



The Florida Senate

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Committee on Finance and Taxation

Senator James E. "Jim" King, Jr., President

IMPLICATIONS OF THE ABSENCE OF A USE TAX ON UTILITIES FOR EDUCATION FUNDING

SUMMARY

The absence of a use tax equivalent to the gross receipts tax on natural gas purchased outside the state for use within the state:

- creates an unequal treatment of natural gas users, with those who purchase from local distribution companies paying a price that includes tax and those who purchase from third-party suppliers or marketers outside the state paying a lower, untaxed price;
- disadvantages local distribution companies compared to out-of-state suppliers; and
- reduces funding for school construction.

These problems should be remedied by extending the existing gross receipts tax to the cost price of imported gas (generally known as a use tax) or by adding a per-unit tax on the distribution of natural gas. Legislation to accomplish this should include parallel taxation of electricity so that the law will be in place to maintain a level playing field with respect to taxes if Florida's electric industry is deregulated.

of-state third-party suppliers or marketers. These purchases are not subject to the Florida gross receipts tax, and neither are charges for transportation of natural gas. Florida companies that sell natural gas are placed at a competitive disadvantage because their sales are taxed, and consumers who buy from Florida companies pay higher prices for natural gas. Funding for public education capital outlay is also reduced by the purchase of untaxed natural gas by Florida consumers.

Florida has not experienced deregulation in the wholesale or retail electricity markets, although the issue has been studied and legislation was filed in 2000 to create a study commission on electricity industry issues. It appears that deregulation of the electric industry in Florida is not imminent, but when it does occur it will create a situation parallel to that in the natural gas industry, with unequal taxation of electricity bought from in-state and out-of-state providers.

BACKGROUND

Section 203.01, F.S., imposes a tax of 2.5 percent upon the gross receipts of every person that receives payment for any utility service, defined in s. 203.012, F.S., as electricity for light, heat, or power; and natural or manufactured gas for light, heat, or power.

The gross receipts tax was created in 1931, and in 1963 the Florida Constitution was amended to place all gross receipts tax revenue in a trust fund for university and junior college capital outlay, and to allow bonds to be issued for this purpose. The Constitution was amended again in 1974 to allow gross receipts tax revenue to be bonded for public school capital outlay expenditures.

Since 1990, deregulation of natural gas markets has allowed some consumers to purchase gas from out-

METHODOLOGY

Staff collected information on changes in national and Florida natural gas markets since deregulation was introduced, and used data from the Public Service Commission, the Florida Municipal Natural Gas Association, and certain municipal gas utilities to determine the extent of untaxed purchases. Information on natural gas prices was taken from the Energy Information Administration/Monthly Energy Review September 2002. This information, plus gross receipts tax revenue history and forecasts, was used to estimate the magnitude of tax loss resulting from these untaxed purchases and its impact on PECO funding.

FINDINGS

When the gross receipts tax was enacted, and for

most of its history, utility services were provided by regulated monopolies. The gross receipts tax was a stable revenue source, and collection of the tax from utility providers was efficient and easy to administer. Even though the statutory imposition of the tax is on the person who receives payment for any utility service, it is understood that the tax is passed on to consumers of the utility services, and the law provides for separately stating the tax on the customer's bill. (S. 203.01(4), F.S.) The law also provides for taxation of electricity produced by cogeneration or by small power producers, or any person other than a cogenerator or small producer who produces electrical energy for his or her own use. (S. 203.01(1) (d) and (e), F.S.)

There is no gross receipts tax imposed on electricity or natural or manufactured gas purchased outside the state for use in the state. Retail sales of electricity have not been deregulated in Florida, and are unlikely to be deregulated in the immediate future, but natural gas purchases outside the state for use in the state have been occurring since 1990, and have become a significant part of the market. These sales are not subject to gross receipts tax, and this creates significant problems:

- There is unequal treatment of natural gas users, with those who purchase from local distribution companies paying a price that includes tax and those who purchase from third-party suppliers or marketers outside the state paying a lower, untaxed price;
- Local distribution companies are disadvantaged compared to out-of-state suppliers; and
- Funding for school construction is reduced.

Deregulation of Natural Gas Sales in Florida

In 1990, the Florida Public Service Commission began to accommodate new competition for local distribution companies in supplying end-users in local markets by approving the purchase of natural gas by an end user from a source other than its local distribution company. It became possible for large users of natural gas to purchase from outside the state through a marketer. The end-user paid the marketer for the gas and separately paid a Florida business to deliver it.

In 1996, a rule was proposed by the PCS to require Florida's investor-owned natural gas companies to offer transportation service to all nonresidential customers. In 2000, rule 25-7.005, F.A.C., was

adopted. It provides all non-residential natural gas customers with the option of purchasing gas directly from a supplier other than the utility serving the territory where the customer is located. It also allows utilities to offer transportation of natural gas to residential customers when it is cost-effective to do so.

The market response to these regulatory changes has been dramatic. In 1990, seven percent of all natural gas provided by investor-owned companies was transported. By 1994, 55 percent of all gas provided by these companies was transported, and this figure rose to 71 percent by 2001. There are seven investor-owned natural gas utilities in Florida. In 2001 five of them offered transportation as well as sales, and transported gas accounted for 71 percent of total throughput. Peoples, City Gas, and Chesapeake, the three largest gas utilities, each transported more gas than they sold.

At least 7 of Florida's 31 publicly-owned natural gas companies provide transportation services for some customers. In FY 2001-02, more than 41 million therms (one therm = 100,000 cubic feet) of natural gas were transported by these public utilities.

Natural Gas Deregulation and Its Effect on Gross Receipts Tax Revenue

Until 1990, all natural gas purchases in Florida were made from local distribution companies that owned the pipelines through which the gas was delivered to the final consumer. The origin of the gas did not matter to the final consumer, because a Florida gas company bought the gas that flowed through its transportation system and resold it to the consumer. The price of natural gas included any costs associated with transporting it to the end-user, and gross receipts tax was calculated on the entire cost of the delivered product.

Changes adopted in 1990 allowed Florida customers to purchase gas from out-of-state vendors. In these transactions, the purchase of gas was not subject to gross receipts tax because the tax is on the vendor, which was not a Florida business. A 1992 Technical Assistance Advisement by the Department of Revenue stated that the gross receipts tax was not applicable to charges for transportation services only, because the statute imposes a tax on persons who receive payment for a utility service, and transportation does not meet the statutory definition of utility service. Because of changes due to

deregulation, the gross receipts tax base has been significantly reduced. Since 1990 the amount of natural gas purchased from out-of-state suppliers has grown to over 70 percent of all gas supplied by privately-owned companies.

Purchase of natural gas from outside the state is no longer limited to large end-users. Rule 25-7.0335, described above, requires Florida’s investor-owned natural gas utilities to offer transportation service to all non-residential customers and authorizes the transportation of natural gas to residential customers when it is cost effective to do so.

The effect of changes on the way natural gas is sold in Florida can be seen in the state’s gross receipts tax revenue history. Gross receipts tax revenue has grown by almost 270 percent since 1985-86 (including rate increases in 1990, 1991, and 1992), but receipts from natural gas have grown much more slowly. In FY 1990-91 gross receipts tax revenue attributable to natural gas was 3.7 percent of total collections. This percentage has trended downward since then, and by 2001-02 it had fallen to 2 percent of total gross receipts tax revenue.

Estimating the Revenue Impact of Out-of-State Gas Purchases

The revenue impact of out-of-state natural gas purchases can be estimated by looking at the quantity of transported gas and estimating how much tax revenue would be generated if it were sold by in-state suppliers. The Florida Public Service Commission provided data for the quantity of gas transported and transport revenue received by investor-owned utilities. Additional information was supplied by municipal utilities.

Estimation Methodology: The quantity of gas transported by Florida utilities for each calendar year is converted to fiscal years and multiplied by the national average price for industrial gas users in that year. This amount is multiplied by the appropriate gross receipts tax rate for that period, to estimate the revenue loss associated with the sales price of the untaxed gas consumed in Florida. The revenue earned by utilities for transporting this gas is also converted to fiscal years and multiplied by the appropriate gross receipts tax rate. The sum of these estimates for each year is the estimated gross receipts tax loss.

Potential sources of error in the estimate: Assuming

that the price paid for gas by these customers was the national average price for industrial users may understate the actual price, especially in later years as commercial end-users have switched to transported gas. These purchasers would have paid higher prices for natural gas than industrial users, and the associated loss in gross receipts tax is greater. Since 1985, the national average commercial gas price has been 80 percent higher than the industrial price, and the average residential price has been 100 percent higher. Another potential source of error is that some transported gas goes directly to end-users and is not distributed by local utilities. The available data does not allow inclusion of these purchases. A final potential error is that available survey data may not include all transportation by municipal utilities.

Estimated Gross Receipts Tax Revenue Loss from Out-of-State Natural Gas Purchases (\$ millions)

Fiscal Year	Value of Out-of-State Purchases	GRUT Loss on Out-of-State Purchases	Transportation Charges Not Subject to Tax	GRUT Loss on Transportation Charges	Total GRUT Loss
88-89	0.0	0.0	0.0	0.0	0.0
89-90	8.1	0.1	4.1	0.1	0.2
90-91	47.9	1.0	13.6	0.3	1.2
91-92	97.0	2.2	21.5	0.5	2.7
92-93	128.8	3.2	23.4	0.6	3.8
93-94	166.3	4.2	31.2	0.8	4.9
94-95	199.2	5.0	27.5	0.7	5.7
95-96	218.4	5.5	27.2	0.7	6.1
96-97	252.9	6.3	35.5	0.9	7.2
97-98	259.4	6.5	36.8	0.9	7.4
98-99	267.9	6.7	50.0	1.2	7.9
99-00	380.1	9.5	47.1	1.2	10.7
00-01	487.9	12.2	82.7	2.1	14.3

Based on FL PSC Annual Gas Reports, data supplied by municipal gas utilities, and U.S. Natural Gas Prices reported in the Energy Information Administration/Monthly Energy Review September 2002

Impact on Public Education Capital Outlay Fund

The Florida Constitution provides that gross receipts tax revenue must be placed in the Public Education Capital Outlay (PECO) Fund, and used to pay for capital projects at universities, community colleges, vocational technical schools, or public schools. These capital projects may be financed by bonds pledging the full faith and credit of the state, and the amount of bonds issued may not exceed 90 percent of the average amount of gross receipts tax revenue from the two preceding years.

The loss of natural gas sales from the gross receipts tax base has reduced the amount of growth in the tax source, and reduced the amount revenue available to fund new school construction. The estimated lost gross receipts tax revenue could have supported an additional \$167 million in PECO appropriations from FY 1990-91 through FY 2000-01. The increased bonding capacity from collecting tax on the value of untaxed delivered gas today is approximately \$300 million.

Related Issues

Purchases of natural gas from out-of-state third-party suppliers or marketers, and potential deregulation of retail electricity markets, have the potential to erode local government revenue as well as revenue that accrues to the state. The public service tax (commonly referred to as the “municipal utility tax”) is based on utility purchases in a municipality or charter county, and franchise fees are traditionally negotiated as a percentage of a company’s gross receipts.

Municipalities and charter counties are authorized under s. 166.231, F.S., to levy a public service tax on the purchase of electricity, metered natural gas, liquefied petroleum gas either metered or bottled, manufactured gas either metered or bottled, and water service. This tax may be at a rate up to 10 percent, and is limited to purchases to purchases in the municipality or charter county. This tax does not include a use tax provision, and out-of-state marketers or third-party providers have been able to avoid collecting the tax.

Franchise fees are generally negotiated between a local government and a utility operating within its boundaries as compensation for use of public rights-of-way. The traditional rate for electric utilities has been 6 percent, but franchise fees have been negotiated above and below that rate. Franchise fees are usually negotiated as a percentage of the gross receipts of the company. Franchise fees can represent up to 25 percent of a jurisdiction’s general revenue and can be pledged.

Deregulation in the natural gas industry and potential deregulation of the electricity market allow consumers to buy from suppliers outside the state or jurisdiction without creating generating franchise fees, since the seller is not utilizing local government rights-of-way and those transportation and transmission facilities that use the rights-of-way are

not receiving revenue for the electricity or natural gas being delivered.

RECOMMENDATIONS

The unequal taxation of natural gas purchases should be remedied by extending the existing gross receipts tax to the cost price of imported gas (generally known as a use tax) or by adding a per-unit tax on the distribution of natural gas. This committee is drafting legislation that would maintain the current gross receipts tax on natural gas sold by in-state companies. Gas transported by these companies would be subject to a per-unit tax, with the tax rate adjusted periodically for the market price, to maintain comparable taxation of gas purchased from in-state and out-of-state suppliers. Gas purchased from out-of-state suppliers that is not transported by Florida companies would be subject to tax on its cost-price, including transportation costs.

The draft legislation also includes parallel taxation of electricity. If Florida’s electric industry is deregulated, the law will be in place to maintain a level playing field with respect to taxes.