State of Washington

Office of Program Research **House of Representatives** **August 1, 2016**

Summary of Initiative 732

Prepared for members of the Washington House of Representatives by the House Office of Program Research.

This information has been prepared in response to various requests for a summary of Initiative 732. It is provided for analytical and legislative policy purposes only. It is not provided as an expression of support for or opposition to any ballot measure. These materials are intended to provide general information and are not intended to be an exhaustive analysis of all issues presented by the measure.

BRIEF SUMMARY

- Imposes a new carbon emission tax on certain fossil fuels and fossil-fuel-generated electricity.

- Reduces the business and occupation tax rate to 0.001 percent for manufacturing and certain other business activities.

- Reduces the state retail sales tax rate from 6.5 percent to 5.5 percent over a two-year period.

- Expands a low-income sales tax exemption program.

BACKGROUND

Initiative 732

Initiative 732 was filed in 2015 as an initiative to the Legislature. Once certified, an initiative to the Legislature is submitted to the Legislature at its next regular session, at which time the Legislature must take one of three actions:

- adopt the initiative as proposed, in which case it becomes law without a vote of the people;
- reject or take no action on the proposed initiative, in which case the initiative must be placed on the ballot at the next state general election; or
- 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.

The Legislature did not act on Initiative 732 during its 2016 Regular Session. This initiative is, therefore, being submitted to the people for approval or rejection at the November 2016 general election.

The ballot title and ballot measure summary are as follows:

Ballot Title
Statement of Subject: Initiative Measure No. 732 concerns taxes.

Concise Description: This measure would impose a carbon emission tax on certain fossil fuels and fossil-fuel-generated electricity, reduce the sales tax by one percentage point and increase a low-income exemption, and reduce certain manufacturing taxes.

Should this measure be enacted into law? Yes [ ] No [ ]

Ballot Measure Summary
This measure would impose a carbon emission tax on the sale or use of certain fossil fuels and fossil-fuel-generated electricity, at $15 per metric ton of carbon dioxide in 2017, and increasing gradually to $100 per metric ton (2016 dollars adjusted for inflation), with [a] more gradual phase-in for some users. It would reduce the sales tax rate by one percentage point over two years, increase a low-income sales tax exemption, and reduce certain manufacturing taxes.

Current Federal and Washington Regulation of Greenhouse Gasses

The United States Environmental Protection Agency (EPA) and state Department of Ecology (ECY) identify carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, and sulfur hexafluoride as greenhouse gases (GHGs) as a result of their capacity to trap heat in the Earth's atmosphere. Under the federal Clean Air Act, carbon dioxide and other GHGs are regulated as air pollutants and are subject to several air regulations administered by the EPA. These regulations include a requirement that facilities and certain fuel and gas suppliers report to the EPA if their associated annual emissions exceed 25,000 metric tons of carbon dioxide equivalent.

At the state level, carbon dioxide and other GHGs are regulated by the ECY under the state Clean Air Act. State law requires facilities and other sources whose emissions exceed 10,000 metric tons of carbon dioxide equivalent each year to report their annual emissions to the ECY, or to local air authorities that implement the state Clean Air Act. A supplier of motor vehicle and aircraft fuels must also report annual emissions if combustion of its fuel product would exceed 10,000 metric tons of carbon dioxide. In addition, in January of 2016, the ECY issued a draft rule under the authority of the state Clean Air Act to limit GHGs. The ECY withdrew the

---

Prepared for members of the Washington House of Representatives by the House Office of Program Research. This information has been prepared in response to various requests for a summary of Initiative 732. It is provided for analytical and legislative policy purposes only. It is not provided as an expression of support for or opposition to any ballot measure. These materials are intended to provide general information and are not intended to be an exhaustive analysis of all issues presented by the measure.

original draft to incorporate feedback from businesses and environmental stakeholders and released an updated draft this spring.

Apart from reporting and other regulations under the state and federal clean air acts, several other state laws and programs explicitly address GHG emissions. State law prohibits Washington utilities from investing in or making a long-term financial commitment to sources of electricity whose generation exceeds a GHG emission performance standard of 970 pounds of GHGs per megawatt-hour. State law also establishes limits for statewide GHG emission levels for 2020, 2035, and 2050, although it is not specified how the state must achieve those limits, nor does the law require emission reductions to be achieved in a particular manner.

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. There are ten different B&O tax rates that apply to various classifications of business activities. With respect to most manufacturing and wholesaling activity, a B&O tax rate of 0.484 percent applies to the value of products manufactured or the gross proceeds of sales. Retailing activity is subject to a rate of 0.471 percent. A few specific types of manufacturing, wholesaling, and retailing activities, such as the production and sale of commercial aircraft, are subject to a lower preferential rate.

Retail 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 end user of the property, digital product, or service. If retail sales taxes were not collected when the user acquired the property, digital products, or services, then use taxes apply to the value of property, digital product, or service when used in this state. The state, most cities, and all counties levy retail sales and use taxes. The state sales and use tax rate is 6.5 percent and local sales and use tax rates vary from 0.5 percent to 3.1 percent, depending on the location.

Working Families Tax Exemption

In 2008, the Legislature enacted a working families' tax exemption (WFTE) in the form of a state sales tax remittance that is equal to a percentage of the federal earned Income Tax credit (EITC). To qualify for the WFTE, a person must be eligible for the federal EITC and must have filed a federal income tax return as a Washington resident. A person's exemption amount is the greater of: $50 or 10 percent of the federal EITC granted to the person. For any fiscal period, the WFTE must be approved in the state operating budget bill before individuals may seek a remittance under the program. Since enactment of the program in 2008, the WFTE has never been funded in the state budget bill.

The Department of Revenue (DOR) determines eligibility based on information provided by the applicant, and through audit, administrative records, and verification of Internal Revenue Service (IRS) records. The DOR may use the best data available to process the remittance.

SUMMARY

Carbon Emission Tax: Tax Rates and Tax Base

Beginning July 1, 2017, a tax of $15 per metric ton is levied on the carbon content of fossil fuels sold or used in the state. A similar $15 per metric ton tax is also levied on the carbon content inherent in electricity consumed in the state. For both fossil fuels and electricity, the tax rate is increased to $25 per metric ton beginning July 1, 2018, and increases every year thereafter by 3.5 percent plus inflation. The tax rate may not exceed a rate of $100 per metric ton, converted into 2016 dollars when adjusted by inflation using the consumer price index.

The carbon content of fossil fuels is the amount of carbon dioxide generated by the combustion of fossil fuels. This includes the carbon dioxide generated from fossil fuels combusted in the production of electricity. To facilitate the calculation of carbon content, the Department of Revenue (DOR) may consider carbon dioxide content measurements for fossil fuels provided by the United States energy information administration and the United States environmental protection agency. Fossil fuels include coal, petroleum products, natural gas and other forms of solid, liquid or gaseous fuels derived from these types of products.

Carbon Tax: Exemptions, Credits, and Other Reductions

The carbon tax does not apply to:

- fossil fuels brought into the state by a fuel supply tank of a motor vehicle, vessel, locomotive or aircraft;
- fuel that is prohibited from taxation under the state or federal Constitution or other law; and
- fuel intended for export outside the state.

A reduction or refund is authorized for the use of fossil fuels if it can be demonstrated that the use did not contribute to increasing atmospheric carbon dioxide concentration, for example, by qualified sequestration. The right to a reduction or refund is not transferrable and may not be banked.

The carbon tax is phased-in for the following uses of fossil fuels:

- diesel, biodiesel or aircraft fuel purchased and used solely for agricultural purposes;
- fuel purchased for the purpose of public transportation;

- fuel purchased for private, nonprofit transportation providers;
- fuel purchased by the Washington state ferry system for use in a state-owned ferry; and
- fuel purchased for school buses.

For these uses of fossil fuels, the tax rate is 5 percent of the carbon tax rate in effect on July 1, 2017, for taxes imposed in the 2017-19 biennium; 10 percent of the carbon tax rate in effect on July 1, 2019, for taxes imposed in the 2019-2021 biennium; and the rate continues to increase by 5 percent biennially until it reaches 100 percent of the carbon tax rate, effective July 1, 2055.

The carbon tax is imposed only once on any sale or use of fossil fuel or any consumption of electricity in the state. Persons subject to the carbon tax on electricity generated outside the state, but consumed within the state, may claim a credit against the carbon emission tax for any similar tax imposed by another state on the generation of the electricity.

Carbon Tax: Administration and Reporting to and by the Department of Revenue

The DOR is the principal agency responsible for administering the carbon tax. More specifically, the DOR must determine the annual carbon tax rate and the carbon content of various fossil fuels and must develop most forms and reports taxpayers are required to submit.

Generally, the DOR will administer the carbon tax on various fossil fuels in a manner consistent with existing state excise taxes; however, the Department of Licensing (DOL) will administer the collection of the carbon tax on fuel in conjunction with vehicle and aviation fuel taxes that are currently administered by the DOL.

Several types of entities have additional reporting requirements. Utilities must submit a monthly fuel mix report indicating the type and amount of fossil fuel used to generate electricity during the period along with the tax. The DOR must assume that the carbon content inherent in electricity is one metric ton of carbon dioxide per megawatt-hour for any utility not providing its actual fuel sources. Refiners using fossil fuels to refine fossil fuels and users of electricity not acquired from a utility must submit a similar monthly report.

The DOR must submit an annual report to the Legislature and Governor until 2027, with biennial reports thereafter, which include the following:

- the total carbon tax collected;
- the total revenue loss from the reduction of the B&O tax, state retail sales tax, and the implementation of the WFTE;
- the total revenue loss from the phase-in for specific uses of fossil fuels;
- the costs associated with the administration of the carbon tax; and
- the overall net revenue gain or loss from the tax policy changes of the initiative.

Business and Occupation Tax

The B&O tax rate for manufacturing activities is reduced to 0.001 percent. In addition, the B&O tax rate for the wholesaling and retailing of commercial airplanes, components of commercial airplanes, and aerospace tooling is also reduced to 0.001 percent.

Retail Sales and Use Tax

Beginning July 1, 2017, the state retail sales and use tax rate is reduced to 6.0 percent. Beginning July 1, 2018, the retail sales and use tax rate is further reduced to 5.5 percent.

Working Families Tax Exemption

The requirement that the legislature authorize the WFTE in the state operating budget bill is eliminated. Therefore, on July 1, 2017, the DOR will begin accepting applications for sales tax remittances under the program.

For 2017, the remittance amount for the WFTE is the greater of: 15 percent of the federal EITC or $100. Beginning in 2018, the remittance amount is increased to the greater of: 25 percent of the federal EITC or $100.

Effective Date: The initiative takes effect on July 1, 2017.

Staff Contacts: Jeff Mitchell (786-7139) and Dominque Meyers (786-7150)

Prepared for members of the Washington House of Representatives by the House Office of Program Research. This information has been prepared in response to various requests for a summary of Initiative 732. It is provided for analytical and legislative policy purposes only. It is not provided as an expression of support for or opposition to any ballot measure. These materials are intended to provide general information and are not intended to be an exhaustive analysis of all issues presented by the measure.