Cite as Det. No. 00-170, 20 WTD 385 (2001)

BEFORE THE 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. 00-170
. . .	)	Registration No. . . .
	)	FY. . .Audit No. . . .

[1] RULE 197: B&O TAX – RECOGNITION OF TAXABLE INCOME. Taxpayer is not required to recognize and pay service B&O tax immediately on "latecomers" fees it receives over many years, the amount of which is entirely speculative and neither fixed nor determinable.

[2] RULE 171: B&O TAX – PUBLIC ROAD CONSTRUCTION B&O TAX -- HOOK-UP FEE CREDITS. Taxpayer, as landowner, owed hook-up fees collected by the municipality as payment for the construction of a stormwater treatment plant. Taxpayer, as contractor, received hook-up fee credits as payment (income) for building the stormwater treatment plant. The income received as hook-up fee credits for building a stormwater treatment plant is subject to public road construction B&O tax.

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:

Taxpayer protests the assessment of Public Road Construction business and occupation ("B&O") tax assessed on payments/credits received from the City of . . . ("[City]") for utility hook-up fees and stormwater treatment system connection fees.[1]

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

FACTS:

Lewis, A.L.J. -- Taxpayer is involved in the land development business. During the time period at question, Taxpayer's land development activities were primarily focused on the development of property in a planned residential community called ". . . ."

The Audit Division of the Department of Revenue's ("Department") audited Taxpayer's books and records for the period January 1, 1994 through September 30, 1997. On December 18, 1998, the Department issued a $. . . assessment.[2] Much of the assessment arose from the assessment of Public Road Construction B&O tax on credits/payments received from [City] for utility hook-up fees and stormwater treatment system connection fees.[3] Taxpayer disagreed with the tax assessment and on July 14, 1999 filed a petition for correction with the Department's Appeals Division.

Taxpayer disagreed with the Audit Division's taxation of payments it received from [City] designated as "latecomers" hook-up fees. The Audit Division assessed Public Road Construction B&O tax on $. . ., the maximum amount of "latecomers" hook-up to utility fees that Taxpayer might receive. The Audit Division made the assessment reasoning that Taxpayer kept its financial records on an accrual basis and that Taxpayer was required to pay tax on income when it was entitled to receive payment and not when payment was actually received.

Taxpayer explained that in order to allow a land developer to recoup costs from third parties that hook-up to a utility facility, the city collects a "latecomers" fee from the "property owner" and refunds a portion to the developer who installed the facility. If the property owner does not hook-up to the system it does not owe the fee. Similarly, if the property owner does not request to be hooked-up to the system prior to the expiration of the latecomer's agreement, Taxpayer receives no additional payment. Accordingly, the amount of latecomer's fees that will be collected is uncertain. Taxpayer maintained the Audit Division erred in requiring it to pay tax on income that was neither fixed nor determinable and entirely speculative.

Taxpayer also disagreed with the Audit Division assessment of Public Road Construction B&O tax on hook-up fee credits it received from [City]. The Audit Division made the assessment reasoning that the credits were in payment of a stormwater treatment plant.[4]

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[2] $. . . tax and $. . . interest.

[3] By agreement with the [City] Taxpayer is to be reimbursed to a maximum of $. . . from utility hook-up fees charged to late-comers. By agreement with the City Taxpayer is to be reimbursed to a maximum of $. . . from connection fees charged property owners.

[4] The stormwater treatment plant was built on land owned by the [City]. By the purpose of the facility and where it was built the Audit Division reasoned the stormwater treatment facility was subject to Public Road Construction B&O tax. Accordingly, the subcontractor was required to pay retail sales tax/use tax on all the materials incorporated into the job. Taxpayer, as prime contractor, would only be subject to the public road construction B&O tax and not be required to collect retail sales tax on the job.

In the case of the . . . development, Taxpayer agreed to provide [City] with a stormwater treatment facility and recover its cost by way of credit against hook-up fees. Accordingly, Taxpayer hired a subcontractor to construct a stormwater treatment facility and [City] agreed to allow Taxpayer up to a maximum of $. . . hook-up credit against the stormwater treatment plant construction cost.

Taxpayer disagrees with the Audit Division's conclusion that it received the hook-up credits in payment for the construction of the stormwater treatment plant. Taxpayer's petition explained:

> …It is the City's policy that the developer pays the equivalent of the current hook up fee for the storm water facilities times the number of units connected. As described above, there are two ways this can be done, pay the fee as you connect, or build the facilities and not pay the hook up fees until such time as you have made as many hookups at the current City fee structure equal to the cost incurred for the facilities. Under either method hook ups are a cost to the Taxpayer the method of payment is the only fact that varied in the first case taxpayer paid the hook up fee as incurred. In the second case taxpayer built a water treatment plant and was able to take the expense of hook ups as a credit against the costs expended to build the plant. The only difference is that in the first case, a third party contractor agrees with the municipality to build the plant in the second instance, the item is a cost or expense to the developer, not a revenue item subject to B&O tax.

ISSUES:

1. Is Taxpayer required to pay public road construction B&O tax on the maximum amount of "latecomer" hook-up fees it is entitled, even before receipt?

2. Is Taxpayer required to pay public road construction B&O tax on the maximum amount of connection fees it receives as a credit against the amount it expended to build a stormwater treatment facility?

DISCUSSION:

[1] The Audit Division relying on a ". . . Agreement . . .," assessed Taxpayer public road construction B&O tax on $. . ., the maximum amount of reimbursements it could expect from hook-ups.[5] Taxpayer did not disagree that the funds it receives are taxable. Rather, Taxpayer's

[5] The ". . . Agreement" states:

> IV. TERM
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> For a period of 15 years from date of recording of this Agreement in the office of the County Auditor of the County in which the real estate is located, any owner (latecomer) of real estate legally described in Section III, and which owner has not fully contributed their pro rata share to the original cost of the above-described facility shall pay the amounts shown in Exhibit C-2 attached hereto. This amount is based on $.13828 per square foot for storm facilities. The charge herein represents the fair pro rata share of the cost of construction of said facilities payable by property owned by the latecomer parcel shown in Exhibits C-1 and C-2. Payment of the latecomers pro rata share is a condition of issuance of the connection permit by

disagreement was that it should have to pay tax on funds it had not received or may never receive.

In making the assessment, the Audit Division relied on WAC 458-20-197 ("Rule 197"), which explains when tax liability arises. Rule 197 states:

> (2) ACCRUAL BASIS.
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> (a) When returns are made upon the accrual basis, value accrues to a taxpayer at the time:
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> (i) The taxpayer becomes legally entitled to receive the consideration, or,
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> (ii) In accord with the system of accounting regularly employed, enters as a charge against the purchaser, customer, or client the amount of the consideration agreed upon, whether payable immediately or at a definitely determined future time.
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> (b) Amounts actually received do not constitute value accruing to the taxpayer in the period in which received if the value accrues to the taxpayer during another period. It is immaterial if the act or service for which the consideration accrues is performed or rendered, in whole or in part, during a period other than the one for which return is made. The controlling factor is the time when the taxpayer is entitled to receive, or takes credit for, the consideration.
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> …
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> (4) SPECIAL APPLICATION, CONTRACTORS.
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> Value accrues for a building or construction contractor who maintains his accounting records on the accrual basis, as of the time the contractor becomes entitled to compensation under the contract.

This is not a case where [City] has agreed to pay Taxpayer a specific amount during the next 15 years. Rather, this is an instance where [City] has agreed to collect and remit to Taxpayer the hook-up fees it collects from property owners who connect late. Taxpayer will only receive payment when a property owner hooks-up and it is within the fifteen year agreement. The amount Taxpayer will receive depends entirely on how many people connect and when. Because there is no certainty as to how many people will connect we find it in error to require Taxpayer to recognize and pay tax on what is only potential income.

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the CITY. The CITY shall reimburse the DEVELOPER at six (6) month intervals any such amounts collected.

V. AMOUNT OF REIMBURSEMENT

Storm facilities: The DEVELOPER, his successors, heirs and assigns, agrees that the amounts which the DEVELOPER is reimbursed from the property owner as specified in Section III of the Agreement, represents a fair pro rata share reimbursement for the DEVELOPER'S construction of the facilities described in Section II of this Agreement. The amount per parcel is shown in Exhibit C-2 attached hereto, and totaling to not more than $. . . in full amount.

In further support of Taxpayer's position, we recognize that were Taxpayer required to pay tax on all income now the nonclaim period would preclude an adjustment for overpaid tax that might not be fully received within the fifteen year (15) period. The nonclaim statute precludes Taxpayer from taking a credit for overpaid taxes paid more than 4 years plus the current. RCW 82.32.060.

[2] The second issue Taxpayer raised is whether the credits it received from [City] for hook-up to a stormwater treatment facility amounts to payment for the facility and is thus subject to the public road construction B&O tax.

Taxpayer explained that as part of the . . . development, [City] required construction of a stormwater treatment facility. Construction of a stormwater treatment plant is a common development requirement. In most instances a city will construct the stormwater facility and recover the cost of construction by charging the developer hook-up fees. Alternatively, the city will allow the land developer to construct the stormwater treatment facility and recover the cost by allowing credits against the hookup fees that it would otherwise charge. Once the cost of the facility is recovered, the developer then must pay the hook-up fees to the city.

Taxpayer maintained that the building of the plant was an expense and not taxable income. Taxpayer argued that by building the plant and being allowed a credit for the hook-ups it was merely prepaying a hook-up expense. We disagree.

In simplest terms, the municipality must build a stormwater treatment facility and collect hook-up fees to pay for it; the landowner must pay hook-up fees to the municipality to pay for the stormwater treatment facility; and, the contractor must be paid for building the stormwater treatment facility. The separate activities would have been most apparent had Taxpayer simply paid hook-up fees and [City] simply collected the hook-up fees, and a third party builder constructed the stormwater treatment facility.

Here, Taxpayer acted as both a landowner and contractor. Taxpayer, as landowner, owed the [City] hook-up fees to pay for the cost of building the stormwater treatment facility. Taxpayer, as contractor, was owed payment from [City] for construction of the stormwater treatment facility. In building and paying for the stormwater treatment facility Taxpayer was relieved of making the individual payments for the hook-up charges. Taxpayer, as landowner, in effect paid the hook-up fees by paying for the stormwater treatment plant. Taxpayer, as contractor, received payment for the stormwater treatment plant by receiving a credit against the required hook-up fees.

The result is the same, whether Taxpayer paid a hook-up fee to [City], which was then used to pay a contractor or whether Taxpayer constructed the stormwater treatment facility and was allowed to a credit for the costs of construction against hook up fees. In both instances, the landowner paid a hook-up fee, which was used to pay the builder of the stormwater treatment facility. In this instance, Taxpayer's compensation, as builder, was credit for the hook-up fees it owed as landowner. Thus, we find the Audit Division was correct to assess Taxpayer public

road construction B&O tax on the amounts it received as hook-up credits. Consistent with the first issue in this decision, Taxpayer is only taxable on the hook-ups credits when received. Accordingly, the issue is remanded to the Audit Division to verify that all the hook-up credits taxed have been received.

DECISION AND DISPOSITION:

Taxpayer's petition is granted as it relates to the first issue. Taxpayer's petition is denied as it relates to the second issue. However, the issue is remanded to the Audit Division to verify that all of the hook-up credits taxed have been received and issue an adjustment consistent with this determination.

Dated this 15th day of September, 2000.