Energy Taxes are Changing

You can minimize their impact on your budget

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State and local governments receive significant revenue through utilities, due both to taxes on power sales and on utility property. When a state deregulates, it may alter how energy taxes are charged, though such changes are not part of the deregulation law. As a result, unsuspecting customers may find themselves paying less for power and more for taxes.

ENERGY TAX BASICS

Power may be taxed in various ways:

- as a percentage of a total electric bill (as sales and/or gross receipts taxes)
- as a $/kWh charge, regardless of the actual price of the power
- as taxes on utility property taxes, which become part of the utility's regulated rate (even after deregulation, utility rates on transmission and distribution remain regulated)

Together, these taxes may add 10%-15% (or higher) to your total power bill. Deregulation rarely offers more than 5%-15% savings, so customers need to keep abreast of tax changes that could threaten those savings.

DELIVERY OF POWER MAY BE TAXED DIFFERENTLY

Under some sales tax laws, delivery of energy may be taxed separately from the commodity you buy from a power marketer. In New York City, starting in 1997, sales taxes on delivery became exempt when bought separately from the power itself. Since delivery charges (also called "T&D" for transmission and distribution) make up 70% of the bill, dropping the sales tax increased total savings. But customers who continued to buy power from their utility did not see those tax savings. That difference was maintained for nearly 3 years, then dropped, and is now being phased back in over the next 4 years.

PLACE OF PURCHASE MAY AFFECT TAXES

At what point do you **own** your electricity? You may think it's at the meter where the power is being measured, but a marketer may buy power on your behalf from a variety of locations, both in and out of your state.

In some cases, taking title to it out of state may avoid taxation. During the early days of natural gas deregulation, many customers took title to their gas in the Gulf of Mexico and avoided sales tax on that commodity. To recapture that revenue, some (but not all) states (such as New York and Montana) have created special energy importer taxes on energy bought out of state.

PERCENTAGE VERSUS DIRECT TAXES

Some states (e.g., New Jersey) replaced percentage-based sales taxes with a $/kWh tax that is constant regardless of commodity power prices. When governments make such changes, they may apply a concept called "revenue neutrality" to keep the total revenue the same as before. In so doing, however, they may also shift the burden among different customers.

Belleville, Illinois, for example, plans to charge a flat $/kWh excise tax to make up for any power price cuts that might reduce its revenue under a percentage-based tax. The new tax would vary across 10 types of customers. **Residentials would see a drop in taxes less than .01%, but an industrial could see his power taxes rise by about 14%.** In at least one case, a switch to a $/kWh tax also involved eliminating the exemption for nonprofit customers (such as schools and hospitals) by making them pay the new tax.

One's load factor may also influence the impact a new tax may have on his budget. Customers with high load factors (yielding lower average power pricing) may find themselves paying more under a $/kWh tax. Those with high peak demands and low kWh consumption (e.g., overcooled 9-to-5 offices) could pay less tax than before.

Percentage-style taxes, however, act as multipliers on high summer rates, such as were seen in San Diego and New York City in the summer of 2000. $/kWh taxes remain flat even when wholesale power prices go through the roof. The form that taxation takes can therefore have serious bottom line implications.

DOES YOUR BUSINESS PAY A LOT IN PROPERTY TAXES?

Utility-owned power plants usually pay much higher property tax rates than similar non-utility industrial property. Until recently, Montana taxed utility property at 12% of assessed value, but only charged 3.85% of assessed value for most other industrial property. Ohio charges utilities on 88% of assessed value, while other industrial property pays on a 25% rate.

When power companies sell off their generating plants, they are no longer taxable as "utility-owned" property, potentially cutting their tax rate. This also happens when utilities simply write down the value of power plants to reflect their real commercial value. That value difference often forms the basis for their stranded costs claims. Since governments want that revenue, taxes must rise somewhere else, typically on other commercial property.

HOW TO FIGHT CITY HALL

Don't be a sap. Wherever deregulation is under discussion, push your trade associations and/or attorneys to watch the tax issues closely.

Don't let others try to shift the burden to you, or otherwise jeopardize your savings. If power prices become volatile, governments charging a percentage-based tax stand to make a bundle. If that happens, *call for tax abatements or reductions by pointing out that "the state is gouging the customer" by making a bad situation even worse.*

Make your energy contracts tax-sensitive. If taxes drop (especially those charged at the wholesale level to your marketer), the price you pay should reflect that change. The only way to enforce that rule is to ensure that it is written into your energy contract. Don't expect your state's Public Utility Commission to help you; taxes are typically out of its jurisdiction. *Require your marketer to inform you any time a tax change occurs. If he fails to do so, or tries to hold onto the savings, call your attorney.*

Keep an eye on your neighborhood. If your firm owns a lot of taxable property (e.g., a mall), keep an eye on what's going on with utility property in your area. If power plants may be sold, you need to know how that action could force your property taxes to rise to make up for a loss in revenue. *To avoid taking a big hit, try to get your tax rate "grandfathered" so that only new businesses are forced to "pick up the tab."*

Try to immunize yourself against energy taxes. Taxes are hard to avoid (lawyers make sure of that) but loopholes may exempt part of your operation from energy taxes. Most tax laws, for example, do not allow double sales taxation for the same item. If a sales tax will be charged when a finished product is sold at retail, some states offer an exemption for the energy that went into the product. Otherwise, tax would be charged twice on the same raw material. Consider the power used in the development of software (e.g., for the computers used by the developers): the product will later be sold (and taxed) at retail, so why isn't that power tax-exempt when first bought by the software maker?

Under that interpretation, the same could be said for power used to produce an information product, such as an electronic newsletter. What, then, about the power used to produce a cable TV show, or a Web site? When those tax laws were written, it's unlikely that the bean counters who wrote them had any concept of non-physical products. While legislators might later eliminate that loophole, such changes may take years—during which you are pocketing the difference. *A little imagination may find other options through a careful (and expansive) review of the tax law in your state.*

CONCLUSION

States and cities are monitoring deregulation hearings with an eye to ensuring their continued tax revenue—even if that means keeping your electric bills high. The time to speak out is not after the changes have been made, but rather during those discussions surrounding utility restructuring.

This article appeared as one of Mr. Audin's "Tips of the Month" commentaries. More can be found at www.EnergyBuyer.org. They are brief excerpts from the Energywiz seminar "Profiting From Deregulation: Power Techniques for Power Purchasing," the only seminar focused on training customers and consultants to handle retail power procurement. For those interested in taking this course, more information is available at www.energywiz.com and www.energyseminars.com

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ABOUT THE AUTHOR

Lindsay Audin (CEM, CLEP, CEP, IES), is the president of Energywiz, Inc., an energy consulting firm serving the competitive energy market, government agencies, large end users, and other consultants.

Audin has been named Energy Manager of the Year by three different national or regional organizations, most recently by the Association of Professional Energy Managers in 1995. In 1993, the Association of Energy Engineers (AEE) named him their International Energy Manager of the Year, and in 1996 inducted him into its Energy Manager's Hall of Fame, the highest recognition in that field.

He served on the board of the New York Designer's Lighting Forum, the *Energy User News* Technical Advisory Board, and an ASHRAE 90.1 technical committee. His column on lighting and energy issues has appeared quarterly in *Architectural Record* magazine since 1991, and his work appears frequently in energy-related publications and on such Web-based magazines as E-Source's *Power Tools*.

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