes are often called city B&O taxes, but cities (like the state) impose higher gross receipts tax rates on utilities. These taxes with higher rates that are imposed on utilities are often called city utility taxes.

Counties have no authority to impose gross receipts taxes.

Overview: Current Taxation of Telephone Services, Gas, & Electricity: State tax rates are uniform throughout the state. Local tax rates vary from location to location. Combining state and local taxes together, the table indicates the highest current excise tax rates for telephone services, gas, and electricity.

Highest Current Rates of Excise Taxation

Tax	Telephone	Gas	Electricity
Retail Sales & Use	6.5%	0.0%	0.0%
Gross Receipts (B&O)	0.471%	0.0%	0.0%
Gross Receipts (public utility)	0.0%	3.852%	3.873%
STATE TAX SUB-TOTAL	6.971%	3.852%	3.873%
Retail Sales & Use (for general funds)	1.0%	0.0%	0.0%
Retail Sales & Use (for dedicated funds)	1.1%**	0.0%	0.0%
Gross Receipts (<i>only cities may impose</i>)	6.0%*	6.0%*	6.0%*
LOCAL TAX SUB-TOTAL	8.1%	6.0%	6.0%
GRAND TOTAL	15.071%	9.852%	9.873%

*A city's gross receipts tax may exceed six percent with voter-approval.

**Local govts. have authority to impose up to 1.8 percent in dedicated sales taxes for purposes such as transit or criminal justice, but no local govt. is using its full taxing authority. The highest current rate is 1.1 percent.

The table illustrates the fact that only telephone services are currently subject to the retail sales tax. The retail sales tax does not apply to sales of gas or electricity.

How Electricity Is Taxed - Additional Information: The state imposes a 3.873 percent gross receipts tax on light and power businesses. There are some tax deductions allowed. A light and power business may deduct any revenues earned from wholesale transactions or from sales of exported power. Light and power businesses that serve less than seventeen customers per mile of line may also deduct thirty to fifty percent of the wholesale amount paid for power.

City tax deductions are not necessarily the same as state deductions. Each city determines if any deductions are allowed. City taxes generally apply only to the gross receipts earned by a light and power business that sells power to customers located within the city. A city that operates its own municipal utility, however, taxes the full gross receipts of its municipal utility, regardless of whether the power was sold to customers located inside or outside of the city's boundaries.

State and city gross receipts taxes are imposed on light and power businesses. Although the Bonneville Power Authority (BPA) is a light and power business, it is also a federal agency and exempt from state and local taxes. Therefore, power sold by the BPA is untaxed.

State and city taxes apply to in-state light and power businesses. On the other hand, out-of-state businesses that sell power to Washington consumers are only subject to tax if the out-of-state business has some sort of nexus or direct connection to the state. For example, an out-of-state light and power business that has some employees located in Washington would be taxable, but an out-of-state business with no employees based in Washington nor any other direct connection to the state is not subject to tax.

If large commercial or industrial consumers of electricity purchase electricity from an out-of-state light and power business that have no connection to Washington, then no state or city taxes are paid on the value of the electricity. It is possible, however, that a local light and power business would deliver this out-of-state electricity to the commercial or industrial customer by wheeling the electricity over its power distribution lines. In this case, the local light and power business would pay state and city taxes on revenues earned from the wheeling fees that it charges to transport the power. The value of the electricity itself, however, is untaxed.

How Gas Is Taxed - Additional Information: The state imposes a 3.852 percent gross receipts tax on gas distribution businesses. A gas distribution business may deduct any revenues earned from wholesale transactions. City gross receipts taxes apply in a manner similar to the state tax, but again city deductions do not necessarily mirror state deductions.

Out-of-state gas distribution businesses (like out-of-state light and power businesses) may not pay any state or city gross receipts taxes. However, while the value of electricity purchased out-of-state may go untaxed, this is not true in the case of gas. There is a brokered natural gas tax that applies to gas that is imported from out-of-state. The state brokered natural gas tax is levied at 3.852 percent, and cities may also impose their own brokered natural gas taxes at rates up to six percent.

How Telephone Services Are Taxed - Additional Information: 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 dedicated purposes such as transit or criminal justice. Adding state, city, county, and dedicated 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 \$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 earned from interstate long distance toll charges. Cities are also limited in their ability to tax network access charges.

How Cable Television Is Taxed: Cable television businesses are subject to a state 1.5 percent service B&O tax. In regards to local governments, the federal 1996 Telecommunications Act limits local cable TV franchise fees to no more than 5 percent, and both cities and counties may impose franchise fees. In addition to franchise fees, many cities impose gross receipts taxes on cable TV. Adding franchise fee rates, city and state gross receipts tax rates together, the highest current rate appears to be 16.5 percent.

Summary:

Overview of How Telecommunications, Gas, & Electrical Services Are Taxed: Combining state and local taxes together, the table illustrates the highest rates of excise

taxation for telecommunications (telecom), gas, and electricity services. The table assumes that cities opt to impose a new telecommunications and energy (T&E) sales and use tax. However, cities are not required to adopt a T&E sales and use tax, as explained below under the header, *Cities have three tax options.*—

Highest Rates of Excise Taxation

Tax	Telecom Service	Gas Service	Electrical Service
Retail Sales & Use	3.0%	3.0%	3.0%
Gross Receipts (B&O)	0.471%	0.471%	0.471%
Gross Receipts (public utility)	0.0%	0.0%	0.0%
STATE TAX SUB-TOTAL	3.471%	3.471%	3.471%
Retail Sales & Use (for general funds)	5.5%	5.5%	5.5%
Retail Sales & Use (for dedicated funds)	0.0%	0.0%	0.0%
Gross Receipts (<i>only cities may impose</i>)	0.2%*	0.2%*	0.2%*
LOCAL TAX SUB-TOTAL	5.7%	5.7%	5.7%
GRAND TOTAL	9.171%	9.171%	9.171%

*A city's gross receipts tax may exceed two-tenths of one percent with voter-approval.

Tax Changes Made:

The following taxes are repealed:

- 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 (these brokered taxes are replaced by use tax.)

Optional Repeal:

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

Replacing the repealed taxes is a telecommunications and energy (T&E) sales and use tax on electrical, gas, and telecommunications services. The T&E sales tax rates are:

3.0 %

State tax.

Up to 5.5%

Local option tax for cities or counties.

Additionally, businesses providing electrical, gas, or telecommunication services become subject to state B&O taxes at regular rates:

Manufacturing & wholesaling	0.484 percent
Retailing	0.471 percent

Cities adopting the T&E tax structure may also impose a gross receipts tax at a 0.2 percent rate, and an even higher rate with voter approval. However, a city must tax businesses making retail sales of telecom, gas, and electrical services at the same rate that a city taxes businesses making retail sales of tangible personal property.

How Electrical Service Is Taxed - Additional Information: There are no tax deductions allowed for revenues earned from sales at wholesale or from sales of exported power. The wholesaling B&O tax 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.

Light and power businesses that generate electricity are engaged in manufacturing, and 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 sub-divisions. Manufacturing tax is owed on any remaining balance after available credits have been taken.

In regards to the T&E sales and use tax, large industrial or commercial customers that buy electricity from out-of-state light and power businesses must pay use tax to the Department of Revenue if sales tax has not been paid. Similarly, if customers that buy electricity from a federal agency such as the BPA that is not required to collect state and local sales taxes, then the customers must pay use tax on their purchases of electricity from the BPA to the Department of Revenue.

How Gas Service Is Taxed - Additional Information: There are no tax deductions allowed for revenues earned from sales at wholesale. Large industrial or commercial customers that buy gas from out-of-state gas distribution businesses must pay use tax to the Department of Revenue if sales tax has not been paid.

How Telecommunication Service Is Taxed - Additional Information: Telephone services are taxed under a broader tax category of telecommunications services. The term telecommunication— is defined using language from the federal 1996

Telecommunications Act as, the transmission between or among points specified by the user, of information of the user's own choosing, without change in the form or content of the information as sent and received.— Telecommunication services are defined, however, as excluding services provided by Internet service providers, one-way radio paging services, and cable television services.

There are no tax deductions or exemptions. Residential telephone service is taxed the same as business telephone service. State and local T&E sales taxes apply to all telecommunications services, including long distance telephone services.

How Cable Television is Taxed: Cable television businesses are subject to a state 1.5 percent service B&O tax. At the local level 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. Counties may impose up to a 5 percent franchise fee but have no authority to impose a gross receipts tax on cable television businesses. By 2004 the highest combined rate of state and local taxes will be 9.5 percent.

Cities Have Three Tax Options: Cities have three tax options. First, a city may restructure its taxes by adopting up to a 5.5 percent T&E sales and use tax and up to a 0.2 percent gross receipts tax. 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 are some tax base expansions. One of the largest expansions in the cities' tax bases comes from the fact that a city's T&E sales tax would apply to all telecommunications services, including long distance telephone toll charges.

Counties Gain New Taxing Authority: 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.

No Local Dedicated Sales Tax Revenues: Cities and counties may impose up to a 5.5 percent T&E sales and use tax to raise revenues for general fund purposes. There are no special sales tax levies for dedicated purposes such as transit or criminal justice that are permitted in addition to this 5.5 percent tax.

Appropriation: None.

Fiscal Note: Requested..

Effective Date of Bill: January 1, 2000.