Cite As Det. No. 96-255, 16 WTD 138 (1996)

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

In the Matter of the Petition	)	D E T E R M I N A T I O N
For Correction of Assessment of	)	
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	)	No. 96-255
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[1] RULE 179; RCW 82.04.417: PUBLIC UTILITY TAX -- ELECTRIC SERVICE -- CONTRIBUTIONS IN AID OF CONSTRUCTION -- BPA -- WPPSS. Electric utilities may not exempt receipts for electric service that they attribute to capital facilities owned either by BPA or WPPSS.

[1] RULE 17901; RCW 82.16.055(1)(b): PUBLIC UTILITY TAX -- ENERGY CONSERVATION -- BPA RATES. Public utilities may not deduct payments to purchase power from BPA as conservation costs.

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:

Public electric utilities request a refund of public utility tax based on deductions for the cost of capital facilities and conservation expenses.[1]

FACTS:

Pree, A.L.J. -- The taxpayers are cities and public utility districts. They provide electrical power to retail consumers. The taxpayers charge various rates per kilowatt hour for electricity. They paid public utility tax on their receipts from the sale of electricity. The taxpayers attribute a portion of their receipts to the cost of capital facilities. They request that the portion of their receipts used for capital construction be exempted from tax for the period January 1, 1991 through June 30, 1993. Similarly, they request a deduction for conservation expenses.

Specifically, the taxpayers purchased power from The Bonneville Power Administration (BPA) and The Washington Public Power Supply System (WPPSS). BPA and WPPSS paid for capital facilities. The taxpayers computed their refund request based upon their payments to BPA and WPPSS.

The taxpayers did not separately state the charges for capital facilities on the invoices that they sent to their customers for electric service. They billed their customers for electricity at a rate per kilowatt hour multiplied by the number of kilowatts used by each customer. The taxpayers account for the charges in the following manner:

To record billings:

Debit: Accounts Receivable $$$
Credit: Revenues by customer class

To record receipts from customers:

Debit: Cash $$$
Credit: Accounts Receivable $$$

The taxpayers did not distinguish between receipts for electric service and receipts for capital facilities in their books. None of the taxpayers used different bank accounts for the receipts. They did separately account for direct fees charged to customers for miscellaneous services such as changing or connecting service, repairs, or line extensions. These receipts were booked in as miscellaneous service revenues under the account numbered 451, as required by the Federal Energy Regulatory Commission (FERC). Likewise, receipts from residential customers for electric service were entered in account numbered 440 while receipts from commercial customers were coded 442. FERC regulates the taxpayers and requires specific accounting entries for their transactions. The taxpayers compile these accounts and file an annual reports with FERC. These reports were used in setting the taxpayers' rates. The taxpayers did not enter either their receipts from their customers, nor their payments to BPA and WPPSS, from which they seek to measure the exemption, into any account for capital facilities.

The taxpayers purchased wholesale electrical power from BPA and WPPSS. BPA acts as an administrator for the federal government and is responsible for supplying electricity to the utilities throughout the Northwest. BPA did not own generating resources, but paid for the operations, maintenance, and debt service of the federal hydroelectric dams in the region and several nonfederal power plants. It also owns transmission facilities.[2] The taxpayers seek to exclude their portion of BPA's share of its costs for capital facilities.

During the refund period, under net billing agreements between the taxpayers, BPA, and WPPSS, the taxpayers sent a portion of their payments to WPPSS. WPPSS paid for three facilities, Washington Nuclear Projects I, II, and III (referred to collectively as WNP and individually as WNP I, WNP II, and

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

[2] BPA also purchases power and participates in exchanges with other utilities.

WNP III). WPPSS is a Washington municipal corporation that financed, built, operated, and maintained WNP. Only WNP II operated during the refund period, and therefore, most of the payments from the taxpayers to WPPSS were for the retirement of obligations and payment of interest for their construction rather than for their operation. A lesser amount was for their maintenance. The taxpayers have identified, from BPA's records the actual expenditures to retire the debt and maintain each facility as well as the operational costs for WNP II. The taxpayers did not include these operational receipts in their refund request. The respective parties accounted for these transactions as shown below:

Power payments to BPA & WPPSS (taxpayers' books):

Debit : Purchase Power - BPA $$$
Debit : Purchase Power - WPPSS $$$
Credit: Cash $$$

Receipt by WPPSS (WPPSS books):

Debit : Cash $$$
Credit: Due Power Purchasers[3]

To record the transfer to the bond funds (WPPSS books):

Debit : Interest payable $$$
Debit : Bonds payable $$$
Credit: Cash $$$[4]

Similarly, BPA's books reflect the transactions:

Debit : Cash $$$
Credit: Electric Revenue

To record the transfer to the bond funds (BPA's books):

Debit : Borrowing Bond Fund - Interest
Debit : Borrowing Bond Fund - Principle
Credit: Cash $$$

Specifically, the taxpayers' books reflected these payments to BPA and WPPSS by debiting the FERC account numbered 555 for purchased power. The taxpayers totalled the account and reported it to the U.S. Department of Energy, Energy Information Administration, on form E1A-412 (line 8, page 8 for 1995) as purchased power.

The obligations for these payments arose nearly thirty years ago from anticipated growth in demand. In 1971, the taxpayers anticipated a growth in energy demand that exceeded the production capabilities of the existing generating facilities. The taxpayers, BPA, and WPPSS entered into participation agreements whereby WPPSS built WNP and agreed to sell the taxpayers a share of the power, while the taxpayers agreed to pay for a share of the power from WNP.

In 1971, each of the taxpayers signed a Net Billing Agreement that required each taxpayer to pay a budgeted amount of its BPA obligation directly to WPPSS each year. The taxpayers assigned their share to BPA. BPA agreed to sell the taxpayers power, using the receipts to credit or offset the taxpayers' annual obligation to WPPSS.

The Net Billing Agreements state that the taxpayers were purchasing the right to future power. The taxpayers did not receive an interest in the facilities themselves. The taxpayers have not provided any document showing that they acquired an interest or share of an interest in any capital facilities regarding their payments to BPA or WPPSS. They refer to their interest as "a share of capability of the nuclear generating plant." Regarding their obligations, however, the agreements provided that the

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[3] FERC account number 242 or WPPSS fund code 42 (revenue fund).

[4] To defer the revenue received for payment of the bond principal, WPPSS debited FERC account 242 (Due Power Purchasers) and credited FERC account 253 for Unearned (deferred) Revenues (Billings in Excess of Cost).

taxpayers were required to pay the costs of WPPSS and BPA whether or not they received any power from WNP.

BPA included the WNP debt and interest charges in its costs used to set its rates charged to the taxpayers for electrical power.[5] BPA set the rates in accordance with the process mandated by The Pacific Northwest Electric Power Planning and Conservation Act of 1980. The process was referred to as BPA's "rate case." BPA's[6] rate case addressed what BPA should charge for its power and transmission services; it did not decide the nature of BPA's services or determine BPA's budget.

The taxpayers explain that, after BPA forecast electrical demand or load for the region, it estimated the costs of providing the load during the rate period. The costs were compared to the revenues generated to provide the load under the existing rate. If the projected costs for the rate period exceeded projected revenue by a significant amount, BPA requested a rate increase. Simply stated, BPA divided its revenue requirement by its customers' projected power use to determine its rates.[7] The result was that BPA requested wholesale electrical rates to recover its costs.

The rate case was a formal legal process before a hearing officer. According to the taxpayers, the role of the officer was not to judge the merits of BPA's proposal. Instead the hearing examiner compiled a complete record as a basis for the BPA administrator's decision on the final rate proposal. All testimony, exhibits, and comments became part of the official record. Formal hearing documents were available for public review at the BPA's information center in Portland, Oregon or by mail. The documents were voluminous and highly technical.

As a result of BPA's rate case, utilities that purchased their electricity from BPA could raise the rates charged to their customers.[8] Their rates were also set to cover their projected costs. Because BPA's charges constituted a major cost to the taxpayers, any change in BPA's rate could affect the rate the taxpayers charged their customers. The taxpayers indicate that their rate setting process was open, and that their consumers could determine the portion of the rate that they paid for the WNP capital construction or capital debt retirement.

All of the taxpayers paid BPA the same rate for electrical power. They computed their refund request by dividing the total capital costs of both BPA and WPPSS, by the total BPA budget including WPPSS costs. That percentage was then multiplied by the power purchased by each taxpayer to determine their refund. In the alternative, the taxpayers contend that the exempt amount could be computed by adding each taxpayer's obligation under the net billing agreements (WPPSS obligation) to the capital portion of its payments to BPA (not WPPSS) for BPA's capital costs. This alternative computation would alter the amount of refund due each taxpayer. In theory, however, the aggregate total should be the same.

Some of the taxpayers generate power. They state that their taxable sales of power did not exceed the amount that they are seeking to exempt.[9]

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[5] BPA charged the taxpayers the priority firm (PF) rate for most of the electrical power purchased. According to the taxpayers, that rate included a component for WNP capital facilities. For the purpose of this determination, elaboration of other rates is unnecessary.

[6] From BPA's Backgrounder January 1993. "Making a case for rates, a description of the rate making process" p. 3.

[7] Actually, there are several rates depending upon the customer group and type of power. Costs are allocated according to federal law directives. We are only concerned with the taxpayers' PF rate.

[8] The rates charged by cities and the public utility districts were not subject to the rate-making supervision of the State Utilities and Transportation Commission. RCW 43.52.450 and RCW 54.16.040.

[9] For instance wholesale sales of power are exempt from public utility tax. RCW 82.16.050(2). The taxpayers are seeking to apply the exemption to their retail sales only. This does not address the issue of whether or not the exemption they seek for

The taxpayers contend that they were entitled to exempt their receipts used for the WNP capital construction or capital debt retirement. The Audit Division of the Department of Revenue (Department) rejected the taxpayers' refund claims indicating that the customers only knew that they were paying for electric service. The consumers did not know what portion of their bill was used to pay for the WNP capital construction or capital debt retirement.

The taxpayers also included in their refund requests a deduction for conservation based upon their payments to BPA. The taxpayers paid to improve customers' energy efficiency. For instance, they paid weatherization installers a portion of their customers' bills. They paid incentives for insulation and house tightening measures for residences. They deducted those amounts directly, referencing RCW 82.16.055(b). BPA reimbursed the taxpayers for these types of conservation expenditures. The taxpayers included the BPA reimbursements in their measure of public utility tax. Their conservation payments may have exceeded the BPA reimbursements. Those expenditures and reimbursements are not at issue.

The taxpayers state that payments for conservation programs were included in the rates that they paid to BPA. While the BPA invoices only showed the kilowatt hours (energy), kilowatts (demand), and rates, the taxpayers note that conservation was a component of the rates. The taxpayers point out that in developing its rates, BPA determined its costs for each budgeted item including conservation. BPA's rates were approved after open meetings. The taxpayers determined the portion of the rate attributable to BPA's conservation budget by multiplying the ratio of BPA's conservation costs to the total BPA budget. The taxpayers request a deduction of this amount from their gross income and a refund of public utility tax.

The taxpayers provided a letter from BPA that states in part:

As a preference customer, [taxpayer] purchases a variety of products and services directly from Bonneville that are funded through the Priority Firm (PF) rate. Products and services provided through the PF rate encompass not only wholesale electric power but also a wide variety of power delivery, energy conservation and other services and programs. . . . embodied within the PF rate is an explicit amount for energy conservation programs. Bonneville's rate setting process incorporates budgeted energy conservation expenditures as an element of its revenue requirements which in turn are recovered via the wholesale power rates.

. . .

. . . [taxpayer] does in fact pay the costs for explicit end-use energy conservation programs as part of its wholesale power purchases. [Taxpayer] purchases and pays for these programs as an inseparable and mandated part of its power bill.

The taxpayers reason that, since the conservation program was part of BPA's costs, conservation was a factor in determining the rates charged by BPA to the taxpayers. Therefore, the taxpayers seek to deduct a portion of their payments to BPA as a conservation expense.

Similar to the payments that they attribute to WNP, the entries in the taxpayers' books reflect only the power purchased from BPA. Regarding a specific requirement to pay for these costs, the taxpayers refer to a provision in an exhibit[10] in the power sales contract agreement with BPA states:

Bonneville's wholesale power rates established on any Rate Adjustment Date shall be developed consistent with the provisions of section 7 of P.L. 96-501.

The taxpayers then refer to Section 7(g) of P.L. 96-501, which states:

Except to the extent that the allocation of costs and benefits is governed by the provisions of law in effect on the effective date of the Act, or by other provisions in this section, the Administrator shall equitably allocate to the power rates, in accordance with generally accepted accounting principles and the provisions of this Act, all costs and benefits not otherwise allocated under this section, including, but not limited to, conservation . . .

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capital construction should be pro-rated between exempt and taxable revenue.

[10] Exhibit B entitled, "General Contract Provisions", page 10, Section 8(e) of the Power Sales Contract between BPA and P.U.D. No. 1 of Snohomish County.

The taxpayers contend that the PF rate applied to delivered kilowatts has the effect of distributing all factored costs (i.e., wholesale electric power and energy conservation costs) to the taxpayers. In this way, the taxpayers reason that they were entitled to deduct BPA's energy conservation costs under RCW 82.16.055.

ISSUES:

1. May the taxpayers exempt a portion of their revenue as a cost of capital facilities based upon amounts they paid to purchase power from BPA and WPPSS?

2. May the taxpayers deduct as conservation a portion of the amounts paid to BPA for power?

DISCUSSION:

[1] EXEMPTION FOR CAPITAL FACILITIES CONSTRUCTED. The public utility tax is imposed upon the gross income of light and power businesses. RCW 82.16.020(b). An exemption was[11] allowed under RCW 82.04.417, which provided:

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.

The taxpayers seek to exempt receipts from their customers as amounts paid for their share of the cost for capital facilities constructed. The first portion of the statute limited the applicability of the exemption to counties, cities, towns, political subdivisions, and municipal or quasi-municipal corporations of the state of Washington. The taxpayers were cities and towns, or public utility districts, which were municipal corporations. See RCW 54.04.020. Therefore, the taxpayers were the types of entities eligible for the exemption.

The taxpayers assert that their customers paid them for the construction of capital facilities. The taxpayers allege that their situation closely matches the situations in Det. No. 87-63, 2 WTD 285 (1987); Det. No. 88-343 (not published, but cited in Det. No. 89-451); and Final Det. No. 89-451, 8 WTD 195, 198-200 (1989). In those determinations, there was no issue of whether or not the taxpayers were purchasing capital facilities. Those utilities owned the facilities.

Det. No. 89-451, supra, discussed whether 14 public utility districts could exempt receipts for capital construction if those charges were not segregated from electric service on invoices to customers. The Department allowed the exemption for utilities that owned the capital facilities provided three requirements were met:

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.

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,

[11] The exemption was repealed and is no longer applicable. It was in effect through June 30, 1993, the end of the refund period.

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.

Det. No. 89-451, 8 WTD 195, 198-200 (1989).

The taxpayers' argument relates each requirement to the other two requirements. The taxpayers assert that their customers (ratepayers) had knowledge of the amount that they were paying for capital facilities. If not stated on their invoices, that amount had to be clear from resolutions or other information publicly available from their open meetings (first requirement). To determine whether the taxpayers' customers had sufficient knowledge of the cost of the capital facilities, the taxpayers direct us to their rate case, the adoption of their rates after reviewing their projected budget. The taxpayers' budgets were adopted after reviewing their costs of power as well as the capital costs that they track in their books (second requirement).

The taxpayers did not segregate WPPSS' WNP costs in their books. Rather they stated that those costs were included in their rates for power from BPA. BPA sets its rates following the federal rule adoption process, a process open to the public. Because the process was open to the taxpayers' customers, the taxpayers reason that the customers had constructive knowledge that their rates included the cost of capital facilities. Likewise, in the budget process the taxpayers' books were open to the public, assuring their ratepayers that they did in fact pay for the capital facilities (third requirement). However, because the amounts paid by the taxpayers depended upon the kilowatts delivered, the taxpayers direct us back to the resolutions to determine the amounts actually paid for the capital facilities. The taxpayers' interrelationship of these requirements made it highly unlikely, if not impossible, for the taxpayers' customers to know at the time they paid their electric bill how much they were paying for capital facilities.

For the reasons outlined below, the taxpayers' refund claims do not meet the requirements of the statute or the determinations referenced by the taxpayers:

A. The determinations are distinguishable. Determination Nos. 87-63, 88-343, and 89-451 are inapposite. They neither involved facts similar to those presented to us, nor did these determinations dictate the result sought by the taxpayers in this case. There are at least seven reasons why the taxpayers' refund requests do not meet the requirements of RCW 82.04.417 and Det. No. 89-451. First, as we will discuss later, the taxpayers purchased the right to power, not capital facilities.

Second, the ratepayers (taxpayers' customers) did not have prior knowledge of the set amount they were paying for the facilities. The amount that customers paid varied both with the amount of power that they consumed, as well as the amount of power BPA delivered to each taxpayer. That could only be determined at the end of BPA's fiscal year, if at all.

Third, the taxpayers did not deposit their receipts for capital facilities into dedicated accounts. Receipts from their customers were deposited in a common account and commingled with all service receipts.

Fourth, the taxpayers did not account for the receipts separately. The taxpayers booked them in as service revenues (FERC codes 440-449). They did not account for the receipts that they seek to exempt as charges for capital facilities using other FERC codes, which may have been more appropriate for capital facility construction. For instance, FERC account 252 provides for customer advances for construction. See 18 CFR 101.252.

Fifth, the taxpayers did not account for their expenditures as costs for capital construction. Their payments were recorded under FERC code 555, an expense account for electricity purchased for resale. A capital facility is an asset. FERC accounts 100-135 are asset accounts for various facilities and funds. FERC account 129 is for special funds including property additions and bond retirements. A separate account, with appropriate title should be kept for each fund. 18 C.F.R. 101.129 (1996).[12] Rather than book the payments in one of those funds, the taxpayers expensed them under FERC Code 555 as purchased power. The Financial Accounting Standards Board (FASB) also requires regulated utilities to capitalize construction amounts. See FASB No. 71, Par. 15 (1996). The taxpayers expensed rather than capitalized the amounts that they seek to exempt.

Sixth, the taxpayers' federal reports did not indicate that either the receipts or the payments were for the cost of capital facilities. They reported the receipts to the U.S. Department of Energy, Energy Information Administration on form E1A-412 as operating revenues on line 1. They claim that their payments to BPA and WPPSS were for capital facilities. Yet, they reported those payments on line 8, page 8 (of form E1A-412 for 1995)[13] as purchased power.

Seventh, the taxpayers' reports to the Department did not indicate that they purchased capital facilities. Public utility districts are required to report to the Department, " . . . the total cost of all generating facilities and the cost of acquisition of land and land rights for such facilities . . ." RCW 54.28.030. The taxpayers indicate that they did not report the costs for WNP; WPPSS did.

Given this accounting and reporting, it was very difficult, if not impossible for the taxpayers' customers to know when they paid their bills what amount, if any, was for capital construction. Further, it is confusing to track these amounts afterwards, and determine with certainty exactly what amount each taxpayer paid for capital construction. Variables exist such as the amount of power delivered, whether or not each taxpayer should apply a different percentage to BPA's PF rate for capital facilities, and what amount of power was generated by each facility. These are questions that the taxpayers' customers could not have answered.

These are important differences between the taxpayers' situation and those addressed in the determinations that the taxpayers argue are controlling. The underlying distinction appears to be that the utilities discussed in the determination owned the facilities. As owners, there was no question that they paid the costs for those facilities.

B. The result sought leads to absurd results. Under their reasoning, the taxpayers have not indicated through how many parties revenue could pass and still have the revenue attributed to the underlying costs of capital facilities. For instance, if BPA purchased power from other utilities for resale to the taxpayers, applying the taxpayers' logic, they could exempt a portion of the capital costs of the other utilities. This raises additional questions. The taxpayers may be selling power to BPA, in which case they may have already deducted the costs of the facilities generating the power. Most vendors who provide the taxpayers services other than electrical power also have capital facilities. Under the taxpayers' logic, costs for those facilities could conceivably be used to measure the exemption. Every purchase from a third party raises the question of whether the taxpayers were paying for capital facilities or the services provided by the third parties.

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[12] Washington also requires special funds for utilities acquiring capital facilities. See RCW 54.24.010 (special funds created by commission by resolution), RCW 54.24.018 (acquisition of property and segregation for bond repayment), and RCW 54.24.030 (creates special fund for revenue obligations).

[13] The taxpayers indicated that the accounting entries continued to be the same as they were throughout the refund period to the present. A 1995 return was available, so it was used as a typical sample.

Statutes must be interpreted to effect their purpose and avoid absurd results. State v. Neher, 112 Wn.2d 347, 351, 771 P.2d 330 (1989). Under the taxpayers' interpretation, utilities who build their own facilities and sell the power to BPA, could be deducting the costs of the facilities twice if they repurchase power from BPA. That interpretation would also allow utilities to deduct the capital costs of their vendors, even if the vendors were selling them something other than electrical power. Furthermore, under this theory the taxpayers could claim an exemption for the capital costs of WPPSS' and BPA's vendors, and their vendors' vendors. RCW 82.04.417 did not allow an exemption for third party costs of capital facilities that were identified as service charges.

C. The taxpayers purchased power not capital facilities. The exemption statute required that the charges or payments be for capital facilities. An exemption was not available to the taxpayers for capital facilities paid for by others, nor was it intended to be available. RCW 82.04.417 specifically excepts service charges from exemption even if "used wholly or in part for capital purposes."

The taxpayers contend that their payments were for capital facilities. In Chemical Bank v. WPPSS, 99 Wn.2d 772, 788, 666 P.2d 329 (1983), appeal after remand 102 Wn.2d 874, 691 P.2d 524 (1984), cert denied 471 U.S. 1065 (1985), the Washington Supreme Court found that participation agreements for WNP 4 and 5 did not convey a sufficient interest to the utilities to constitute the equivalent of an ownership interest. While the public utilities had the statutory authority to construct or acquire electric generating facilities, that authority was conditioned upon either an ownership interest or their active participation in the management of those facilities.

While the Chemical Bank decision involved WNP 4 and 5, the nature of the participation agreements appears similar to the participation agreements and the net billing agreements for WNP I, II, and III. WPPSS built WNP and agreed to sell the taxpayers a share of the power. The taxpayers agreed to pay for a share of that power, not the capital facilities. Id., at 779.

The Net Billing Agreements obligated the taxpayers to pay for the facilities regardless of whether or not they generated power. The taxpayers point out that obligation is unconditional. Yet their customers, whose payments the taxpayers seek to exempt, had no such obligation. They only paid for the power that they consume.[14]

The taxpayers contracted for the right to power, not a right in the capital facilities. The Net Billing Agreements state that the taxpayers purchased a "Participant's Share" or a decimal fraction of project capability from WPPSS. In the same agreement, the taxpayers assigned their "Participant's Share" to BPA.

The taxpayers' receipts from their customers must have represented "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." The taxpayers have attempted to show that their customers paid them for a share of the cost of those capital facilities or the debt incurred to construct those facilities.

We find that neither the taxpayers nor their customers paid for capital facilities. They purchased electric power. Electric power is not a capital facility. Invoices from the taxpayers to their customers did not segregate or otherwise mention a charge for capital facilities. Rather, the invoices showed only the charge for electric service computed based upon kilowatts consumed. Likewise, BPA's invoices to the taxpayers computed the charges based upon kilowatts delivered.

D. The taxpayers' claims are contrary to legislative intent. Exemption statutes should be construed narrowly. Exemptions in a tax statute must be strictly construed in favor of the tax. Unemployment Compensation Department v. Hunt, 17 Wn.2d 228, 135 P.2d 89 (1943). In cases of doubt or ambiguity exemptions are interpreted against taxpayers, though fairly and in keeping with the ordinary meaning of their language. Crown Zellerbach Corp. v. State, 45 Wn. 2d 749, 278 P.2d 305 (1954). Taxpayers must demonstrate that their transactions fall within an exemption. Weaver v. King County, 73 Wn.2d 183, 191, 437 P.2d 698 (1968).

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[14] Customers may have been required to pay other charges such as changing or connecting service, repairs, or line extensions if separately stated on the invoices (FERC account # 451). This determination does not address the taxability of those receipts, only the normal electric service charges (FERC accounts # 440-449).

In interpreting RCW 82.04.417, our primary objective is to ascertain and give expression to the intent of the legislature from the language of the statute as a whole. Clements v. Travelers Indem. Co., 121 Wn.2d. 243, 254, 850 P.2d 1298 (1993). When a statute is ambiguous, we attempt to determine the intent of the Legislature. Human Rights Comm'n v. Cheney Sch. Dist. 30, 97 Wn.2d 118 , 121, 641 P.2d 163 (1982). The legislative history of the statute is an important tool to ascertain intent. See Bellevue Fire Fighters Local 1604 v. City of Bellevue, 100 Wn.2d 748 , 751-53, 675 P.2d 592 (1984), cert. denied, 471 U.S. 1015 (1985).

Services were expressly excepted from the exemption. The evidence also indicates that the statute was never intended to be applied to utility companies that had no ownership interest in the capital facilities. RCW 82.04.417 was enacted in 1969, about the same time initial proposals for WNP were being considered. There is no evidence that anyone involved with the legislation (House Bill 659) anticipated exempting receipts from utility customers for such projects.

Prior to the enactment of RCW 82.04.417, the Supreme Court of Washington had ruled in King County Water District No. 68 v. Tax Comm., 58 Wn.2d 282, 362 P.2d 244 (1961) that payments from prospective water customers for constructing facilities were not subject to the public utility tax, which imposed the tax then, as now on "the operating of a plant or system for the distribution of water for sale." RCW 82.16.010(4).[15] See also Seattle v. State 59 Wn.2d 150, 367 P.2d 123 (1961). In Kennewick v. State, 67 Wn.2d 589, 409 P.2d 138 (1965), the court held that receipts from existing customers used to repay bonds issued for capital improvements were "operating" income subject to public utility tax while receipts from prospective customers for capital improvements were not subject to the public utility tax, but the business and occupation tax.

House Bill 659, which became RCW 82.04.417, and other bills were introduced to reverse these holdings. House Bill 659 was discussed on the floor of the Senate on April 9, 1969. A senator (Atwood) asked what was meant by "service charges", which were specifically excepted from the exemption. The Journal of the Senate contained the following:

Senator Guess: "Senator Atwood, the normal service charge is on a sewer charge. They have in certain instances paid a part of the city's care out of the service charge on the sewage disposal system."

Senator Atwood: "Are you quite certain that those include only the normal water and service charges that presently pay B&O taxes?"

Senator McCormick: "I think I have an answer here. I have a letter from Don Burrows, assistant director of the department of revenue and he says the impact of both bills would be similar and would affect essentially providers of water and sewer charges. These measures would exempt from the coverage of the B&O tax [money] that is received by taxing districts municipal corporations or political subdivisions from payment or contribution for capital improvement. All such payments made prior to initiation of service are presently subject to B&O tax."

Senator Atwood: "I just wanted a clarification. I think their bill is okay as long as there is no misunderstanding about what that service charge is."

Senate Journal, 41st Legislature, at 1175 (1969).

The Bill passed 38-0. The Senate did not anticipate that utilities would seek to exempt the normal electric service charges, even if used for capital purposes.

Upon passage by both the House and the Senate, John Sherwood, an employee in the Governor's office, explained House Bill 659 to Governor Evans in a memo dated April 23, 1969:

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15 For electric utilities, RCW 82.16.010(5) provides:

"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.

This bill would exempt cities and other taxing districts from paying the state's B & O tax on their LID [Local Improvement District] assessments or, for payments financing capital improvements. All such payments made prior to the initiation of service have now been ruled by the Department of Revenue to be subject to the B&O tax.

Explanation: For over 30 years, since the 1935 Revenue Act was first adopted, the state has never sought to collect B & O taxes from cities LID assessments until the past year.

The cities argue that while assessments are not taxes, they are in the nature of taxes. They are levied under the power to tax, and are closely allied to ad valorem taxes against real property. The contention is that they are a capital account item, not an income account item, and should not be treated as ordinary income.

The Governor signed the bill, which was codified as RCW 82.04.417, on April 24, 1969. The next day, on April 25, 1969, amendments to RCW 54.24.018 became effective regarding public utility district financing. Because of the relative timing of two bills, it should have been evident to the legislature and the governor that the utilities to whom the exemption would be applied, accounted for capital items differently than they accounted for income or services.

The fiscal notes showed that the estimated fiscal impact of the exemption would total $80,000 for the 1969-1971 biennium and $210,000 for the next five years.[16] Therefore, it is also evident that no one involved with this legislation intended the broad application, which would result under the taxpayers' interpretation.

The taxpayers seek a refund of over $20 million based upon their interpretation of this exemption statute. This refund action alone, without considering claims by other utilities, dwarfs the projection in the fiscal note.

We interpret the statute as it was intended to be applied by the legislature and the governor. To qualify for the exemption, the taxpayers must have clearly demonstrated to their customers, so that the customers knew they were paying for their costs of capital facilities, and understood that these were not normal service charges. The statute acknowledges that normal service charges could have been applied for capital purposes. But, regardless of whether or not the normal service charges were used for capital purposes, those charges, like the charges in the taxpayers' situation, were not exempt. The last sentence of RCW 82.04.417 specifically excepts normal service charges from the exemption:

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

The taxpayers did not charge their customers for capital facilities in the manner required for the exemption. The taxpayers accounted for them as revenue items, not capital items as discussed in April 23, 1969 memo to the Governor. Regarding the receipts that they seek to exempt, they bill their customers for electric service, not capital facilities. The taxpayers' receipts were for service, not capital facilities. RCW 82.04.417 excepted service charges from the exemption. Therefore, the taxpayers were not entitled to exempt their electric service revenue.

[2] <u>CONSERVATION DEDUCTION</u>. The taxpayers rely on RCW 82.16.055 as authority for their position. Subsection (1) of that statute provides in part:

In computing tax under this chapter there shall be deducted from the gross income:

(b) Those amounts expended to improve consumers' efficiency of energy end use or to otherwise reduce the use of electrical energy or gas by the consumer.

Subsection (5) of RCW 82.16.055 authorizes the Department of Revenue to determine the measures for deductions. The Department promulgated WAC 458-20-17901 (Rule 17901) that provides in subsection (1)(b):

(1) In computing tax under this chapter there shall be deducted from the gross income:

(b) Those amounts expended to improve consumers' efficiency of energy end-use or to otherwise reduce the use of electrical energy or gas by the consumer.

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[16] The fiscal notes were identical for HB 659 (#70), SB 567 (#56), SB 622 (#622).

BPA charged the taxpayers for electrical energy. The taxpayers accounted for these payments to BPA under FERC account 555, for purchased power, not conservation. The rate may have included a conservation component, or conservation may have been considered in determining the rates. But, the taxpayers were paying to purchase electricity from BPA, not consumer efficiency of end-use energy or other consumer energy reductions. They reported it that way on form E1A-412. The BPA invoices did not exclude the amounts designated for energy conservation from the amounts paid to receive the electricity.

We note that Rule 17901 also provides:

The question of the deductibility of any expenditures not expressly covered in this rule must be submitted to the department in writing for an express ruling before deduction may be taken.

Nothing in Rule 17901 addresses components of the BPA rates. These conservation expenses were paid by BPA, not the taxpayers. BPA charged the rates based on the quantity of electricity purchased. The taxpayers' could only determine their alleged share of BPA's conservation expenses after they computed the kilowatts delivered from BPA. BPA invoiced the taxpayers for kilowatts delivered, not conservation. Similarly, they contracted for the purchase of electricity, not conservation.

We also note that subsection (2) of RCW 82.16.055 provides:

(2) This section applies only to new facilities for the production or generation of energy from cogeneration or renewable energy resources or measures to improve the efficiency of energy end use on which construction or installation is begun after June 12, 1980, and before January 1, 1990.

The taxpayers are claiming refunds for the period beginning January 1, 1991. It is unlikely that the taxpayers' payments to BPA after January 1, 1991 were for measures to improve the efficiency of energy end use for which the construction or installation began before January 1, 1990.[17]

The taxpayers purchased electricity from BPA. An expenditure for electricity was not deducible as conservation. The taxpayers' payments to BPA did not qualify for the conservation deduction.

DECISION AND DISPOSITION:

The taxpayers' petitions are denied.

DATED this 18th day of December, 1996.

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[17] The taxpayers specifically requested the refund under RCW 82.16.055. RCW 82.16.052 provided a deduction for amounts expended for efficient end use if priority was given to senior citizens and low-income citizens. The taxpayers have made no such claim. Additionally, subsections (3)(e) and (3)(g)(vi) of Rule 17901 provide that the costs must be directly cost accounted. Since these costs were not incurred by the taxpayers they could not be directly cost accounted.