

HOUSE BILL REPORT

2SHB 2339

As Passed House:

February 13, 2004

Title: An act relating to tax relief for aluminum smelters.

Brief Description: Providing tax relief for aluminum smelters.

Sponsors: By House Committee on Finance (originally sponsored by Representatives Morris, Ericksen, Linville, Quall, Condotta, Wood, Conway, Sullivan, Mielke, Armstrong, Boldt, Orcutt, Newhouse, Hinkle and Hudgins).

Brief History:

Committee Activity:

Technology, Telecommunications & Energy: 1/14/04, 1/16/04 [DPS];

Finance: 1/27/04, 2/5/04 [DP2S(w/o sub TTE)].

Floor Activity:

Passed House: 2/13/04, 92-5.

Brief Summary of Second Substitute Bill

- The business and occupation (B&O) tax rate under manufacturing and wholesaling are reduced for aluminum smelters to 0.2904 percent through 2006.
- Aluminum smelters may take a credit against B&O tax liability for property taxes paid through 2006.
- Businesses that sell electricity or natural or manufactured gas to aluminum smelters may receive a credit against tax liability under either the public utility tax or the B&O tax, if the price of the electricity or gas is reduced by the tax savings.
- Aluminum smelters may take a credit against retail sales and use tax liability through 2006 for the amount of the state portion of sales and use taxes paid on property and labor and services associated with the property.
- Aluminum smelters are exempt from the brokered natural gas use tax through 2006.
- Goals are set for the businesses that use the tax incentives in the bill with respect to employment levels and industry operation.

· Aluminum smelters that claim any of the incentives under the act must submit a report to the Department of Revenue with detailed wage, employment, and benefits information.

HOUSE COMMITTEE ON TECHNOLOGY, TELECOMMUNICATIONS & ENERGY

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 15 members: Representatives Morris, Chair; Ruderman, Vice Chair; Sullivan, Vice Chair; Crouse, Ranking Minority Member; Anderson, Blake, Bush, Delvin, Hudgins, Kirby, McMahan, McMorris, Romero, Wallace and Wood.

Minority Report: Do not pass. Signed by 2 members: Representatives Nixon, Assistant Ranking Minority Member; and Tom.

Staff: Mark Matteson (786-7145).

HOUSE COMMITTEE ON FINANCE

Majority Report: The second substitute bill be substituted therefor and the second substitute bill do pass and do not pass the substitute bill by Committee on Technology, Telecommunications & Energy. Signed by 9 members: Representatives McIntire, Chair; Hunter, Vice Chair; Cairnes, Ranking Minority Member; Orcutt, Assistant Ranking Minority Member; Ahern, Conway, Morris, Roach and Santos.

Staff: Mark Matteson (786-7145).

Background:

Aluminum industry

Within Washington, the aluminum smelting industry has contracted in recent years as a result of declining aluminum prices in the global aluminum commodities market and local increases in the price of electricity, a major cost driver in aluminum prices. In 1998 the industry in the state employed over 5,300 people and had taxable income of \$2.4 billion. The 2001 energy crisis, and the spiking wholesale power prices, resulted in most of the state's smelters shutting down at least temporarily, and most have not resumed normal operations. In the state fiscal year 2002, taxable income for the industry was down to \$700 million and only 2,200 persons were employed.

The industry has also served an important role in the region's economy for electricity. According to the Northwest Power Planning Council, at full operational capacity the smelters would account for about 15 percent of the Pacific Northwest's demand for

electricity. Prior to 1996, the industry received most of its electricity from the Bonneville Power Administration (BPA) at preferential rates and, in exchange, provided a portion of the BPA reserve requirements through interruptibility provisions in their electricity service contracts. This reserve requirement provided a buffer in times when demand was high and hydroelectric and other electricity supplies were short. However, since 1996 the BPA has reduced the energy allocated to the industry to less than half of the smelter electricity demand, requiring smelters to rely more on the wholesale market.

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. The tax is imposed on the gross receipts from all business activities conducted within Washington. Revenues are deposited in the state general fund. A business may have more than one B&O tax rate, depending on the types of activities conducted. Rate categories for the B&O tax are as follows:

Processing meat (at wholesale); processing soybeans, canola, and dry peas; manufacturing wheat into flour; manufacturing raw seafood; warehousing/reselling of prescription drugs; and manufacturing fresh fruit, vegetables and dairy products.	0.138%
Travel agents, stevedoring, and freight brokers, international investment management services.	0.275%
Retailing, environmental cleanup, and radioactive waste cleanup for the United States.	0.471%
Manufacturing, wholesaling, extracting, extracting and processing for hire, commissions of insurance agents/brokers, printing and publishing, child care, income derived from royalties, warehousing, radio and television broadcasting, public road construction, government contracting and retailing of interstate transportation equipment.	0.484%
Professional and personal services, public/nonprofit hospitals, and activities not classified elsewhere.	1.5%
Disposal of low-level radioactive waste.	3.3%

The B&O tax does not permit deductions for the costs of doing business, such as payments for raw materials and wages of employees. Nonetheless, there are many exemptions for specific types of business activities and certain deductions and credits are allowed under the B&O tax statutes. To address the possibility that a person may be engaged in multiple activities involving the same product, a credit is allowed for taxes that have already been paid. For example, if a business manufactures a product and then

sells the product at wholesale, the business may take a credit for tax paid on the value of the manufactured product against tax then owed on income derived from the wholesale of the product.

Certain businesses are classified as utilities and subject to the state Public Utility Tax and not the B&O tax (see below). However, other businesses that do not fall into such classifications may sell electricity or natural gas to consumers and are subject to the B&O tax in such circumstances. An example is an industrial business that produces surplus electricity through cogeneration processes and then sells the surplus to a retail customer.

Public Utility Tax and Brokered Natural Gas Use Tax

Public and privately-owned utilities are subject to the state Public Utility Tax (PUT). The PUT is applied to the gross receipts of the business. Revenues are deposited to the state general fund. Different rates apply, depending on the type of utility. Examples include:

Generation or distribution of electrical power	3.873 %
Distribution of natural gas	3.852 %

Natural or manufactured gas that is consumed within the state is subject to the state brokered

natural gas use tax, if the supplier was not subject to the state Public Utility Tax. The brokered natural gas use tax is applied to the value of the gas as delivered to the customer.

The rate is the same as that for natural or manufactured gas under the PUT. Revenues are deposited in the state general fund.

Like the B&O tax, the PUT and brokered natural gas use taxes do not permit deductions for the costs of doing business, but a number of exemptions exist for specific activities.

Retail Sales and Use Tax

The retail sales tax applies to the selling price of tangible personal property and of certain services purchased at retail. The tax base includes goods and certain services. The tax is levied at a 6.5 percent rate by the state. Cities and counties may levy a local tax at a rate up to a maximum of 3.4 percent. As of December 2003, local rates levied range from 0.5 percent to 2.4 percent. Sales tax is paid by the purchaser and collected by the seller.

The use tax is imposed on items used or services purchased in the state that were not subject to the retail sales tax, and includes purchases made in other states and purchases from sellers who do not collect Washington sales tax. The state and local rates are the same as those imposed under the retail sales tax. Use tax is paid directly to the

Department of Revenue (Department). The state portion of the sales and use tax is deposited into the state general fund.

All retail goods and services are included in the tax base for the retail B&O classification and for retail sales and use taxes, unless specifically exempted. In addition, for certain activities, credits are allowed against current retail tax liability. For example, a credit is allowed against use tax liability for sales and use taxes paid on items that were purchased in another state and brought into Washington.

Tax Incentives Accountability

A number of tax incentives include accountability provisions. The principal components of these provisions are disclosure requirements and enforcement mechanisms. Firms that take certain incentives are required to disclose such information as number of jobs created, location of new investments, and other information. For certain incentives, firms must meet certain eligibility requirements, such as the requirement under the rural county and distressed area sales and use tax deferral that for counties with community empowerment zones a certain number of employees be hired from within the zones, depending on level of investment. Firms in such areas that fail to meet these requirements are required to repay the deferred taxes.

Summary of Second Substitute Bill:

A number of incentives are provided to firms in the aluminum smelting industry, including B&O tax, sales and use tax, public utility tax, and brokered natural gas use tax incentives.

Through 2006, the B&O tax rates on the manufacturing, processing for hire, and wholesaling of aluminum by aluminum smelters are reduced to 0.2904 percent.

A credit is provided to aluminum smelters against B&O tax liability for the amount of property taxes paid with respect to all property owned by a smelter that is reasonably necessary for the purposes of a smelter's business. Credits may be claimed for property taxes levied for collection through 2006.

Businesses that sell electricity or natural or manufactured gas to an aluminum smelter may take a credit against either the public utility tax or the B&O tax, if the tax savings attributable to the credit are passed along to the smelter through reduced energy prices. The credit is equal to the gross income derived from the sale of the electricity or gas, multiplied by the applicable tax rate under the B&O or public utility tax. Aluminum smelters are exempt from the brokered natural gas use tax through 2006.

Through 2006, aluminum smelters may receive a credit against retail sales and use tax

liability for the amount of the state portion of sales and use taxes paid with respect to property used at a smelter or to labor and services rendered with respect to the property. The smelter is required to submit documentation to the Department detailing the qualifying purchases or acquisitions.

The bill includes accountability provisions relating to employment goals, reporting requirements, and an evaluation. The goals of the incentives are to maintain aluminum production at a level that will preserve at least 75 percent of the jobs that were on the payroll as of January 1, 2004, adjusted for any reductions announced prior to December 2003; and to allow the aluminum smelting industry to continue operations in the state through 2006 when energy costs are anticipate to drop.

Smelters must annually report to the Department details of employment, wages, and benefits per job (but excluding individual employee identification) at the manufacturing site. The report must also include the amount of aluminum smelted. The first report must include employment, wage and benefit information covering the 12-month period preceding the effective date of the incentives. The report content is not subject to statutory confidentiality requirements. During any year, if a business fails to submit a report, all tax savings attributable to the incentives for the year are due.

By December of 2005 and 2006, the fiscal committees of the House and Senate, in consultation with the Department, must issue a report evaluating the effectiveness of the incentives, including the effect on job retention.

Appropriation: None.

Fiscal Note: Available on original bill.

Effective Date: The bill contains an emergency clause and takes effect immediately.

Testimony For: (Technology, Telecommunications & Energy) This is a different situation than those that the semiconductor and aerospace industries were facing last year. The aluminum industry is struggling right now, through no fault of their own. There has been a great deal of sacrifice among the companies and the workers. Alcoa has been an important part of the communities in Bellingham and Wenatchee. We don't want to see these jobs go away. This is a temporary tax reduction to get the industry through to 2006 when electricity prices are expected to moderate. It is our decision to make, whether to keep the aluminum industry in the state.

The impact of record high electricity prices from the Bonneville Power Administration (BPA) has been very significant. In 1998 there were nine smelters operating in the state; Intalco is the only one still operating to any extent. We feel that this legislation is necessary for us to continue to operate while we work on getting the rates down. We have been an important part of the community in this state historically. We were invited

to invest in the state decades ago after the federal government developed large amounts of hydroelectric capacity up here, which resulted in reliable supply of wholesale power at reasonable rates. In recent years, demand has outstripped supply of electricity, creating a crisis situation for our industry. Our competitiveness depends very much on the price of electricity, which represents 30 percent to 40 percent of our costs.

At the Wenatchee plant, 40 percent of the power is received under an arrangement with the Chelan Public Utility District. However, this is not enough to make operations economically viable. We have retained 40 workers on the payroll, but this is a great reduction.

This should not be a partisan issue. The union has worked closely with the company to try to work things out and keep things going. Workers' income depends in part on swing shifts and overtime pay, which are no longer available to us.

It is imperative that an employer that was once the number one employer in Whatcom County, but is now in trouble, receive some help. The industry has depended on affordable power, but in return has helped the state by providing an emergency reserve to stabilize the electric system. A study by Western Washington University, in consultation with the port, indicates that 1,200 to 1,800 jobs are directly associated with the Intalco plant and are imperiled by its potential closure.

Intalco is important for the tax base. The school district is projected to grow significantly in the coming years. The help that Intalco has provided us is unusual from a corporate perspective and has been very rewarding.

In Wenatchee, Alcoa has been the model of a great corporate citizen. Alcoa employees provided over 87,000 hours of service to the community last year. The company provides family wage jobs in an area where such jobs are otherwise scarce. With the elimination of overtime and shift work possibilities, people no longer have discretionary dollars to spend, which has hurt the rest of the economy in the region.

Alcoa is a wonderful example of philanthropy in the work place. While giving is way down, they are still the number one contributor in the community. They continue to provide financial contributions that support scholarships, which has been vital to some of our students.

Testimony For: (Finance) This industry provides the type of jobs that everyone had when I was growing up. It was blue-collar but high paying, provided a good lifestyle. In recent years, though, I've seen a lot of my classmates move to other states because of lack of work. This bill gives us a chance to keep a toehold on an important industry to this state. In the past, aluminum companies have gotten preferential rates from the Bonneville Power Administration (BPA), and in exchange have played an important role. These plants allow BPA to keep the electricity grid running smoothly. They have the

ability to take a 400 average megawatt load and shut down if necessary. Without this reserves ability, it would be much harder for BPA to project load down into Oregon or California.

This is about families. These are tough times, and not just for the folks on the pot lines. Concessions have been made by both management and the unions. Our community, workers, and plant management need some security for aluminum products. This is not just a tax base protection issue. Alcoa is an excellent corporate citizen and without them, our communities will be devastated. Alcoa has done a great job of keeping people on the payroll. Even so, the secondary impacts to small business owners has been very tough. This is not a permanent tax break, just something to get them through 2006.

The study by Dick Conway's group shows how important this industry has been to the state, and how conditions have deteriorated significantly in recent years. In 1998, our State had nine plants operating; now we have one. These are important and beneficial jobs. Because of the multiplier effect, for each of these jobs there are 2.9 jobs created elsewhere. If we take into account these effects, this industry in 1998 was responsible directly or indirectly for 4,000 jobs and \$221 million in income.

The aluminum industry is an industry under attack. Since 1998, BPA rates have almost doubled. There are two companies in the State in bankruptcy. Intalco is still running because of strategic location with respect to some of our clients. The price we pay for power is \$37 per megawatt-hour (mWh), even though BPA's cost is only \$5 mWh. Intalco is one of the most efficient, low-cost plants in the nation, but we've had to notify about 300 people of job losses. Wenatchee is also a good plant. While we get 40 percent of our power needs from the public utility district, the economics don't pencil out, and so we can't operate. This legislation sends a clear message to the industry about the commitment of the state.

These jobs are dangerous, but we take a lot of pride in them. We have all become more efficient, and have made every cut humanly possible. We don't like asking for help, but we need some temporary assistance. Our people are proud, and we're doing a lot of community service, but we just want to get back to work.

Alcoa has been a vital link in the charity giving chain in our communities. They are a wonderful example and are still the second largest contributor to United Way, even in the past couple of years. However, the donations have dropped more than 50 percent. The amount of community service provided by their employees has been astonishing - almost 87,000 man hours. Alcoa has also been a great leader in Wenatchee. However, with the loss of jobs, members of the community have been leaving and our schools are losing students. The company has never backed away from community participation. They recently contributed \$20,000 for science materials in classrooms.

Our local bond rating is in jeopardy. This very short term investment by the state will

yield huge benefits not just in the community but statewide.

Testimony Against: (Technology, Telecommunications & Energy) None.

Testimony Against: (Finance) None.

Persons Testifying: (Technology, Telecommunications & Energy) Senator Brandland; Representative Linville; Representative Ericksen; Representative Armstrong; Representative Condotta; Sandi Swarthout; Mike Tanchuk; Vicki Henley; Jo Kaiser; and Bob Wilt, Alcoa; Roger Leonard, Ferndale School District; Pete Kremen, Whatcom County; Rob Pochert, Bellingham/Whatcom County Financial Development Council; Michael Brophy, Eastmont School District; Dianne Cornell, United Way; and Craig Larsen, Wenatchee Valley Chamber of Commerce.

Persons Testifying: (Finance) (In support) Senator Brandland, Representative Linville, Representative Condotta and Representative Erickson, sponsors; Sandi Swarthout, Mike Tanchuk and Bob Wilt, Alcoa; Vicki Henley, Machinist Union Intalco; Tim DeShazo, Steelworkers Union; Pete Kremen, Whatcom County; Brian Flones, Wenatchee School District; and Dianne Cornell, United Way.

Persons Signed In To Testify But Not Testifying: (Technology, Telecommunications & Energy) (With concerns) Robert Hemsley, Association of Western Pulp and Paper Workers Union.

Persons Signed In To Testify But Not Testifying: (Finance) None.