

BEFORE THE DIRECTOR
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petitions)
For Refund of)
N)
)
)
)
14 PUBLIC UTILITY DISTRICTS)
)

F I N A L
D E T E R M I N A T I O

No. 89-451

Registration Nos.
(See attached listing)

[1] RULE 179; RCW 82.04.417: PUBLIC UTILITY TAX --
EXEMPTION -- SERVICE CHARGES -- CONTRIBUTIONS IN AID
--CAPITAL FACILITIES -- BONDED INDEBTEDNESS. Gross
receipts of utility districts through utility
service rate charges include taxable "service
charges" as well as tax exempt amounts attributable
to capital construction and reduction of bonded
indebtedness. Such amounts are all derived from the
sale of utility services (power, water, etc.).

[2] RULE 179; RCW 82.04.417: PUBLIC UTILITY TAX --
EXEMPTION -- SERVICE CHARGES -- CONTRIBUTIONS IN AID
--CAPITAL FACILITIES -- BONDED INDEBTEDNESS.
Entitlement to exemption from public utility tax of
amounts received for capital construction purposes
is determined by a threefold test:
A. Pre-receipt identification and approval of
billing amounts or percentages levied for capital
facilities or capital purposes;
B. Segregation of capital facilities or capital
purpose levies upon receipt; and
C. Dedication and ultimate capital facility or
capital purpose expenditure of such levies following
receipt.

[3] RULE 179; RCW 82.04.417: PUBLIC UTILITY TAX --
EXEMPTION -- SERVICE CHARGES -- CONTRIBUTIONS IN AID
--CAPITAL FACILITIES -- BONDED INDEBTEDNESS.

P.U.D.s satisfy the first of the threefold criteria through publicly adopted rate schedules which set and identify amounts or percentages levied for capital facilities/purposes expenditure.

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.

HEARING CONDUCTED BY DIRECTOR'S DESIGNEE:

Edward L. Faker, Sr. Administrative Law
Judge

DATE OF CONFERENCE: May 25, 1989.

NATURE OF ACTION:

Taxpaying Public Utility Districts (hereinafter P.U.D.s) seek refunds of public utility taxes paid on income expended or to be expended on capital facilities, capital improvements, or bonded indebtedness for such purposes, interest, penalties, and other expenses related thereto.

FACTS AND ISSUES:

Faker, Sr. A.L.J. -- The Department of Revenue has received numerous separate petitions for refund or credit of public utility taxes paid by individual P.U.D.s upon "capital" portions of gross receipts. Each petition asserts that the law (RCW 82.04.417) and the Department's own rulings entitle the taxpayers to such relief. RCW 82.04.417 provides:

The tax imposed by Chapters 82.04 and 82.16 RCW shall not apply or be deemed to apply to amounts or value paid or contributed to any county, city, town, political subdivision, or municipal or quasi municipal corporation of the state of Washington representing payments of special assessments or installments thereof and interests and penalties thereon, charges in lieu of assessments, or any other charges, payments or contributions representing a share of the cost of capital facilities constructed or to be constructed or for the retirement of obligations and payment of interest thereon issued for capital purposes.

Service charges shall not be included in this exemption even though used wholly or in part for capital purposes.

In each of the cases now before the Department, the taxpayers were denied "capital facility/purpose" refunds or credits of tax paid on gross utility charges. It was found that the taxpayers failed to itemize "capital" charges on their customer service billings or, in place of such itemization, failed to obtain advance authorization through publicly enacted ordinances or resolutions specifically authorizing the levy of such "capital" charges separate from service charges. Audit Section found there was insufficient notice to, and approval by, the general public and customers of the purpose, amount and rate of collection of such capital charges. Such advance notice and approval was prerequisite to all refund requests.

After evaluation and due consideration of the common issue in each case, the Department called for a joint conference with all similarly petitioning public utility districts. All taxpayers attended an informal conference with the Department of Revenue on May 25, 1989 for an exchange of information, discussions of procedural requirements, and an examination of the department's current administration of RCW 82.04.417, the tax deduction statute in question.

With the tacit agreement of those present, the department agreed to issue a Final Determination applicable to all parties setting forth its position on the issue of deductibility. The Department's senior audit staff met with selected representatives of the P.U.D.s to review and evaluate the various accounting methods, data availability, and customary financial practices of the several petitioners.

At the conclusion of that study, the audit staff reported that it could "look at each P.U.D. to determine the amounts from the sales of power which were identified through resolutions and rate hearings as being for capital improvements." Further, audit could determine if "these funds were used for that purpose or are still available." In any event, "from an accounting stand point we can trace the amounts sufficiently to satisfy the concerns .." for identification, tracking, and destination of capital funds.

TAXPAYERS' POSITIONS:

The P.U.D.s have duly and regularly paid public utility tax upon gross receipts derived from charges for utility "services" rendered to the public. They request refund, however, of taxes computed and paid upon that portion of gross receipts which was collected pursuant to P.U.D. rate studies, resolutions or ordinances, and subsequently segregated into dedicated accounts for capital expenditures, construction of capital improvements, or reduction of capital improvement bonded indebtedness.

The taxpayers formally object to the denials for two reasons:

First, the P.U.D.s have adopted authorizing resolutions, ordinances, budget approvals, rate studies, etc., all duly approved after full public notice and public meeting.

Secondly, The P.U.D.s have maintained records and internal accounting/tracking of the capital improvement, capital facilities, or capital bonded indebtedness funds, such that there is unquestionable identification, separation, and ultimate expenditure of such dedicated funds for capital purposes.

DISCUSSION:

The P.U.D.s argue that RCW 82.04.417, together with Determination 87-63, 2 WTD 285 (1987) and Determination 88-343, ___ WTD ___ (1988), support their refund requests. Relevant provisions from those authorities are appended to this Final Determination, as Exhibit A.

We have carefully reviewed the statutory provision, the Determinations referenced above, and the evaluation by the Audit Section of the sufficiency of records and accounts of the several taxpayers. We are convinced that the P.U.D.s are entitled to deduct amounts received, separated and expended for capital facilities construction and retirement of obligation for capital purposes.

Gross income from the operation of a plant or system for the generation, production, or distribution of electrical energy for hire or sale (RCW 82.16.010) is generically designated as utility service rate charges. "Service charges" are expressly excluded from the exemption for contributions in aid of capital construction or the retirement of obligations and interest thereon issued for capital purposes. However, the

term "service charges", as used in RCW 82.04.417, is not statutorily defined.

Regardless of the designation it may be given, it is clear that income from the sale or distribution of electrical energy or other utility services may include straight utility "service charges" as well as amounts dedicated to the cost of capital purposes. The very statutory authority which authorizes and mandates Public Utility Districts to collect "rates or charges for electric energy and water and other services" dictates that such charges shall be adequate to provide revenue sufficient for the payment of the principal and interest on revenue obligations and the replacements and renewals of public utility facilities. (RCW 54.24.080).

When, as they are authorized, utility districts increase their rates or charges for the sale of utility services to provide and generate sufficient revenue to cover capital construction or the reduction of bonded indebtedness for capital purposes, such increases and other energy sales income dedicated to these purposes is entitled to exemption from the B&O tax and public utility tax.

However, because "service charges" are excluded from these exemptions, the responsibility of the utility districts is to identify the portion of its gross income derived from "rates or charges from electrical energy" or other utility service which portion constitutes a customer's share of the cost of capital facilities or payment for the retirement of obligation and interest thereon, and to distinguish it from any other kinds of operating income.

The three criteria necessary for gross income segregation, prerequisite to deduction of capital facilities/capital purpose receipts are:

1. IDENTIFICATION OF THE CUSTOMER CHARGES ATTRIBUTABLE TO CAPITAL CONSTRUCTION AND RETIREMENT OF OBLIGATIONS FOR CAPITAL PURPOSES. In order for funds received as contributions, donations, taxes, assessments, payments or other charges in lieu thereof to be tax deductible, the law requires EITHER prior ratepayer notice and acknowledgement of the necessity and amount of charges for capital facilities, improvements, or bonded indebtedness therefor, OR a county, city, town, etc. ordinance or resolution enacted in open public meeting, setting the amount, and determining necessity, which process shall be deemed equivalent to said ratepayer knowledge and approval.

The Washington Legislature clearly indicated that business and occupation or public utility taxes shall be due and owing upon regular revenues generated solely from providing ordinary public utility services. However, equally evident is the legislative intent that no tax be assessed on properly pre-identified assessments, billings, taxes, contributions, or payments which are both segregated upon receipt and paid to or for capital facilities and expenditures. RCW 82.04.417.

Charges which are itemized on customer billings as contributions in aid of construction, or publicly adopted on behalf of all ratepayers by the governing body of which the ratepayer is a member, are necessary to provide due notice, certainty and pre-authorization. Either method of identification and pre-authorization is sufficient to satisfy this requirement. Determination 87-63, 2 WTD 285.

2. SEGREGATION OF CAPITAL FACILITIES AND CAPITAL PURPOSE CHARGES UPON RECEIPT. Revenues derived through the duly identified and authorized methods set forth above must be separately accounted for and segregated into dedicated accounts, separate from other funds of the taxpayer's governing body. Commingling of such receipts may result in the loss of deductibility, for reason of uncertainty and ambiguity as to the source and purpose of the funds.

This requirement is strictly enforced, both for reason of legislative prohibition in RCW 82.04.417 against deduction of ordinary service charges, and for reason of accountability, clarity and ease of tracking expenditures to capital improvements.

3. DEDICATION AND ULTIMATE EXPENDITURE OF CAPITAL FACILITIES AND CAPITAL PURPOSE CHARGES FOLLOWING RECEIPT. Revenues derived through duly published and authorized methods and separated and segregated into separate accounts distinct from all other funds, must be used exclusively for the stated and approved capital facilities or improvements, or for the retirement of construction loans, bonds, or other indebtedness incurred for capital purposes. Such revenues may not be used for any other purpose.

This last requirement speaks for itself. Taken together with the second requirement, the Legislative intent to insure that funds properly derived be kept distinct from all other funds and ultimately expended upon the approved capital purpose is satisfied. While a county, city, town, or other governing

body may always expend funds for otherwise eligible capital purposes, improvements, or facilities, only monies meeting all three requirements above are eligible for deduction.

DECISION AND DISPOSITION:

The taxpayers' petitions for correction of assessments and/or for refunds are granted. These matters are returned to the audit section for review, verification and/or recomputation of tax, in light of this determination. The taxpayers will be notified of the final computations and refunds will issue for deductible capital facilities or capital purpose receipts.

DATED this 6th day of September 1989.

EXHIBIT A

RCW 82.04.417
Determination 87-63, 2 WTD 285 (1987).

[2] The Department's position is to allow an exemption for collections for bond retirement upon certain conditions. These conditions are as follows:

1. The billing to the customer must clearly identify the charge as being for retirement of revenue bonds and the amount of such charge must be separately stated from any other charges on the same bill.
 2. Revenues derived from this source must be separately accounted for in the books of the city and may not be commingled with other funds.
 3. Income from this source must be used exclusively for the retirement of revenue bonds and may not be used for any other purpose.
- Separate itemization on billings is not required if the additional charge for bond retirement is authorized by city ordinance or resolution as a separate charge from utility services rendered, and if the second and third conditions are satisfied.

Determination 88-343, WTD (1988).

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Following Departmental policy and Determination 87-63, the auditor was unable to allow the deductions, because he was not presented with information showing that the City had enacted a plan in its normal, public manner, thus providing notice to its ratepayers and qualifying under the "special authorization" exception to the Department's separate billing requirement.

In the future, in addition to annual adjustment reports, taxpayers similarly situated should provide audit personnel with any other comprehensive authorizing studies or ordinances which support their positions.