Cite as Det. No. 93-163, 13 WTD 322 (1994).

THIS DETERMINATION HAS BEEN OVERRULED OR MODIFIED IN WHOLE OR PART BY DET. NO. 99-011R, 19 WTD 423 (2000)

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 93-163
	)	
. . .	)	Registration No. . . .
) FY . . ./Audit No. . . .		
	)	
. . .	)	Registration No. . . .
	)	FY . . ./Audit No. . . .

[1&2] RULE 179: PUT -- LIGHT AND POWER BUSINESS -- OPERATING. Operator of a hydro plant, not the owner is liable for public utility tax.

[3] RULE 118: SERVICE B&O -- OPTION TO PURCHASE. Payment for an option to purchase real estate is not subject to service B&O.

[4] RULE 111: SERVICE B&O -- ADVANCE/REIMBURSEMENTS. Legal fees billed to the taxpayer as a matter of convenience for which the taxpayer is not primarily or secondarily liable are excludable from the taxpayer's Service B&O tax measure.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

. . .

NATURE OF ACTION:

A Corporation selling a pulp and paper mill with related hydro projects protests the assessment of public utility tax and service business and occupation tax on the transaction.

FACTS AND ISSUES:

Pree, A.L.J.-- . . . .

The taxpayer manufactured paper and wood products. It owned a mill and controlled hydro projects which supplied dedicated power to the mill. Those hydro projects provided a substantial portion of the mill's electric requirements. While it had operated the hydro projects in the past, the taxpayer had not been able to obtain a long term license to do so for the future.

During the audit period the taxpayer sold the mill. The parties also intended to convey related hydro projects which generated power for the mill. Because hydro projects were subject to relicensing proceedings before the Federal Energy Regulatory Commission (FERC), fee title could not be conveyed until relicensing was complete and FERC approved the transfer. That process has not yet been completed.

The law firm representing the taxpayer with regard to the licensing proceedings prior to closing represented the buyer in these proceedings after the closing. The firm continued to bill the taxpayer as a matter of convenience. It has provided a letter stating that it considered only the buyer liable for its charges and that the taxpayer was neither primarily nor secondarily liable for payment of its fees.

The purchase agreement provided that during the relicensing proceedings the taxpayer would retain legal title to the hydro projects and the taxpayer would continue to be identified as the applicant for a new license during the proceedings. The purchase agreement provided that the buyer would operate the hydroelectric facilities under a separate Management and Power Supply Agreement. That agreement also provided that the buyer would operate the hydro projects and receive their electrical output. The buyer was responsible for all operating costs plus capital expenditures required by FERC. The buyer was also responsible for insurance and risk of loss. The taxpayer had to diligently pursue its right to a new license, with the buyer bearing the costs. In a response to an FERC inquiry, the taxpayer acknowledged that it continued to own and control the projects, but that the buyer operated them and was responsible for their operating costs.

Specifically, the Management and Power Supply Agreement provided that the buyer would perform the operation activities. The agreement defined "Operation Activities" as:

> . . . all activities necessary or appropriate for operation and/or maintenance of the Hydroelectric

> Facilities, including, without limitation, providing the engineering, purchasing, repair, replacement, supervision, training, inspection, testing, protection, operation, use, management, and maintenance necessary or appropriate to operate, maintain and repair the Hydroelectric Facilities, including hiring all personnel required for such purposes.

The taxpayer retained legal title to the hydro project while the buyer took possession of the facilities and operated them. The parties specifically bargained for both the mill and hydro project as an integrated facility. Full price was paid at closing (during the audit period) regardless of when legal title transferred.

According to the auditor, legal title could not be transferred unless the projects were relicensed and the transfer approved by FERC. If the transfer was made before FERC approval, public utilities could intervene and claim a right to take over the dams under Sec 7(a) of the Federal Power Act, 16 USC 800. The taxpayer's original license for the hydro projects expired years ago and it is unclear whether the taxpayer was licensed to operate the projects during the audit period.

The total purchase price was [$A] for both the mill and the hydro project. The taxpayer met with various Department of Revenue representatives regarding the taxability and allocation of the sales price. The taxpayer allocated the [$A] price as shown:

> [$B] for mill;
> [$C] for specified intangibles;
> [$D] for hydro & other intangibles broken down:
> [$E] for option to purchase dam;
> [$F] for intangibles & goodwill.

Following a meeting with the Department's representative, the taxpayer paid real estate excise tax (REET) on [$G] for real property interests. Apparently, the Department agreed to the taxpayer's allocation of the purchase price and the [$E] would be treated as the purchase of a real estate interest at that time. The taxpayer paid REET on the [$E]. They also apparently agreed that the [$F] allocated for the buyer's right to possession and operation of the hydro projects was an intangible interest exempt from REET & sales/use tax.

At the time the taxpayer filed the returns related to the transaction, the only apparent controversy concerned intangible value of tax deferral credits. The Interpretation and Appeals Division issued [a determination] regarding that issue. There is no indication of whether any other business and occupation tax or public utility tax ramifications were discussed.

The taxpayer was then audited. The auditor assessed public utilities tax on [$F] (on Schedule VII which the taxpayer had identified was received for intangibles and goodwill). The audit report characterized that portion of the contract as, "a contract to supply power to the . . . Mill." The auditor also assessed public utilities tax on the amounts incurred by the buyer to operate the hydro projects. These were the buyer's costs under the agreements, and the taxpayer received nothing for them.

Service B&O was assessed on the [$E] purchase option which the taxpayer treated as the sale of a real estate interest subject to REET. Credit was allowed for the REET. Service B&O was also assessed on legal fees regarding the relicensing proceedings paid by the buyer to the taxpayer who treated them as advances/reimbursements under Rule 111.

This determination will address the following four issues:

1. Is public utility tax due from the seller on the . . . purchase price attributed to the buyer's right to possession and operation of the hydro projects?

2. Is public utility tax due from the seller on the costs incurred by the buyer to operate the hydro projects?

3. Is service B&O due on the . . . purchase option?

4. May legal fees regarding the relicensing proceedings after closing billed to the seller, but paid by the buyer, be excluded by the seller if the seller was not primarily or secondarily liable for them?

DISCUSSION:

[1 & 2] RCW 82.16.020(b) imposes public utility tax on the act or privilege of engaging within this state in the light and power business. RCW 82.16.010 defines light and power business as:

> (5) "Light and power business" means the business of operating a plant or system for the generation, production or distribution of electrical energy for hire or sale and/or for the wheeling of electricity for others. [Pre 1991 law applicable to audit period.]

Any person falling within the statutory definition is taxable under the public utility tax even though the taxpayer is primarily engaged in another business or sells only a relatively small amount of energy to a single buyer. Whether the taxpayer is a "public utility," in either the sense that it is subject to

state regulatory authority or makes sales to the public at large, is not relevant. Det. No. 89-372, 8 WTD 115 (1989).

RCW 82.16.010(12) which defines gross income, the measure of the tax, provides:

> "Gross income" means the value proceeding or accruing from the performance of the particular public service or transportation business involved, including operations incidental thereto, but without any deduction on account of the cost of the commodity furnished or sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

In order to measure the public utilities tax, we must identify the value proceeding or accruing from the performance of the particular public service, "operating a plant or system for the generation, production or distribution of electrical energy for hire or sale." "Operating" as opposed to owning or even controlling is required for the tax to be imposed. The taxpayer is not being paid for performance of a public service or operating a plant, it is being paid to transfer its rights.

While it is unclear whether the taxpayer was licensed to operate the hydro projects following the sale, it is clear from the purchase agreement and the Management and Power Supply Agreement that the buyer, not the taxpayer, operated the hydro projects. Neither the [$F] portion of the purchase price nor the subsequent costs incurred by the buyer were paid to the taxpayer for operating the hydro projects. Therefore, the taxpayer was not subject to the public utility tax assessed . . . . The taxpayer's petition is granted as to this issue.

[3] RCW 82.04.390 exempts sales of real estate from business and occupation tax, stating:

> This chapter shall not apply to gross proceeds derived from the sale of real estate. This however, shall not be construed to allow a deduction of amounts received as commissions from the sale of real estate, nor as fees, handling charges, discounts, interest or similar financial charges resulting from, or relating to, real estate transactions.

"Sale" is defined under RCW 82.04.040:

> "Sale" means any transfer of the ownership of, title to, or possession of property for a valuable consideration and includes any activity classified as a "sale at retail"

> or "retail sale" under RCW 82.04.050. It includes renting or leasing, conditional sale contracts, leases with option to purchase, and any contract under which possession of the property is given to the purchaser but title is retained by the vendor as security for the payment of the purchase price. . . .

(Emphasis supplied.)

The AUDITORS' DETAIL OF DIFFERENCES AND INSTRUCTIONS TO TAXPAYER in SCHEDULE IV describe the transaction as:

> A non-refundable purchase option for the . . . dams was made in February of 1988. No title transfers, or any other rights transfer other than the right to obtain title to the dams if Federal Energy Regulatory Commission (FERC) licensing is approved upon [the taxpayer's] application and a transfer of license applied for and approved after [the taxpayer's] approval is obtained. Real estate excise tax was paid on this transaction, however, a sale of real estate has not taken place, and therefore, the tax is not due. This schedule asserts the service and other activities tax on the amount paid for the purchase option, and refunds the amount paid for real estate excise tax.

The right to obtain title is an option to purchase. Options to purchase constitute an interest in real property. Strong v. Clark, 56 Wn.2d 230, 233, 352 P2d 183 (1960). The payment for such a right is exempt from business and occupation tax under RCW 82.04.390. REET was correctly paid in accordance with the instructions from the Department and should not be refunded.
. . . .

[4] Rule 111 excludes from the measure of tax, amounts representing money or credit received by a taxpayer as reimbursement of an advance. It applies only when the customer or client alone is liable for the payment of the fees or costs and when the taxpayer making the payment has no personal liability therefor, either primarily or secondarily, other than as agent for the customer or client.

In this case, the law firm performing the services and submitting the invoices to the taxpayer has stated that the buyer, not the taxpayer was liable for payment of the invoices. The vendor has stated that the taxpayer was neither primarily nor secondarily liable for such payments. Therefore, the taxpayer was entitled to exclude the payments [from its measure of B&O tax].

DECISION AND DISPOSITION:

The taxpayer's petition is granted. The file will be referred to the audit division to delete the schedules referenced above. The tax due with interest will be recomputed by the audit division.

DATED this 10th day of June, 1993.