

HOUSE BILL REPORT

2SSB 6304

As Reported by House Committee On:

Finance

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

Brief Description: Providing tax relief for aluminum smelters.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators Brandland, Parlette, Spanel, Morton, Doumit, T. Sheldon and Rasmussen).

Brief History:

Committee Activity:

Finance: 3/4/04 [DPA].

Brief Summary of Second Substitute Bill (As Amended by House Committee)

- Reduces the business and occupation (B&O) tax rate under manufacturing and wholesaling for aluminum smelters to 0.2904 percent through 2006.
- Allows aluminum smelters to take a credit against B&O tax liability for property taxes paid through 2006.
- Provides businesses that sell electricity or natural or manufactured gas to aluminum smelters 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, through June 2011.
- Provides aluminum smelters 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.
- Exempts aluminum smelters from the brokered natural gas use tax through 2006.
- Sets goals for the businesses that use the tax incentives in the bill with respect to employment levels and industry operation.
- Requires aluminum smelters that claim any of the incentives under the act to submit a report to the Department of Revenue with detailed wage, employment, and benefits information, which may be disclosed to the public.

HOUSE COMMITTEE ON FINANCE

Majority Report: Do pass as amended. Signed by 7 members: Representatives McIntire, Chair; Hunter, Vice Chair; Orcutt, Assistant Ranking Minority Member; Ahern, Conway, Morris and Santos.

Minority Report: Without recommendation. Signed by 2 members: Representatives Cairnes, Ranking Minority Member; and Roach.

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 Amended 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 until July 1, 2011 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. Another report must be conducted by December 2010 on the effectiveness of the B&O tax and PUT credits for sales of electricity to smelters.

Amended Bill Compared to Second Substitute Bill:

Terminates the ability to earn B&O tax or PUT credit on sales of electricity to a smelter on July 1, 2011. Provides that the credits do not apply on to income received from resale of electricity that was originally sold under contract for the purposes of smelting. Requires an evaluation of the B&O tax and PUT credits by December 2010.

Requires smelters to make an annual report if receiving any incentive in the bill except the B&O tax or PUT credit for sales of electricity made to a smelter. Requires the report to contain detailed employment information by the total number of full-time, part-time, and temporary positions. Requires that the report information, and the amount of taxes that are due if a report is not filed, be disclosed to the public upon request. Requires an additional evaluation of smelter incentives in 2005 and that the evaluation be conducted by the Legislative fiscal committees.

Appropriation: None.

Fiscal Note: Requested on March 3, 2004.

Effective Date of Amended Bill: The bill takes effect on July 1, 2004.

Testimony For: This bill is just as critical as the House bill you heard earlier this session. We need this bill to save jobs. Power costs are a huge issue for us and we can't cover increases in rates. We would like no sunset on the utility-related incentives.

There are a tremendous number of people out there who are affected by this issue. We are not asking for a handout, just an opportunity to help us survive this difficult period. We really want to get back to work.

Testimony Against: None.

Persons Testifying: Sandi Swarthout, Alcoa; and Daren Krag, International Association

of Machinist and Aerospace Workers.

Persons Signed In To Testify But Not Testifying: None.