

**ALTERNATIVE WAYS TO PAY FOR A
CLEAN ENVIRONMENT**

WASHINGTON STATE DEPARTMENT OF REVENUE

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INTRODUCTION

We live in a beautiful state. We want to keep it beautiful. We want to keep our beaches uncontaminated by oil spills, our roadsides free from litter, our air clean, and our environment protected from hazardous substances.

For many years, Washington has imposed a variety of so-called environmental taxes that provide the vast majority of funds for the state programs directed to accomplishing these goals. All of the taxes are administered by the Department of Revenue. They include the oil spill tax (enacted in 1991), the litter tax (1971), the hazardous substance tax (1988), the wood stove fee (1988), and the petroleum products tax (1989). These environmental taxes are dedicated to fund specific programs operated by the Department of Ecology, such as contaminated site clean-up, oil spill response programs, and litter collection and recycling programs. The continued viability of many of these programs is dependent upon these taxes.

Because of our appreciation for our state and our concern about the adequacy of funding for environmental programs, the Department of Revenue independently conducted a study of the environmental taxes. This study began in the summer of 2000 as an internal analysis to clearly identify the problems surrounding the environmental taxes and then to explore whether there could be administrative or legislative improvements to the taxes, or altogether new alternatives for funding these important programs, that would resolve the perceived problems. As a result of that effort, the Department developed three proposals for consideration by the Legislature during the 2001 session, none of which were adopted. The Department remains committed to the idea that it is important to evaluate the funding sources that support the state's major environmental programs, so that the problems inherent in their make-up are recognized and addressed. To that end, we wish to share the results of our internal analysis with others for the purposes of exposing our alternatives to a wider audience and for fostering dialogue on these significant issues.

It is important to note that the Department's analysis was conducted solely from the perspective of our role as the agency responsible for administering these tax sources. Our analysis is limited to an examination of administrative problems we have observed and an exploration of possible solutions measured against what we believe to be sound tax policy principles. We recognize that there are other considerations to be taken into account in determining whether these particular tax sources are appropriate for the purposes for which they were enacted.

Problems

Our analysis began with identifying the tax administration problems or issues surrounding each of the environmental taxes. The problems we identified may be summarized as follows:

- For the foreseeable future the taxes will not be sufficient to maintain programs at current levels.
- The level of voluntary compliance is lower than for other, more broad-based, mainstream, taxes.
- It is difficult for taxpayers to identify what is subject to tax.
- Significant items and activities that contribute to the risk of an unclean environment are not subject to the environmental taxes.
- The amount of revenue received fluctuates considerably from year to year and accurate yields for future years cannot be projected with much confidence. The taxes are administratively complex and more costly to collect than other, more mainstream taxes.
- The taxes are susceptible to challenge on constitutional and other legal grounds.

Premises

Once the problems were identified and before we contemplated solutions or alternatives, we explored the premises, or characteristics, of a high quality tax system that could be used as a guide to measure present and alternative tax sources.

Well recognized attributes of a high quality tax system include the following:

- The tax system should fund the decisions made by the Legislature, not determine them.
- Revenue collections should not fluctuate dramatically.
- Receipts should be relatively easy to forecast.
- Taxpayers in similar situations should be treated similarly.
- Tax systems should not influence business decisions.
- Taxes should be easy to understand and minimize taxpayers' administrative costs of compliance.
- Taxes should be designed to minimize government costs of collection.

As with any set of principles they cannot all be fully achieved at the same time. Depending upon the particular circumstances for imposing a particular tax or series of taxes for a given purpose, some attributes are emphasized more than others. All should be kept in mind, however, and an attempt should be made to achieve each one as much as is possible. Within an effective tax system there is substantial room for proposals in addition to those based strictly on the above tax principles. In some instances, individual taxes can be designed to incorporate both key attributes of sound tax policy and the "polluter pays" principle. Such proposals would focus on developing a tax that operates similarly to other taxes within the Washington State tax system, such as the business and occupation tax or the sales and use tax, but is imposed on particular polluting business activities. A tax of this nature would be effective in raising revenue but may not

necessarily be effective in prohibiting the undesirable polluting activity. However, it is not clear that the current environmental taxes are successful in this regard. If we wish to discourage specific polluting activities, the most straightforward method is probably some combination of fees, fines, and penalties that are administered and imposed outside the tax structure. Inherent in this method is the distinction between a “fee” and a “tax,” each of which possesses a distinct legal construct. A fee is usually associated with payment for some identifiable benefit received. A tax is usually not associated with any specific benefit but is used to fund more general governmental programs.

Alternatives

After considering the premises and exploring various alternatives, it was concluded that a simple and comprehensive way to alleviate many of the problems associated with the current environmental taxes would be to replace them with a single, broad-based source of revenue.

The source of revenue could be in the form of an allocation of a certain percentage of existing business and occupation (B&O) and public utility (PUT) tax or sales tax revenues. Or, it could be in the form of a surtax on the B&O and PUT taxes or the sales tax. Another possibility would be to impose a tax on employers, based on the number of employees.

Using a tax or taxes that are broad in coverage would represent a large shift in the burden of paying environmental taxes. The shift is away from those specific industries viewed as contributing to environmental problems and toward a broader population. The broader population is the business community in the case of the B&O/PUT surtax and the employer tax. In the case of the sales tax surtax, the broader population is the business community and the general public.

The benefits of these broad-based solutions are:

- They are simple for both taxpayers and tax agencies to administer.
- They spread the cost of paying for a clean environment very widely.
- The rate of tax would be very low.
- The funding for environmental programs would be much more reliable and predictable.

In addition to these kinds of alternatives, the current environmental taxes could each be modified in ways that would improve their individual administration. This approach embodies both the principles of sound tax administration and the polluter pays principle. The Litter Tax Proposal and the Comprehensive Oil Tax Proposal (developed for the 2001 legislative session) reflect these combined principles. Both of these proposals impose a B&O tax on particular business activities and dedicate the revenue proceeds to existing environmental funds.

The following sections of this report provide detailed analysis of the problems and solutions the study team identified. First, the report discusses five major reform proposals, any one of which would materially change the environmental tax structure. Each of these proposals includes a

description of how it would meet the criteria of a high quality tax system, as well as some concerns that may be raised by stakeholders or policymakers. The next section addresses the issue from a more incremental approach. The current environmental taxes are analyzed individually and solutions are proposed that leave them substantially intact but modified. Finally, the report concludes with a summary of tax proposals developed during the 2001 legislative session.

BROAD-BASED ENVIRONMENTAL TAX PROPOSALS

This section discusses several broad-based environmental tax proposals. The framework for the discussion is to describe each proposal in terms of what it does and how it fits in with certain policy considerations. For all of these proposals, support from the Department of Ecology and other parties with a direct interest would be essential.

Policy Considerations

- Constitutional and Other Legal Issues – the proposal should not have constitutional or other legal problems.
- Simplicity – the proposal should be simpler to understand and administer than existing environmental tax programs.
- Administrative Costs – the cost of collection should be low.
- Existing Administration – a new administrative structure should not be necessary to implement the proposal.
- Dependable Funding Source – the proposal should raise at least as much money on an ongoing basis as the current taxes. The yearly yields should be relatively stable and, therefore, more reliable and predictable than existing sources.
- Broadly Based – the tax should fall upon as broad a group of taxpayers as possible. This will limit instability in the funding source and reduce the tax burden on individual taxpayers. This also acknowledges that the environment concerns everyone.
- I-601 – there should be an understanding of how the proposal interacts with the initiative, both as to the impact on the general fund spending limit, and the voting requirement to increase tax revenue. The proposal should not decrease the spending limit. There should be an awareness of the political problems should the proposal be impacted by the initiative.

Proposal One: B&O and PUT Surtax

Description: A simple surtax on all classifications of the business and occupation tax and the public utility tax.

Constitutional and Legal Issues: There are no apparent constitutional or other legal issues.

Simplicity: This proposal is extremely simple.

Administrative Costs: The cost of collection is very low, being folded into the costs already incurred in collecting the B&O and PUT taxes.

Existing Administration: No new administrative structure would be necessary.

Dependable Funding Source: The B&O and PUT taxes are dependable and productive and should raise enough money if the rate is set properly.

Broadly Based: The B&O and PUT cover essentially all sectors of the economy, except agriculture.

I-601: Under I-601, this tax increase would require a two-thirds majority in the Legislature. It would not impact I-601's spending limit if the tax receipts are deposited into the same accounts, outside the general fund, as the current environmental taxes. The spending limit would be increased if the accounts were transferred into the general fund.

Other Concerns: This would be a shift within the business community of the burden of paying for environmental programs.

To maintain current levels of funding, the surtax rate would be 2.95 percent. Rates would be raised as follows:

<u>Classification</u>	<u>Current Rate</u>	<u>Rate with Surtax</u>	<u>Increase</u>
Service and other, etc.	0.015	0.01544	0.00044
Manufacturing/Wholesaling, etc.	0.00484	0.00498	0.00014
Retailing, etc.	0.00471	0.00485	0.00014
Manufacturing fresh fruit, etc.	0.00138	0.00142	0.00004
Travel agent, etc.	0.00275	0.00283	0.00008
Disposal of low level waste	0.033	0.0397	0.0067
Water distribution	0.05029	0.05177	0.00148
Sewer collection, gas distribution	0.03852	0.03966	0.00114
Power	0.03873	0.03987	0.00114
Motor transportation, etc.	0.01926	0.01983	0.00057
Urban transportation, etc.	0.00642	0.00661	0.00019

Proposal Two: Dedicate a Portion of the B&O and PUT Tax

Description: Dedicate a portion (percentage) of B&O and PUT tax receipts to the accounts into which the current environmental taxes are now deposited.

Constitutional and Legal Issues: There are no apparent constitutional or other legal issues.

Simplicity: The proposal is extremely simple.

Administrative Costs: There is no additional cost of collection.

Existing Administration: No new administrative structure would be necessary.

Dependable Funding Source: The B&O tax is a reliable and productive source of funds. The amount earmarked should provide enough money.

Broadly Based: The B&O and PUT cover essentially all sectors of the economy, except for agriculture.

I-601: There are no apparent I-601 implications if the money is earmarked to the current environmental tax accounts, outside the general fund. If the accounts were transferred into the general fund, the I-601 spending limit would be increased.

Other Concerns: It would reduce general fund revenue available for other state programs.

Proposal Three: Sales Tax Surtax

Description: A simple surtax on the state retail sales tax rate.

Constitutional and Legal Issues: There are no apparent constitutional or legal issues.

Simplicity: The proposal would be much easier to understand and administer than the current environmental taxes.

Administrative Costs: There would be a relatively small one time cost to change the combined excise tax return and to prepare and distribute new collection schedules to retailers.

Existing Administration: No new administrative structure would be needed.

Dependable Funding Source: The sales tax is not as stable as the B&O tax, but should be able to raise the necessary money over the long term if the rate is set correctly.

Broadly Based: The sales tax is paid by a broader range of people than either payroll taxes or the B&O tax.

Spending Limit: I-601 would require a two-thirds majority in the Legislature to impose this surtax. The I-601 spending limit would not be affected if the surtax were deposited in the same accounts, outside the general fund, as the current environmental taxes receipts. The spending limit would be increased if the accounts were transferred into the general fund.

Other Concerns: Washington already has one of the highest sales tax rates in the country. This proposal would raise the rate further and increase the regressivity of our tax structure.

To maintain current levels of funding, the sales tax rate would be raised from 6.5 percent to 6.6 percent.

Proposal Four: Dedicate a Portion of the Sales Tax

Description: Earmark a portion (percentage) of sales tax receipts to the accounts into which the current environmental taxes are now deposited.

Constitutional and Legal Issues: No apparent constitutional or other legal issues.

Simplicity: This is extremely simple.

Administrative Costs: The cost of collection would already be incurred as part of regular sales tax collection.

Existing Administration: No new administrative structure would be needed.

Dependable Funding Source: The sales tax is not as stable as the B&O tax, but should be able to raise the necessary money over the long term.

Broadly Based: The sales tax is very broadly based.

I-601: There are no apparent I-601 implications if the money is earmarked to the current environmental tax accounts, outside the general fund. If the accounts were transferred into the general fund, the I-601 spending limit would be increased.

Other Concerns: It would reduce general fund revenue available for other state programs.

Proposal Five: Payroll Tax

Description: Impose a tax on employers that piggybacks on the payroll tax that pays for unemployment compensation.

Constitutional and Legal Issues: There are no apparent issues. Our understanding is that as long as the state pays the administrative costs, there would be no objections from the federal government.

Simplicity: This is very simple. It would just involve one additional line or entry for employers already filing an unemployment tax return.

Administrative Costs: The costs of collection should be very low because the tax would be collected along with a tax that has an existing administrative structure.

Existing Administration: No new administrative structure would be necessary. However, the employment security department might have to take some extra steps to make sure the tax was deposited into the correct accounts or funds in the correct proportion.

Dependable Funding Source: The source should be fairly reliable absent a drastic drop in employment. Assuming a relatively stable employment base, the amount raised should be sufficient if the proper rate of tax is chosen.

Broadly Based: All employers in the state who pay for unemployment insurance is a very broad base.

I-601: This would be a new tax and would require a two-thirds majority in the Legislature under 601. It would not impact the 601 spending limit if deposited into the same accounts as the current environmental taxes because those accounts are outside of the general fund. If the accounts were transferred into the general fund, the I-601 spending limit would be increased.

To maintain current levels of funding, an annual tax of \$23.70 per employee would be required.

Other Concerns: This would shift the tax burden to employers. The tax would not be used for an employment-related purpose. The support of the Employment Security Department would be needed for the proposal to move forward. Also, the tax may not be as productive during times of economic recession as other sources.

CURRENT DEDICATED FUND ENVIRONMENTAL TAXES

Any number of policy factors may make the choice of a broad-based alternative impractical at this time. If that is the case, decisions may still be made to simplify and improve current environmental taxes that will meet many of the sound tax administration goals reflected in the broad-based approaches while preserving the polluter pays principle encapsulated in the current environmental taxes. Proposals for modifying some of the individual funding sources are offered below.

Litter Tax

Tax base. The litter tax has a unique base. The base is a list of targeted items deemed in 1971 to most likely contribute to the litter problem in the state. This is a “polluter pays” type of tax. The targeted products consist primarily of items most commonly used by individuals, as opposed to businesses. This unique tax base creates confusion for taxpayers and requires extensive education efforts by the Department.

Rate. The tax rate is 0.015 percent times the gross amount of income generated by the targeted products through manufacturing, wholesaling, and retailing. One million dollars in sales generate \$150.00 in tax revenue ($\$1,000,000 \times .00015 = \150.00). Some stakeholders believe that the tax rate should be increased so that the amount of tax collected is worth the effort expended to report and collect it.

Compliance. In its first biennial report to the Legislature on compliance with the litter tax laws, the Department estimated that there was an 18.7 percent non-compliance rate for the period ending December 31, 1998. The Department’s second biennial study of litter tax compliance, released in February 2001, shows that non-compliance found through enforcement is 13.5%. Estimated undetected noncompliance is 26.5 percent for a total estimated non-compliance of 40 percent. The non-compliance rate for all taxes administered by the Department is 3.4 percent.

Cost to administer. The litter tax’s unique tax base creates confusion for taxpayers and requires extensive education efforts by the Department, creating costs to educate taxpayers and Department employees. There have been many instances where a taxpayer has properly reported all excise taxes, except for litter tax. The amount of unpaid litter tax is often so small that it is far outweighed by the cost of pursuing collection.

Revenue fluctuations. Litter tax revenues are used by the Department of Ecology for youth litter patrol programs (highway roadside crews) and for public education and awareness programs relating to litter control and recycling. Tax collections have been up and down over the last 10 years and, as a result, program levels have had to be adjusted accordingly.

Recent Collections

Fiscal Year	Collections (\$000)	% Change from Prior Year
2000	\$5,851	-14.3 %
1999	6,826	43.5
1998	4,758	-9.1
1997	5,236	11.8
1996	4,684	12.6
1995	4,161	9.0
1994	3,819	-13.8
1993	4,431	7.4
1992	4,125	10.4
1991	3,738	15.7
1990	3,230	-0.2
1989	3,237	5.5

Because economic fluctuations have been relatively minor and the categories on which the tax is collected are fairly constant, there should be a more direct relationship between the growth in the economy and the revenues collected from litter tax.

Industry point of view. Stakeholders who were interviewed repeated one consistent point: the items subject to the litter tax under the list adopted by statute in 1971 do not correspond to the items of litter collected from highways and public places in our state. There is a disconnect between the tax base and the litter problem.

Possible alternative. Replace the litter tax with a surcharge on the business and occupation tax paid by retailers. To raise the same amount of revenue as the current tax, the business and occupation tax rate paid by retailers would change from 0.00471 to 0.004772. If additional revenue were desired, the rate could be set accordingly. While this would broaden the base somewhat, the tax would actually better correspond to the litter problem. Most of the litter found on the roads is purchased at retail. This alternative would tax sellers of construction materials, tires, automobile parts, and other categories of items which contribute greatly to the litter problem and which are not currently in the tax base.

Concerns with alternative. There may be opposition from the original stakeholders and from new taxpayers.

Wood Stove Fee

Vendors of wood stoves collect a fee of \$30 on each sale. The revenues are deposited into the Wood Stove Education and Enforcement Account used by the Department of Ecology to educate consumers about the effects of wood stove smoke upon air quality. The wood stove fee does not experience the problems inherent with the other environmental taxes and therefore has not been

analyzed for purposes of developing an alternative source of revenue. Moreover, the statute allows the Department of Ecology to adjust the fee annually to account for inflation.

However, the fee does suffer from its own unique problem and that is the problem of success. As the education efforts by the Department of Ecology have successfully advised consumers of the harmful effect of wood stove smoke on air quality, sales of wood stoves have declined and the receipts from this fee have dropped dramatically. From 1993 to 1998 revenues declined by 60 percent. Even though fewer consumers are purchasing wood stoves the education efforts need to be maintained; therefore, funds must continue to be generated. For that reason, replacement for the wood stove fee revenues is wrapped into the comprehensive alternative package.

Recent Collections

Fiscal Year	Collections	% Change from Prior Year
2000	\$243,210	-14.5 %
1999	284,460	6.1
1998	268,094	12.5
1997	238,286	-51.4
1996	489,715	--

OIL RELATED TAXES

This portion of the report first describes the taxes that relate to oil and oil products. It then offers broad-based alternatives to the problems discussed and then goes on to propose individual alternatives for those taxes.

Hazardous Substance Tax

Description of the Tax. The hazardous substance tax (HST) is a privilege tax that is imposed on the first possession of certain “hazardous” items within the state. Hazardous substances, for the purposes of the tax, include petroleum products, pesticides, and substances found on the federal CERCLA (Comprehensive Environmental Response, Compensation, and Liability Act) lists as of March 1, 1989. The lists currently contain about 15,000 items classified as hazardous. A tax on hazardous substances has been in place since 1989, when voters approved Initiative 97.

The tax rate is 0.7 percent and the tax measure is the wholesale value of the hazardous substance. The collected revenues are deposited into two accounts. The state toxics control account, which receives 47.1 percent, is administered by the Department of Ecology for hazardous waste management and other projects. The local toxics control account, which receives 52.9 percent, is also administered by the Department of Ecology to provide grants to local government for the same purposes.

Revenue Fluctuations. Collections have varied widely.

Recent Collections

Fiscal Year	Collections (\$000)	% Change from Prior Year
2000	\$49,472	50.1 %
1999	32,966	-24.0
1998	43,398	-14.2
1997	50,570	24.2
1996	40,703	4.8
1995	38,843	12.8
1994	34,445	-12.4
1993	39,333	7.7
1992	36,519	-21.0
1991	46,227	10.0
1990	42,039	80.1
1989	23,343	--

Issues and Problems.

- The tax is product-based. The lists of products subject to the tax currently contain over 15,000 specific items that a taxpayer and the Department of Revenue must examine. Not only is identifying which inventory items are actually subject to the tax difficult but once the items are identified the sales revenues of those items must be distinguished from total sales revenues. In addition, the section of the statute regarding the CERCLA portion of the hazardous substance lists creates ongoing problems. The statute declares that anything on the CERCLA lists as of March 1, 1989, is hazardous but it does not provide any allowance for later changes in the lists. Since 1989, the federal government has removed some items from the CERCLA lists and has added others. The Department of Revenue is asserting tax on the items listed on the March 1, 1989, CERCLA lists in accordance with the statute.¹
- There are constitutional roadblocks to amending the HST list so that it would track federal CERCLA changes as they occur. It may be an improper or unconstitutional delegation of legislative authority for a state to allow the federal government to establish

¹ On September 19, 2000, the State of Washington Board of Tax Appeals rendered a final decision in the matter of Tessengerlo Kerley, Inc. v. Department of Revenue, Docket No. 55090. The Board concluded that the taxpayer was entitled to a refund of taxes paid on its possession of ammonium thiosulfate solution, despite the fact that the substance was listed on the March 1, 1989, CERCLA lists. The Board found that, through revocation of the original listing of the substance six months after March 1, 1989, the EPA was retroactively voiding its original listing. The Board determined that the EPA's revocation had the same effect as though the listing of the substance had never occurred.

As of the publication date of this report, the Department has taken this decision under consideration and is weighing the legal options available.

in a federal publication the items upon which a state may assert tax.

- Since the tax is product-based, it is difficult to identify which taxpayers have the duty to pay the HST.
- There is a high rate of noncompliance for the HST, 6.3 percent; the third highest rate for any tax.
- The tax is not uniformly applied: non-business people are exempt from the HST on chemicals for home use, even though individuals use and dump any number of hazardous substances.
- Petroleum products are subject to the oil spill taxes and the petroleum products tax as well as the HST. This may be interpreted as imposing a larger tax burden on petroleum businesses than other types of businesses and individuals that also use hazardous substances.
- Due to the complexity of the tax and the high rate of non-compliance, revenue for the HST accounts is unpredictable and unreliable. In addition, audits (particularly of large fuel companies) occasionally result in huge downward adjustments in projected HST revenues. Because the Department of Ecology and other agencies rely on the collection of the HST for day-to-day program management, these fluctuations in revenue create fiscal planning difficulties.

Oil Spill Tax

Description of the Tax. The oil spill tax encompasses two separate but related taxes: the oil spill response tax and the oil spill administration tax. The oil spill response tax and the oil spill administration tax are imposed on the privilege of receiving crude oil or petroleum products at a marine terminal within this state from a waterborne vessel or barge operating in the navigable waters of the state. The owner of taxable products, immediately after receipt of the products into storage tanks at a marine terminal, is liable for the tax. There are at least 39 large oil handling facilities and transmission pipelines within the state.

A one-cent per barrel tax on crude oil or petroleum products is deposited into the oil spill response account. This account is used to fund state response costs of oil spills that involve cleanup costs in excess of \$50,000. A four-cents per barrel tax is deposited into the oil spill administration account. This account is used to fund oil spill prevention, response, and restoration programs, administrative costs, and the tax collection costs of the Department of Revenue.

Revenue Fluctuations. The revenue from the oil spill tax has been highly unstable since inception of the tax.

Recent Collections

Fiscal Year	Collections (\$000)	% Change from Prior Year
2000	\$5,664	85.4 %
1999	3,055	-55.6
1998	6,885	49.7
1997	4,600	-25.2
1996	6,151	104.3
1995	3,011	-45.7
1994	5,545	-3.9
1993	5,773	21.6
1992	4,749	--

Issues and Problems. There has been some confusion about the tax base. Initially, some taxpayers significantly overpaid the tax. They apparently did not understand that they were eligible to take a credit for exported product. This situation led to overpayments, which subsequently led to large credits. These circumstances have made it difficult to accurately forecast future receipts/balances in the two accounts.

- In recent years the tax base has declined because of the large number of export tax credits taken and the increase in oil being imported into the state via pipeline.
- Oil that comes into the state via pipeline is not subject to this tax, even though there have been pipeline accidents and spills.
- Tanker trucks that transport oil within and through the state are not subject to the tax.
- Tax is volume based, **not** value based, and is not responsive to inflation.
- Tax is reported on a separate return that is not compatible with the other taxes administered by the Department of Revenue.
- There is litigation pending that challenges the constitutionality and legality of the tax on the basis it violates the Interstate Commerce and Import/Export clauses of the United States Constitution.
- The tax is paid when the product is received into the storage tank. However, the product may not be exported during the same year. Also, the exporter who is taking the credit is not necessarily the same entity that paid the tax on the product when it first arrived in the state.

Petroleum Products Tax

The petroleum products tax is imposed on the privilege of possessing petroleum products in the state. The revenue is deposited in the Pollution Control Liability Trust Account and funds insurance related to leakage from underground storage tanks. The tax has been suspended for several years because money in the account has been above the statutory threshold at which collection is no longer mandated.

Revenue Fluctuations. Although the tax is currently not being collected, the revenue history shows the same fluctuations which plague other taxes under review in this report.

Recent Collections

Fiscal Year	Collections (\$000)	% Change from Prior Year
2000	--	--
1999	--	--
1998	--	--
1997	--	--
1996	--	--
1995	--	--
1994	--	--
1993	\$5,139	-61.50 %
1992	13,346	-20
1991	16,682	26
1990	13,236	--
1989	--	--

Proposed Alternative. No specific alternative is proposed for this tax. However, this tax is proposed to be eliminated as part of the comprehensive oil related alternatives.

Broad-Based Alternatives for Oil Related Taxes

“Upon Receipt” Tax Related to Petroleum Products

Combine all taxes based on petroleum products into one tax. Assess one tax on all crude oil and petroleum received in the state. The tax would be assessed against the person or entity that first receives possession of the petroleum product. To maintain the current level of funding, the rate of tax would be 0.76 percent of the value of the product. The purpose of the tax would be to prevent oil spills, to pay for clean-up costs related to oil spills, and to respond to other ground and water contamination.

Components of Alternative:

- The tax would combine the petroleum products portion of the HST, the oil spill tax, and the petroleum products tax. One new tax would be created from four existing taxes: the HST, two oil spill taxes, and one petroleum products tax.
- The tax on petroleum products will be removed from the HST. The HST tax would then be asserted on chemicals, pesticides, and the items listed on the CERCLA lists.
- Impose the tax on petroleum products brought into the state via pipelines and oil tank trucks.
- Remove the export credit.
- Include in statute the priority in which the revenues in a new “petroleum tax” fund are to be allocated, preferably on a percentage basis.
- Determine the levels of the funds to be combined to ensure that the taxes to be collected will not exceed current levels. The combined total shall be the total amount of the new tax to be collected. If the total revenue in the account exceeds this amount, the tax rate will be reduced. On the other hand, if additional funding were desired, the rate could be set accordingly.
- Update the date of the CERCLA lists used in the statute to the present.
- The tax is product based, so only those persons involved in petroleum will be required to pay the tax. The taxpayers will be easier to identify and educate.
- This combined tax would create one incidence of tax on petroleum products in the state, regardless of the method by which these products arrive in the state and who receives the products.
- Change the basis for assessment of the oil spill tax from volume to value.

Concerns. Industry will oppose the elimination of the export credit.

“At the Rack” Tax Related to Petroleum Products

Combine all taxes based on petroleum products into one tax. Assert one tax on all product placed at the rack (distribution facilities). The tax would be assessed against the person or entity that owns the product when it is placed at the rack, applying a rate of tax against the number of gallons at the rack. To maintain current levels of funding, a tax of approximately one cent per gallon would be needed. The purpose of the tax would be to prevent oil spills, to pay for clean-up costs related to oil spills, and to respond to other ground and water contamination.

Components of Alternative:

- The tax would combine the petroleum products portion of the HST, the oil spill tax, and the petroleum products tax. One new tax would be created from four existing taxes: the HST, two oil spill taxes, and one petroleum products tax.
- The tax would be applied by assessing the tax rate against the number of gallons at the rack.
- Include in statute the priority in which the revenues in a new “petroleum tax” fund are to be allocated, preferably on a percentage basis.
- Determine the levels of the funds to be combined to ensure that the taxes to be collected will not exceed current levels. The combined total shall be the total amount of the new tax to be collected. If the total revenue in the account exceeds this amount, the tax rate will be reduced. On the other hand, if additional funding were desired, the rate could be set accordingly.
- This combined tax would create one incidence of tax on petroleum products in the state, regardless of the method by which these products arrive in the state and who receives the products.
- Update the date of the CERCLA lists used in the statute to the present.
- The tax is product based, so only those persons involved in petroleum will be required to pay the tax. The taxpayers will be easier to identify and educate.
- The tax on petroleum products will be removed from the HST. The HST tax would then be asserted on chemicals, pesticides, and the items listed on the CERCLA lists.

Concerns. Implementation of this proposal might require an amendment to the State Constitution because of a provision that taxes on fuel for road use be used for road purposes. Another concern is that this would represent increased direct taxation of the consumers.

Individual Alternatives for Oil Related Taxes

Possible alternatives for the hazardous substance tax.

- A) *Remove the exemption for non-business use of hazardous chemicals and the exemption for retailers possessing small amounts of hazardous substances for sale to consumers (less than \$1000 value per hazardous substance).*

The intent of the initiative that enacted the HST was to ensure that all persons share in the rights and responsibilities associated with maintaining a clean environment. Individuals as well as businesses share these rights and responsibilities. The exemptions for home use of hazardous substances and for retailers who sell these substances to individual consumers should be removed so that all hazardous substances, no matter who the end user is, are taxed once in this state. The administration of the tax in this form would be easier for the Department of Revenue and for the businesses that are responsible for collecting the HST. In effect, all in-state wholesale sales of hazardous substances would be taxable regardless of the purchaser or amount of inventory.

This proposal would cause previously exempt persons and vendors to pay the HST. Because there may be administrative and/or political issues associated with this proposal, further study and consultation with stakeholders and other state agencies is necessary.

B) Change the date listed in the statute regarding the CERCLA lists.

If the statute were to refer to a more current CERCLA listing, at least the problem of identifying what products are “hazardous substances” would be eased. This would require a simple statutory amendment.

Possible alternatives for the oil spill tax.

A) Include pipelines and tanker trucks in the tax base.

There are currently three pipelines that bring oil into the state: Trans Mountain/Olympic, Yellowstone, and Chevron. The pipelines respectively run from Canada south along the I-5 corridor adjacent to Puget Sound, from Spokane to Moses Lake, and from Utah into the Tri-Cities area where it crosses the Columbia River. If the intent of the tax is to prevent and clean up spills, it seems logical to tax all sources from which oil is shipped into and through the state. The tax could still be imposed on the volume of the oil received in the state and a credit for oil that is exported could still be taken. As to pipelines, the volume of oil could be measured at the point of entry and then again upon exit from the state.

Pipeline companies and the owners of oil tanker trucks will be strongly opposed to being subject to a new tax. There may also be constitutional problems related to the interstate commerce clause.

B) Change the tax base from volume to value.

If the tax were asserted on the value of the crude oil and petroleum product, the tax would be more like mainstream taxes. This may eliminate the need for a separate return to be filed by taxpayers and processed by the Department of Revenue. Most states’ taxes are based on value, not volume.

However, the price of oil fluctuates constantly so the ability to forecast account revenues will be difficult. Additionally, the purpose of the tax is to prevent and clean-up oil spills. Thus, the greater the volume of crude oil and petroleum product the more likelihood of a spill, so taxing the volume of crude oil received in the state does seem to have a logical basis.

Current taxpayers can be expected to oppose a shift from volume to value.

C) Limit the export credit to the same year (or biennium) in which the tax was paid and limit it to the entity that paid the tax.

Limiting the duration and availability of the export credit may create more predictability and certainty in the oil spill account balances. More money may accumulate in the oil spill response fund so that if a large spill occurs there will be sufficient money in the account to pay the clean-up costs.

By allowing only the entity that paid the oil spill tax to take the export credit, there will be a direct correlation between the taxed entity and the entity claiming the credit. It will be easy to predict who will claim the credit – this may ease administration of the tax.

Current taxpayers may question the fairness of losing the export credit merely because the incidence of tax and the incidence of export occur in two different biennia.

D) Eliminate the export credit and reduce the rate so the amount of money in the fund remains revenue neutral.

Eliminate the export credit. Elimination of the credit will relieve administrative complexity for both the Department and for taxpayers; the complexity is inherent in that under current law the person or entity claiming the credit is not necessarily the same person or entity that paid the oil spill tax upon first possession. Determine how much revenue is needed to fund the oil spill accounts and lower the rate of tax imposed, because without the export credit the amount in the fund should be predictable.

The industry will strongly oppose the elimination of the export credit.

E) Combine the Oil Spill and Petroleum Products Taxes.

Assert one tax on crude oil and petroleum shipped into the state via ship, pipeline, or tanker truck. The first person or entity that receives possession of the crude oil and petroleum product is liable for the tax. The purpose of the tax would be preventing oil spills and paying for clean-up costs related to oil spills.

Components of Alternative:

- The tax will combine the oil spill and petroleum products taxes. One new tax will be created from three existing taxes: two oil spill taxes and one petroleum products tax.
- Change the basis for assessment of the oil spill tax from volume to value.
- Impose the tax on pipelines and oil tank trucks.
- Remove the export credit.
- Include in statute the priority in which the revenues in a new “petroleum tax” fund are to be allocated, preferably on a percentage basis.
- Determine the levels of the funds to be combined to ensure that the taxes to be collected will not exceed current levels. The combined total shall be the total amount of the new tax to be collected. If the total revenue in the account exceeds this amount, the tax rate will be reduced.
- The tax is product based, so only those persons involved in petroleum will be required to pay the tax. The taxpayers will be easier to identify and educate.
- This combined tax would be on petroleum products in the state, regardless of the method by which these products arrive in the state and who receives the products.

2001 LEGISLATIVE SESSION

After completing the preceding portion of this report the Department of Revenue developed three legislative proposals that incorporate and develop some of the concepts discussed.

Litter Tax Proposal. This proposed legislation would have replaced the existing litter tax and the non-petroleum products portion of the hazardous substance tax with a B&O surcharge. The department added the non-petroleum products portion of the hazardous substance tax to the new litter tax because both existing taxes suffer from similar problems. Both taxes are based on specific inventory items rather than on general gross receipts which places a significant record keeping burden on the taxpayer. Further, this portion of the hazardous substance tax has the third highest non-compliance rate, in excess of 6.3 percent, following the use tax and the litter tax.

The B&O surcharge proposed was six one-thousandths of one percent (.00006) added to the rate paid by retailers, wholesalers, and drug warehouse. Credits would have been allowed for retail sales of services that do not entail selling tangible personal property. The revenues generated by the surcharge were to be deposited proportionately between the two toxics accounts currently funded by the hazardous substance tax and the waste reduction, recycling, and litter control account currently funded by the litter tax.

Hazardous Substance Tax Proposal. To address the issue of outdated references to federal law, the Departments of Revenue and Ecology proposed a bill that updated the federal law references and excluded certain non-compound metals. The bill failed to pass for various reasons including the unfortunate circumstance that the hearing before the Senate was scheduled on the day of the earthquake. The two departments have offered the same bill in the 2002 session (SB 6060).

Comprehensive Oil Tax Proposal. The Department developed but did not run a bill that replaced the petroleum portion of the hazardous substance tax, the oil spill taxes, and the petroleum products tax with a new B&O activity tax payable by oil product importers and refiners. The proposal provided for account balance triggers to increase or decrease the rate of tax to parallel the account caps contained in current law for the pollution liability insurance program trust account and the oil spill response account. Revenues were to be distributed ratably to the affected current accounts. The proposal spread the tax to new taxpayers such as the owners and operators of the petroleum pipelines.

Even though the Department of Revenue is not running either the Litter Tax Proposal or the Comprehensive Oil Tax Proposal in the 2002 session, it continues to believe the tax policy positions reflected in each bill are viable. In an appropriate legislative session and given the opportunity to solicit significant stakeholder input, the Department anticipates developing viable legislation in the future that incorporates options explored in this report.

CONCLUSION

This report presents a multitude of tax policy considerations in the area of Washington State's environmental taxes. For many years, Washington has had programs in place to attempt to achieve the goals of a clean environment. For the reasons mentioned, there are flaws and deficiencies in the present funding system that policymakers might choose to address. This report has laid out alternatives that would replace existing sources and others of a more incremental nature that would improve tax administration and compliance. Perhaps more importantly, some of the alternatives proposed in this report would appropriately derive revenues from sources that both contribute to environmental risks and benefit from a clean environment. These sources would also provide a more stable revenue stream for the agencies administering the environmental programs.

It is often the case that sound tax policy might not perfectly align with other policy considerations. However, advocacy of sound tax policy can, over the course of time, contribute to the political/policy dialogue and shape options for change. We hope that the information in this report does contribute in a positive way to the dialogue and policymaking in this area.