

SENATE BILL REPORT

ESB 5309

As Passed Senate, March 2, 2023

Title: An act relating to eliminating the state public utility tax deduction for the instate portion of interstate transport of petroleum products and crude oil.

Brief Description: Eliminating the state public utility tax deduction for the instate portion of interstate transport of petroleum products and crude oil.

Sponsors: Senators Lovelett, Rolfes, Hasegawa, Hunt, Keiser, Nguyen and Nobles.

Brief History:

Committee Activity: Ways & Means: 1/24/23, 2/16/23 [DP, DNP].

Floor Activity: Passed Senate: 3/2/23, 27-22.

Brief Summary of Engrossed Bill

- Eliminates Public Utility Tax deductions for the instate portion of the interstate transport of petroleum products and crude oil.

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: Do pass.

Signed by Senators Rolfes, Chair; Robinson, Vice Chair, Operating & Revenue; Billig, Conway, Dhingra, Hasegawa, Hunt, Keiser, Nguyen, Pedersen, Saldaña, Van De Wege and Wellman.

Minority Report: Do not pass.

Signed by Senators Mullet, Vice Chair, Capital; Wilson, L., Ranking Member, Operating; Gildon, Assistant Ranking Member, Operating; Schoesler, Ranking Member, Capital; Warnick, Assistant Ranking Member, Capital; Boehnke, Braun, Torres and Wagoner.

Staff: Jeffrey Mitchell (786-7438)

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not part of the legislation nor does it constitute a statement of legislative intent.

Background: The Public Utility Tax (PUT) applies to the gross operating income of public service businesses, including businesses engaging in transportation. The PUT is in lieu of the business and occupation (B&O) Tax and, similar to the B&O tax, applies to the gross receipts of a business without deductions for the costs of doing business.

Six different rates apply, depending upon the specific utility activity. The rates, including permanent surtaxes, are:

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

Generally, wholly instate freight transport—trips from one point in Washington to another—are fully subject to PUT. However, current law provides a deduction from the PUT for instate portions of the interstate shipments of goods where the carrier authorizes the shipper to stop the shipment in Washington to store, manufacture, or process the goods, then continues to transport the same goods or their equivalent, in the same or a converted form, to the final destination noted under a through freight rate, also known as a through bill of lading. The preference applies to transportation of goods by truck, rail, and certain water transportation. Current law also provides a PUT deduction for the transportation of commodities from a point in Washington directly to an instate port, dock, wharf, export elevator, or shipside for direct shipment by a vessel outside the state.

The Joint Legislative Audit and Review Committee (JLARC), as part of its tax preference review process, reviewed these deductions in 2010. JLARC noted that the Legislature did not state its intent when these preferences were enacted in 1937. The implied intent appears to be based on the 1930s-era U.S. Supreme Court analysis and interpretation of federal Commerce Clause prohibitions. At the time, the U.S. Supreme Court interpreted the federal Commerce Clause in the U.S. Constitution to bar a direct tax on gross receipts from activities related to interstate transportation. These PUT deductions were consistent with the constitutional analysis of commerce clause prohibitions at the time. JLARC further noted that taxing the instate portion of interstate transportation activities is now recognized as constitutional as long as the tax satisfies a four-prong test promulgated by the U.S. Supreme Court in *Complete Auto Transit v. Brady* (1977), which held that a state tax does not violate the commerce clause when it is applied to interstate activity if:

- the taxpayer has a substantial nexus with the taxing state;
- the tax is fairly apportioned;
- the tax does not discriminate against interstate commerce; and
- the tax is fairly related to the services provided by the state.

Summary of Engrossed Bill: The PUT deductions that wholly exempt the instate portion of gross income derived from interstate transportation activities related to goods and passengers transported by truck, rail, and some watercraft do not apply to the transport of petroleum products not packaged for sale to ultimate consumers and crude oil. Beginning October 1, 2023, business income derived from the instate portion of interstate transport services related to petroleum and crude oil would be subject to the state PUT. Most of this activity is assumed to be subject to the 1.926 percent tax rate for motor and rail transportation.

"Packaged for sale to ultimate consumers" means petroleum products that are prepared and packaged for sale at usual and ordinary retail outlets.

"Petroleum product" means plant condensate; lubricating oil; gasoline; aviation fuel; kerosene; diesel motor fuel; benzol; fuel oil; residual oil; liquefied or liquefiable gases such as butane, ethane, and propane; and every other product derived from refining crude oil, but the term does not include crude oil.

Generally, gross income is apportioned to Washington based on the ratio that revenue miles of the business in this state during the tax period bear to the revenue miles of the business everywhere during the tax period. Gross income subject to tax includes only the income derived for transporting petroleum products or crude oil, or both. For businesses that transport petroleum products or crude oil by pipeline, gross income is apportioned to Washington based on the ratio that the total number of traffic units in Washington during the tax period bear to the total number of traffic units everywhere during the tax period. "Traffic unit" means the movement of one unit of taxable petroleum product or crude oil for a distance of one mile.

Appropriation: None.

Fiscal Note: Available.

Creates Committee/Commission/Task Force that includes Legislative members: No.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony: PRO: The current tax preference is primarily enjoyed by agricultural commodities transporting products by rail and truck. The outlier was transportation of crude by rail and truck. This body should give an examination of our tax preferences. This bill has the potential to generate upwards of two million dollars annually for the general fund.

CON: The language of the original exemption in 1935 was intended to be economy wide, so it is unclear why petroleum products and crude oil are targeted in this bill. There is no specific exemption for petroleum products and crude oil, the public utility tax provides a broad exemption for transportation businesses involved in interstate commerce. It is not

commodity specific. Before changing long-standing economic policy, the Department of Revenue, Office of Financial Management, or Economic and Revenue Forecast council should conduct an economic and impact study on the affects of termination of the tax preference on the competitiveness of affected taxpayers and tax impacts of termination.

Persons Testifying: PRO: Senator Liz Lovelett, Prime Sponsor.

CON: Greg Hanon, Western States Petroleum Assoc.; Tom Wolf, bp America.

Persons Signed In To Testify But Not Testifying: No one.