



Summary of Taxes Paid By
Investor Owned Utilities and Public Utility Districts
July 31, 2008

EXECUTIVE SUMMARY

One question that typically is of concern when Public Utility Districts (PUDs) look at providing electric service to an area currently served by Investor Owned Utilities (IOUs), has to do with the taxes that the respective utilities pay and if there will be a significant change in the tax revenues received by local government. In light of current consideration by some PUDs of providing electrical service to customers now served by Puget Sound Energy (PSE), the Washington PUD Association has commissioned the creation of this report. The short answer is that a transition to a PUD electricity provider should not harm or reduce the revenues to a local taxing district.

There are a number of taxes paid by both IOUs, like PSE, and PUDs to support both state and local governments. The Washington State tax system relies on property taxes and excise taxes for this support. Both types of taxes are imposed upon the electric utility industry in various forms. Below is a table showing the types of taxes paid by electric utilities and which of these taxes are paid by each type of entity.

Tax	Paid By	Basis
Public Utility Tax	Both	Gross Revenue of retail sales of electricity
Privilege Tax	PUDs	Gross Revenue of retail sales of electricity and imputed value of energy generated
Property Tax	IOUs	Property value
Sales/Use Tax	Both	Value of goods and services
B&O Tax	Both	Value of goods and services
Municipal Tax	Both	Gross revenue of retail electric sales

As you can ascertain from the table above, the only significant difference in taxes paid between an IOU and a PUD is in the area of Property Taxes and Privilege Taxes. While not explicitly stated in statute, the Privilege Tax is paid in lieu of Property Tax. While the basis for these taxes differs, the results of the tax are generally quite similar. In fact, RCW 54.28.120 provides that privilege taxes paid by a PUD on acquired IOU property will not be less than was paid prior to the IOU properties acquisition. There are also details to protect local taxing districts within RCW 54.28.080 related to bonded indebtedness of school districts and RCW 54.28.110 related to property taxes paid to any taxing entity for removal of property from tax rolls. The full text of these RCWs can be found in the text of this analysis below.

It is quite possible that certain local governments could benefit from the acquisition of an IOU's facilities in the area of sales/use tax. This would depend on the delivery point of goods and services of the PUD. Sales tax is charged based on said delivery point. Therefore, if sales taxable goods and services are primarily received by an IOU in a different city and/or county than that of the PUD, the local portion of the sales tax would not currently be collected in that jurisdiction. Assuming this delivery point changed once the PUD began operating as an electric utility, then the city and/or county portion of the sales tax would accrue to the new jurisdiction. To quantify this potential benefit of PUD electric service it would be necessary to know how goods and services are purchased by the existing IOU to be able to calculate this difference, if any.

In summary, local taxing districts within a PUD's service territory should not be negatively affected by the creation of a new electric PUD.

INTRODUCTION

There are a number of taxes paid by both Investor Owned Utilities (IOUs) and Public Utility Districts (PUDs). This paper will examine the taxes paid by each of these entities and how the differences may impact a taxing district's revenue from electric utilities.

Below is a table that analyzes the various taxes.

Tax	Paid By	Basis	Current Rate
Public Utility Tax	Both	Gross Revenue of retail sales of electricity.	3.873%
Privilege Tax	PUDs	Gross Revenue of retail sales of electricity and imputed value of energy generated	2.14% for sales and various rates for generation depending upon the type of generation
Property Tax	IOUs	Property value	Varies by taxing District
Sales/Use Tax	Both	Value of goods and services	6.5% for the state; varies by taxing district for other governments
Municipal Tax	Both	Gross revenue of retail electric sales within the city	No greater than 6% without a vote.
B&O Tax	Both	Value of goods and services	Varies by activity

Following are some questions and answers that may assist the public and taxing districts in their deliberations regarding PUD electric service.

- 1. Will taxing districts see any differences in revenue with a PUD?** Property taxes are calculated on a different basis than Privilege taxes. Variations may occur in specific taxing districts depending on where property is located. The allocation of Privilege tax collected occurs based on how the county treasurer decides to allocate the funds. If property values are used for allocation purposes, revenues should be proportional to those collected from Property tax.
- 2. What impact will schools see in regards to the loss of property taxes if a PUD were to provide service?** School revenues should not be impacted. RCW 54.28.080 requires a PUD that acquires the property of an IOU pay taxes directly to the school district for any outstanding bonded indebtedness. This statute specifically states that the PUD “ . . . shall, in addition to the tax imposed by this chapter, pay directly to the school district a proportion of all subsequent payments by the school district of principal and interest on said bonded indebtedness, . . . ”. In addition, 37.6% of funds collected by the state from Privilege tax go to the portion of the state general fund identified for public schools.
- 3. How does the Privilege tax work in relation to the Municipal tax currently being collected by some cities?** The Privilege tax and the Municipal tax are separate and distinct taxes. One is not impacted by the other. If cities are currently collecting the municipal tax from an IOU, they will continue to collect it if the IOU is replaced by a PUD.

4. How do Property taxes and Privilege taxes differ in their calculation and allocation?

Property taxes are based on property values as determined by an assessor. This information is then shared with the State of Washington Department of Revenue (DOR). The DOR then gathers additional information from the IOU such as personal property (large computer programming systems, vehicles, etc.) and calculates an equalized market value. The DOR then apportions the multi-state property taxes by taxing district and provides the results to the specific county assessor's office. Privilege taxes are revenue based so are determined by the amount of retail revenue collected by a PUD (this is true for generating assets as well although the Privilege tax is based on an imputed value of the power generated). Property taxes are allocated to taxing districts based on the property values within each taxing district. Privilege taxes are allocated to taxing districts on a method determined by the county treasurer. If a property value method is used then taxes received by a taxing district should be similar in nature to what is currently received. If some other allocation method is used, such as a revenue basis, then taxes to specific taxing districts may vary but the overall tax collected should be proportional. There is a provision in RCW 54.28.110 that would allow a PUD to ensure tax revenues, at the time property is acquired, be no less than before the property was acquired by a PUD.

In summary, the main variation in the calculation of taxes for IOUs and PUDs is between the Property tax and the Privilege tax. While the amount of taxes collected may vary, there are statutes currently in place to allow for the mitigation of tax collections should tax revenue decline from their level at the time a PUD would acquire the assets of an IOU.

Following are the details surrounding each tax and a more thorough explanation of the various taxes paid, as they have been outlined above.

ELECTRIC UTILITY TAXES for IOUs and PUDs

The Washington State tax revenue system relies primarily on property taxes and excise taxes. Both types of taxes are imposed upon the electric utility industry. Following is a summary of each tax imposed under state statute and how they are applied to both an IOU and a PUD.

Excise Taxes. Excise taxes are composed of a variety of taxes and reported to the State on a “Combined Excise Tax Return”. The State’s excise taxes most pertinent to this summary include the *Public Utility Tax (PUT)*, the *Business and Occupation Tax (B&O tax)* and the *Sales and Use Tax*. Depending upon the activity generating income one of these taxes may apply. Following is a discussion of each of these taxes.

Public Utility Tax. (RCW 82.16) The PUT is derived from the operation of both an IOU and a PUD. It is applied to the gross revenues received from providing electric service to consumers. The PUT tax rate is currently 3.873 % of gross revenues from the sale of electricity **regardless of whether the utility providing the electric service is an IOU or a PUD.** All of the PUT is deposited to the state General Fund. Certain smaller utilities may be eligible for the low density discount (RCW 82.16.053) on payment of the tax, depending upon the number of customers per mile. Such a determination must be made on a case by case basis. Other exemptions and deductions are available, as well, on a case-by-case basis.

Business and Occupation Tax. For electric utilities, the most common types of B&O taxes paid are for wholesaling, service and other activities and retailing. Again, these taxes apply **regardless of whether the utility providing the service is an IOU or a PUD.** These taxes are relatively minor in nature compared to other taxes, representing less than 1% of all taxes paid.

Sales and Use Tax. Sales and Use Tax are really one in the same. Use tax applies when a supplier/vendor should have charged sales tax but failed to do so.

Sales tax is paid on all goods and services acquired by a utility that are deemed sales taxable by the state. Sales tax is paid to suppliers/vendors **regardless of whether the utility purchasing the taxable goods or services is an IOU or a PUD.** The amount of the local city and/or county sales tax paid is dependent on where possession of the goods is taken or where taxable services are performed. **The local portion of the tax may be affected depending on this criteria and it may differ from an IOU to a PUD.** Sales taxes paid directly to suppliers/vendors are not reported on the Combined Excise Tax Return of the utility. It is the suppliers/vendors responsibility to report and pay these taxes to the State. Use taxes, by their nature, are reported on the Combined Excise Tax Return.

Any time a utility sells a tangible item, the sales tax would apply. The State’s sales tax rate is 6.5%. Added to that is the local city and/or county sales tax rate which varies by taxing location.

Property Tax Washington taxes privately owned real and personal property. IOUs are privately owned so do pay property tax. The property tax levied in 2007 allocated approximately 22% to the state general fund for education and 78% to the local taxing jurisdictions.

If the property is located in a single county it is locally assessed by the county assessor who determines the value. Typically, the local assessor revalues real property by conducting a physical inspection once every four years.

If the IOU's property is located in more than one county, the assessed value is determined by the Department of Revenue (DOR). The DOR values inter-county electric light and power companies annually. The DOR establishes the value of the property and certifies the value to the county assessor who in turn levies and collects the property tax at the county level, but identifies the monies by taxing district..

PUD Privilege Tax. (RCW 54.28) This tax is imposed upon PUDs only. Although not stated in the statute, the tax is intended to be in lieu of property tax since PUDs are governmental entities and do not pay property tax.

The PUD privilege tax applies to electric power sold by PUDs and is levied at 2.14% of revenues from the retail sale of electric energy. If a PUD owns generating facilities, then an imputed value of the kilowatt-hours (kWh) generated (4 mills times the kWh generated) is used to assess a 5.35% tax on the generating facility.

The PUD privilege tax collected by the State is distributed as follows:

- (1) Basic tax rate (i.e., 2 percent of gross revenues and 5 percent of first 4 mills)
 - 4% state general fund
 - 37.6 % state general fund for public schools
 - 62.4% counties to be further allocated as follows:

Receipts from the 2% tax on gross revenue go to those counties from which the sales to customers were made in the same proportion, and

Receipts from the 5% tax on the first 4 mills for both self-generated power and sales for resale are distributed based on the location of the dams and the reservoirs they create. In instance where the dams and reservoirs are located in more than one county, RCW 54.28.050 provides a complex distribution mechanism based on the total cost of the facilities to allocate the receipts among these counties.

The county treasurer shall further distribute amounts received under this distribution to all local taxing districts, except schools, in the most equitable manner (in most instances to approximately the distribution of property tax levies). Cities shall receive a minimum amount equal to 0.75 percent of the gross revenue derived by the PUD from the sale of energy within the city.

(2) Surtax (7 percent surtax which increases the basic rates to 2.14 percent and 5.35 percent)

- 100% state general fund

This difference between an IOU and a PUD becomes much less when the light and power businesses do not own generating facilities. In such an instance, a PUD has the higher tax obligation. This is because the PUD privilege tax on sales results in a higher effective tax rate for the PUD than for an IOU. Thus the lower distribution (62.4% vs. 78% above) to local jurisdictions is offset by the higher effective tax rate.

Certain sections of RCW 54.28 discuss the ways in which tax revenues of governments are protected when IOU facilities are purchased by a PUD. Please reference RCW 54.28.080, 54.28.110 and RCW 54.28.120 for further information on this subject. The text of those RCWs follows.

RCW 54.28.080

Additional tax for payment on bonded indebtedness of school districts.

Whenever any district acquires an operating property from any private person, firm, or corporation and a portion of the operating property is situated within the boundaries of any school district and at the time of such acquisition there is an outstanding bonded indebtedness of the school district, then the public utility district shall, in addition to the tax imposed by this chapter, pay directly to the school district a proportion of all subsequent payments by the school district of principal and interest on said bonded indebtedness, said additional payments to be computed and paid as follows: The amount of principal and interest required to be paid by the school district shall be multiplied by the percentage which the assessed value of the property acquired bore to the assessed value of the total property in the school district at the time of such acquisition. Such additional amounts shall be paid by the public utility district to the school district not less than fifteen days prior to the date that such principal and interest payments are required to be paid by the school district. In addition, any public utility district which acquires from any private person, firm, or corporation an operating property situated within a school district, is authorized to make voluntary payments to such school district for the use and benefit of the school district.

[1957 c 278 § 8. Prior: 1949 c 227 § 1(g); 1941 c 245 § 2; Rem. Supp. 1949 § 11616-2(g).]

RCW 54.28.110

Voluntary payments by district to taxing entity for removal of property from tax rolls.

Whenever, hereafter, property is removed from the tax rolls as a result of the acquisition of operating property or the construction of a generating plant by a public utility district, such

public utility district may make voluntary payments to any municipal corporation or other entity authorized to levy and collect taxes in an amount not to exceed the amount of tax revenues being received by such municipal corporation or other entity at the time of said acquisition or said construction and which are lost by such municipal corporation or other entity as a result of the acquisition of operating property or the construction of a generating plant by the public utility district: PROVIDED, That this section shall not apply to taxing districts as defined in RCW 54.28.010, and: PROVIDED FURTHER, That in the event any operating property so removed from the tax rolls is dismantled or partially dismantled the payment which may be paid hereunder shall be correspondingly reduced.

[1957 c 278 § 13.]

RCW 54.28.120

Amount of tax if district acquires electric utility property from public service company.

In the event any district hereafter purchases or otherwise acquires electric utility properties comprising all or a portion of an electric generation and/or distribution system from a public service company, as defined in RCW 80.04.010, the total amount of privilege taxes imposed under chapter 278, Laws of 1957 to be paid by the district annually on the combined operating property within each county where such utility property is located, irrespective of any other basis of levy contained in this chapter, will be not less than the combined total of the ad valorem taxes, based on regular levies, last levied against the electric utility property constituting the system so purchased or acquired plus the taxes paid by the district for the same year on the revenues of other operating property in the same county under terms of this chapter. If all or any portion of the property so acquired is subsequently sold, or if rates charged to purchasers of electric energy are reduced, the amount of privilege tax required under this section shall be proportionately reduced.

[1957 c 278 § 14.]

Municipal Tax (RCW 54.28.070) Cities have the authority to impose a privilege tax without voter approval of up to six (6) percent of gross revenues from the sale of electric energy within their city limits **regardless of whether the utility providing the electric service is an IOU or a PUD**. An amount greater than six (6) percent may be imposed by a vote of the people (see RCW 35.21.870).

CONCLUSION

There are many taxes paid by both IOUs, like PSE, and PUDs. These include the following:

- Public Utility Tax
- Privilege Tax (Only paid by PUD)
- Property Tax (Only paid by IOU)
- Sales/Use Tax
- Municipal Tax
- Business & Occupation Tax

The only state and local taxes that are significantly different between the two types of electric utilities are the Privilege tax and the property Tax. While the Privilege tax is revenue based and the Property tax is based on property values, the resulting taxing district revenues from each are currently proportional to one another. Also, there are provisions in the statutes, RCW 54.28.080, 54.28.110 and 54.28.120, which guarantee that the taxes paid by a PUD, when acquiring the assets of an IOU, will be no less than those paid by an IOU at the time the assets are acquired by a PUD.

In the case of sales tax revenue, the local city/county portion may be increased for the local community depending on the purchasing practices of the IOU that previously purchase goods and services. Such a change may actually be a benefit to certain local taxing districts.

Municipal taxes are paid by both entities and would only vary to the extent that there is a variation in revenues from an IOU to a PUD.

In conclusion, the potential for a PUD to provide electric service should be viewed positively by local taxing districts.

For more information, contact the Washington PUD Association, 212 Union Ave. SE, Olympia, WA 98501, (360) 741-2675, www.wpuda.org.