SENATE BILL REPORT
SI 732

As of April 11, 2016

Title: An act relating to taxation.

Brief Description: Creating a carbon pollution tax on fossil fuels to fund a reduction in the state sales tax, a reduction in the business and occupation tax on manufacturing, and the implementation/enhancement of the working families' sales tax exemption.

Sponsors: People of the State of Washington.

Brief History:
Committee Activity: Energy, Environment & Telecommunications: 2/09/16.

SENATE COMMITTEE ON ENERGY, ENVIRONMENT & TELECOMMUNICATIONS

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Background: Initiatives to the Legislature. Article II, Section 1, of the Washington State Constitution authorizes the initiative process, allowing the people to place a proposition on the ballot or to submit the proposed law to the Legislature. If an initiative to the Legislature is certified for sufficient signatures, the Legislature must take one of the following three actions:

1. adopt the initiative as proposed, in which case it becomes law without a vote of the people;
2. reject or refuse to act on the proposed initiative, in which case the initiative must be placed on the ballot at the next state general election; or
3. approve an alternative to the proposed initiative, in which case both the original proposal and the Legislature's alternative must be placed on the ballot at the next state general election.

Business and Occupation (B&O) Tax. The B&O tax is imposed on the gross receipts of business activities conducted within the state. 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. There are a number of different rates. Manufacturers' products are taxed at 0.484 percent.

Sales Tax. Retail sales taxes are imposed on retail sales of most articles of tangible personal property, digital products, and some services. A retail sale is a sale to the final consumer or

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end user of the property, digital product, or service. The state, most cities, and all counties levy retail sales taxes. The state sales tax rate is 6.5 percent.

Working Family Tax Exemption (WFTE). In 2008, the Legislature enacted the WFTE, which creates a sales tax exemption in the form of a refund for low-income families, using the federal Earned Income Tax Credit (EITC) as a proxy for sales tax paid. The exemption amount for the prior federal tax year is the greater of 10 percent of the granted EITC amount or $50. In order to qualify for the WFTE an applicant must first be eligible for and have been granted the federal EITC, been a Washington resident for at least 180 days, and have paid Washington sales tax. In September 2008, the WFTE Program was suspended due to budget shortfalls.

Fuel Mix Report. Each retail electric utility in the state must disclose its actual or imputed annual fuel mix used to generate electricity. The disclosure must generally provide the percentage attributable to each of the following generation sources: coal, hydroelectric, natural gas, nuclear, or other. A declared resource is an electricity source specifically identified by a retail supplier to serve retail electric customers.

Summary of Bill: Intent. The intent of the Carbon Pollution Tax Act (Act) is to encourage sustainable economic growth with a phased-in 1 percent reduction of state sales tax, a reduction of the business and occupation tax on manufacturing, the implementation and enhancement of the WFTE, all funded by a phased-in carbon pollution tax on fossil fuels sold or used in Washington and on the consumption or generation of electricity in Washington.

Definitions. Fossil fuel means petroleum products, motor vehicle fuel, special fuel, aircraft fuel, natural gas, petroleum, coal, or any form of solid, liquid, or gaseous fuel derived from these products.

Carbon Pollution Tax (Carbon Tax) means (1) the carbon content of fossil fuel sold or used within Washington, which includes fossil fuel sold or used for aviation or marine purposes; and (2) carbon content inherent in electricity consumed in Washington. This includes electricity generated within or imported into Washington, or acquired from the Bonneville Power Administration (BPA).

Carbon Tax. The tax rate is equal to the following:
- $15 per metric ton (MT) of carbon dioxide (CO2), as of July 1, 2017;
- $25 per MT of CO2, as of July 1, 2018; and
- increasing 3.5 percent plus inflation, annually, thereafter.

The tax rates are not to exceed $100 per MT of CO2 when converted into 2016 dollars by adjusting for inflation using the consumer price index.

For refineries, and other fossil fuels sold or used in Washington by any person, the Department of Revenue (DOR) must determine the tax by applying a carbon calculation for electricity consumed within the state.

DOR must adopt rules and provide forms for reporting the consumption of fossil fuels and electricity generated by the consumption of fossil fuels. DOR may coordinate with the

Department of Commerce to adopt a consolidated form for the reporting of electricity generated by fossil fuels. The consumer of electricity is taxed, but a seller located in Washington must collect the full amount of the tax from the consumer. The seller is liable for taxes due. Refinery operators must report CO2 emanating into the atmosphere as a result of the consumption of fossil fuels in refineries and pay the Carbon Tax within 15 days of reporting.

The Carbon Tax must be reduced or refunded proportional to the fraction of emissions from the use of fossil fuels that do not contribute to increasing the atmospheric CO2 concentration, such as qualified sequestration. The right to a reduction may not be transferred, traded, or banked.

The Carbon Tax is imposed only once at the time and place of the first taxable event and upon the first taxable person within this state.

Carbon Tax Exemptions, Phase-Ins, and Credits. The Carbon Tax does not apply to fossil fuels brought into Washington by a fuel supply tank of a motor vehicle, vessel, locomotive, or aircraft; fuel that is prohibited from being taxed under federal or state laws; and fuel intended for export outside of Washington.

The Carbon Tax rate is phased-in for diesel fuel, biodiesel fuel, or aircraft fuel used solely for agricultural purposes; fuel that is purchased for public transportation or by a private, nonprofit transportation provider; fuel purchased by the Washington state ferry system for use in a state-owned ferry; and fuel purchased for school buses. The tax rate is the following:

- 5 percent of the rate, as of July 1, 2017;
- 10 percent of the rate, as of July 1, 2019; and
- increasing by 5 percent, biennially, thereafter, until it is at 100 percent effective July 1, 2055.

If a person paid the Carbon Tax on fuel consumed in the generation of electricity, the electricity is not be subject to the Carbon Tax.

If a person consumes electricity in Washington but has paid a similar Carbon Tax in another state for electricity generated in that state, then the person is allowed a credit not to exceed the tax liability in Washington.

Reporting. By the 10th day of each month, utilities and users of electricity not generated in state or acquired from a qualifying utility must file with DOR a fuel mix disclosure report together with the tax calculated based on DOR's tax tables. If a utility or electricity user reports electricity products with no declared resources or fails to provide the sources of the resources, DOR must assume the carbon content inherent in the electricity to be one metric ton of CO2 per megawatt hour.

By the 10th day of each month, refineries must file with DOR a fuel use report similar to EPA's greenhouse gases tool report together with the tax calculated based on DOR's tax tables.

A utility, electricity user, or refinery that does not have the information required for a fuel mix disclosure or fuel use report, may file an interim report based on estimates with an estimated payment and file a final report at a later date. Interests and penalties on underpayments must be imposed.

By December 31, 2017, DOR must submit an annual report to the Governor and the Legislature until December 31, 2027, and a biennial report thereafter. The report must include the following:

- total Carbon Tax collected for a year;
- total revenue foregone by the state resulting from disbursement made under the WFTE, and reductions in sales taxes, use taxes, and B&O taxes under this Act;
- revenue foregone by the state as a result of the phase-in Carbon Tax, in total as well as disaggregated by exemption;
- administration costs for the Carbon Tax; and
- overall net revenue gain or loss from the Act in both dollar amounts and as a percentage of the state general fund.

<u>B&O Tax.</u> The B&O tax rate is reduced to 0.001 percent for activities including: manufacturing, manufacturing semiconductors; certain food and agricultural products, airplanes and components, and timber or wood products.

<u>Sales Tax.</u> The sales tax is reduced to 6 percent beginning July 1, 2017, and reduced to 5.5 percent beginning July 1, 2018.

<u>WFTE.</u> Beginning in 2017, the WFTE for the prior year is the greater of 15 percent of the EITC or $100. Beginning in 2018 and thereafter, the exemption for the prior year is the greater of 25 percent of the EITC or $100.

Applications for the exemption must be made under penalty of perjury and must include a copy of the applicant's federal income tax return. DOR is authorized to obtain information from the Internal Revenue Service to verify information in the application.

<u>Rulemaking.</u> The Directors of DOR and the Department of Licensing must adopt rules and regulations to implement and administer this Act. The Departments may begin administrative work, including rule making, to implement the Act beginning July 1, 2016.

Effective Date: This bill takes effect July 1, 2017, if passed by the Legislature or approved by the voters at the next general election.

Appropriation: None.

Fiscal Note: Available.

Committee/Commission/Task Force Created: No.

Staff Summary of Public Testimony: PRO: I-732 responds to the best science, creates a less regressive tax system, leads to a reduction in our carbon footprint, encourages new energy technologies, provides business opportunities, and makes Washington a bipartisan example for the rest of the nation. We can respond to increasing greenhouse gases (GHGs) by (1) adaptation or (2) mitigation - reducing mitigation emissions. I-732 lets the free market decide on the best approach. Every locality is a small part of the global problem. The free market provides strong foundation for prosperous society. However carbon pollution that contributes to climate change is an instance of a market failure. Economics teaches that the best way to deal with this is to put a price on carbon. A carbon tax would promote conservation, innovation, and the development of new technologies. The best way to minimize the impact of a carbon tax is to recycle revenue into reductions of existing taxes. The basic theory is to tax "bads" rather than "goods." For an example, we can look to British Columbia (BC). In 2008, BC created a $30 carbon tax and used revenue to reduce other taxes and the economy is doing fine. I-732 is intended to be neutral. We have a moral obligation to take action on climate change.

There are three policy options for addressing pollution: (1) subsidies; (2) mandates; and (3) pricing mechanisms that apply a tax to pollution you don't want and the market will find a way to reduce it - which is I-732. Government subsidies for good behavior can be very effective for new technology but can be very expensive. A cap and trade approach builds bureaucracy in government and invites regulatory gaming. Caps cover only the largest emissions. Trade is problematic because trading prices can fluctuate wildly. A tax on carbon emissions is simple and creates adaptation as it goes. I-732 is a small government free-market solution and improves the regressive nature of our tax system. A tax on carbon emissions helps with other pollution and promotes environmental justice. The REMI model shows we can grow the economy and increase jobs if we tax carbon. I-732 sets a price on carbon. Ecology could use this price for its rule.

A revenue-neutral carbon tax can harness business innovations, is predictable, and has been successful. In absence of federal leadership, states need to take leadership. I-732 can pass with the business community acquiescing with more support than any other measure. I-732 is not a win-lose situation; we are all winners in the long run. I-732 will price dirty carbon closer to the real costs. We are the first generation to feel the effects of climate change and the last generation to do something about it. I-732's benefits are not reflected in the fiscal note. It will help reduce poverty, which is associated with an increase in health. Reducing emissions will also improve health. The cost of doing nothing should be considered. People in Washington care about the environment, want action, and are willing to make sacrifices for the future of their children as long as their family will continue to thrive economically. I-732 isn't perfect but is politically feasible. A carbon tax is the essential first step to a transition from fossil fuels to renewable energies. Large companies are using our atmosphere as a garbage dump. We need an economy no longer based on fossil fuels. People adjust to gas prices, which already fluctuate. An alternative initiative would be too be confusing. An I-732 benefit is tax reform. Students at every major university support I-732. There will be winners and losers economically in any change, but the question is. will humanity be winners or losers? Angel investors want to contribute to a vibrant, clean-tech economy. Investors are not looking for subsidies when looking at companies, but putting a meaningful price on carbon would put a more level playing field in place. We still need strong standards like building codes and renewable portfolio standards (RPS). I-732 is an incentive to encourage what you do want and reduce what you don't. The cost to address these issues is not as high as some suggest because of the ability to create technology.

CON: The idea of revenue neutrality is worthy of pursuit. But I-732 is revenue-neutral to the State of Washington, not to the businesses, employers, employees, or voters of Washington. The policy creates winners and losers. We must look at proposals in the entire regulatory environment, which includes the Governor's carbon rule, the federal clean power plan, other ballot measures, and ancillary policies around carbon that are cost drivers. We have regulatory uncertainty in Washington. The business community needs to be part of the solution. One-third of a truck load carrier's operating expense is fuel. Truck load carriers can run between 1600 and 1800 miles without refueling. If fuel in Washington is more expensive, some will purchase fuel outside of state. This puts in-state truckload carriers at a disadvantage. I-732 is not revenue-neutral to energy intensive manufacturers. Pieces of I-732 are troublesome to the natural gas industry. I-732 does not state clearly that natural gas users would pay the tax as it does for electricity users. It is a large tax on energy used by the food processing industry. The cost varies depending on who the serving utility is, which is outside of a customer's control. I-732 exempts transportation fuels coming into state, but not imported electricity. The initiative climbs to $100. But much of the modeling has only been done at $15 per MT of CO2. Any proposal going forward should bar the Governor's clean air rule, because the two proposals together would be a substantial cost to the consumer. Policies with investments in low-carbon alternatives are more effective. Sustainable alternatives must be more available to all people in Washington. I-732 spends all revenues on tax cuts rather than usher Washington into low-carbon economy. I-732 fails to accommodate for and provide transition for employees in energy-intensive trade energies. B&O tax cuts from some businesses are insufficient. The fiscal note speaks for itself. As written, I-732 adversely impacts industries and low-income residents. The family rebate doesn't work if you don't file an income tax return. Public Utility Districts (PUDs) are 95 percent clean energy utilities relying mostly on hydropower. Yet, I-732 will cost PUDs between $8 and $90 million a year because it captures market purchases to meet demands when hydropower is not available. Four basic principles should be considered for carbon reduction: (1) make carbon policies complimentary; (2) least cost; (3) ensure reliability; and (4) provide value to our community.

OTHER: It is necessary to have clear definitions within the electric utility industry so that there is not a risk of taxpayers ending up within unknown tax liability. There are uncertainties in this proposal. The methodology regarding accounting for carbon emissions used in the last 15 years is antiquated. Utilities could end up taxing customers for resources we don't use. We would like the industry to move toward more accurate emissions sourcing for undeclared resources to allow for more predictability within the market. Revenue neutrality is critical because we don't want to push business out of state to simply operate elsewhere. We already spend money on carbon reduction efforts in terms of subsidies. Why are we unwilling to see tax cut but okay with spending money on ineffective subsidies? I-732 can't be on top of other regulations. We need a comprehensive plan that reduces carbon and strengthens the economy; that puts predicable prices on carbon; that drives innovation; that rewards when we achieve carbon reduction goals; that funds environmental mediation; that reforms existing wasteful programs; and that reduces the regressiveness of the current system. The challenge of the initiative is it is cast in stone. Thus, we should pursue an I-732B, and address fiscal challenges and other regulatory systems at the same time.

Persons Testifying: PRO: Yoram Bauman, Cliff Mass, Carbon WA; Greg Rock, Sharon Nelson, A.P. Hurd, Carbon WA; Michael Ruby, none; William McPherson, Unitarian Universalist Voices for Justice; Joel Carlson; Kate Pflaumer, attorney; Mary Spokane; Jeffrey Morris, Ph.D. Economist; Gwen Hanson, MD; Francine Gaillour, Ki Health, Medical Director; Jeffrey Silesky, Davis-Silesky Real Estate; Patricia Baird; Ben Silesky, Carbon Washington; Cathy Carruthers, Individual - Small Business Investor & Owner; Amber Carter, Amber Carter Government Relations LLC; Bourtai Hargrove, Confronting the Climate Crisis; Ben Silesky, Carbon Washington; Bourtai Hargrove, Confronting the Climate; Madeline Goodwin, The Evergreen State College/Graduate Student; Patricia Holm, Confronting the Climate Crisis, Parent PTA; Mary Moore, League of Women Voters of Washington; Laurel Wolf; Court Olson; Cindy Franklin, self; Kyle Murphy, Carbonwa; Alex Lenferna, University of Washington, Student; Lars Johansson, Eric Berman, Angel Investor; Joe Ryan, Carbon WA; Trace McKellips.

CON: George Caan, Executive Director, Washington PUD Association; Julie Salvi, Washington Education Association; Ellicott Dandy, OneAmerica; Brandon Houskeeper , Assoc. of WA Business; Sheri Call, Washington Trucking Assoc.; Tim Boyd, Industrial Customers Of Northwest Utilties; Charlie Brown, Cascade Natural Gas; Randy Ray, Benton & Franklin PUDs.

OTHER: Dave Arbaugh, Snohomish PUD; Shaun Seaman, Chelan PUD; Todd Myers, Washington Policy Center; David Giuliani, Isaac Kastama, Washington Business Alliance.