

FINAL BILL REPORT

EHB 2199

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Synopsis as Enacted

Brief Description: Creating business and occupation and public utility tax exemptions for certain amounts received as the result of receipt, generation, purchase, sale, transfer, or retirement of allowances, offset credits, or price ceiling units under the climate commitment act.

Sponsors: Representatives Orcutt, Fitzgibbon, Reed, Doglio and Leavitt.

House Committee on Finance

Senate Committee on Environment, Energy & Technology

Senate Committee on Ways & Means

Background:

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. Businesses must pay the B&O tax even though they may not have any profits or may be operating at a loss.

A taxpayer may have more than one B&O tax rate, depending on the types of activities conducted. Major B&O tax rates are 0.471 percent for retailing; 0.484 percent for manufacturing, wholesaling, and extracting; and 1.5 percent (businesses with taxable income of less than \$1 million) or 1.75 percent (businesses with taxable income of \$1 million or more) for services and activities not classified elsewhere. Several preferential rates also apply to specific business activities.

In addition, a taxpayer may be eligible to utilize other tax preferences, including credits and deductions, to reduce their tax liability. For example, a taxpayer engaging in activities subject to different B&O tax rates may be eligible for a Multiple Activities Tax Credit. A taxpayer may also be eligible for a small business credit that will either eliminate or reduce their B&O tax liability. In general, the small business credit is \$70 per month for service

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businesses and \$35 per month for all other businesses, multiplied by the number of months in the reporting period. The amount of the credit available phases out based on the business's gross receipts.

Public Utility Tax.

The gross income derived from the operation of publicly and privately owned utilities is subject to the public utility tax (PUT), unless otherwise exempt. The PUT is imposed in lieu of B&O tax and is applied only on sales to consumers. Other income of the utility, such as retail sale of tangible personal property, is subject to the B&O tax. There are six different PUT rates, depending on the specific utility activity. The rates are:

- 3.852 percent on telegraph companies, distribution of natural gas, and the collection of sewage;
- 3.8734 percent on the generation or distribution of electrical power;
- 0.642 percent on urban transportation and watercraft vessels under 65 feet in length;
- 1.926 percent on motor transportation, railroads, railroad car companies, and all other public service businesses;
- 5.029 percent on the distribution of water; and
- 1.3696 percent on log transportation.

A taxpayer who engages in one or more businesses subject to a PUT is fully exempt from the tax if their total gross income is \$2,000 or less per a month. Any taxpayer that has a total gross income greater than \$2,000 per month does not receive an exemption or deduction under this provision.

A business does not have to file an excise tax return for a PUT if the business does not owe other taxes or fees to the Department of Revenue (DOR) and has annual gross proceeds of less than \$24,000.

Tax Preferences.

State law provides for a range of tax preferences that confer reduced tax liability upon a designated class of taxpayer. Tax preferences include tax exclusions, deductions, exemptions, preferential tax rates, deferrals, and credits. Currently, Washington has over 650 tax preferences, including a variety of sales and use tax exemptions. Legislation that establishes or expands a tax preference must include a Tax Preference Performance Statement (TPPS) that identifies the public policy objective of the preference, as well as specific metrics that the Joint Legislative Audit and Review Committee (JLARC) can use to evaluate the effectiveness of the preference. All new tax preferences automatically expire after 10 years unless an alternative expiration date is provided.

Climate Commitment Act Overview.

Under the 2021 Climate Commitment Act (CCA), in order to ensure that greenhouse gas (GHG) emissions are reduced consistent with the state's 2030, 2040, and 2050 emissions limits, the Department of Ecology (Ecology) must implement a cap on GHG emissions from covered entities and a program to track, verify, and enforce compliance through the use of

compliance instruments, which include allowances or eligible offset credits. The Cap-and-Invest Program (Program) commenced on January 1, 2023.

The Program:

- establishes annual allowance budgets that limit emissions from covered entities;
- defines those entities covered by the Program (covered entities), those entities that may voluntarily opt into coverage under the Program (opt-in entities), and other persons that participate in auctions or allowance markets by purchasing, holding, selling, or voluntarily retiring compliance instruments (general market participants);
- provides for the distribution of emissions allowances at no-cost to certain covered entities, or by purchase at an auction;
- provides for offset credit as a method for meeting compliance obligations;
- defines the compliance obligations of covered entities;
- provides for the transfer of allowances and recognition of compliance instruments, including those issued by jurisdictions with which Washington may have linkage agreements in the future; and
- provides monitoring and oversight of the sale and transfer of allowances.

Climate Commitment Act Allowance Auctions, Compliance Obligations, and Enforcement.

Except for directly distributed, no-cost allowances allocated to certain entities, allowances must be distributed via allowance auctions. Auctions are open to covered entities, opt-in entities, and general market participants that are registered entities in good standing.

Covered entities and opt-in entities may not buy more than 10 percent of the allowances offered during a single auction. General market participants may not buy more than 4 percent of the allowances offered during a single auction and may not in aggregate own more than 10 percent of the total number of allowances issued in a calendar year.

Certain entities, including emissions-intensive trade-exposed (EITE) facilities, receive directly distributed, no-cost allowances from Ecology.

For electricity, the covered entity that must satisfy a compliance obligation is specified in statute and in rule, and includes first jurisdictional deliverers of electricity, which include importers of electricity.

Offset Credits.

In addition, the CCA allows for offset projects and the securing of offset credits. In order to qualify, an offset project must provide direct environmental benefits to the state or be located in a jurisdiction with which the state has entered into a linkage agreement and meet other requirements. Covered entities may use an offset credit to meet a certain percentage of their compliance obligations.

Summary:

A B&O and PUT tax exemption is authorized for covered entities, opt-in entities, and

entities that receive no cost allowances under the CCA for amounts these entities receive from the receipt, generation, purchase, sale, transfer, or retirement of allowances, offset credits, or price ceiling units under the CCA. This exemption is both retroactive and prospective.

This act is exempt from the requirements of a TPPS, a JLARC review, and an automatic 10 year expiration.

Votes on Final Passage:

House	97	0
Senate	48	1

Effective: April 1, 2024