

Cite as Det. No. 99-114, 19 WTD 243 (2000)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petitions For Refund of	)	<u>D E T E R M I N A T I O N</u>
	)	
	)	No. 99-114
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...	)	Registration No. ...
	)	REFUND REQUEST
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[1] RCW 82.16.417: USE TAX – BUSINESS AND OCCUPATION TAX – PUBLIC UTILITY TAX – EXEMPTION – COST OF CAPITAL FACILITIES. The exemption to the public utility tax, provided by the former RCW 82.16.417, does not extend to amounts paid to a municipal corporation’s water department from a water district, organized under ch. 57.04 RCW, when the municipal corporation’s water department uses a portion of those payments to pay for its capital facilities.

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:

Four water districts appeal denials of tax refunds for “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.”<sup>1</sup>

FACTS:

Gray, A.L.J. – The four taxpayers here are water districts located in King County. Each water district sells water to customers located within its district. Each water district paid public utility tax on the receipts from its water sales. They applied for refunds calculated by reducing the receipts subject to tax for “capital contributions.”

All four have appealed to this Division from the Audit Division’s denials of their requests for tax refunds. The basis for the claims is payments made by the water districts to the City of . . . Water Department [city] representing amounts used by [city] for capital construction. The authority for the refund was RCW 82.04.417, which was repealed effective July 1, 1993.

Three of the four water districts filed refund requests on December 28, 1993, for tax paid in 1989 on amounts the water districts paid to the City of . . . under a purveyor’s contract. Three of the four water districts filed additional refund requests in 1995 for tax years 1990 through 1993. The fourth water district filed a refund request in 1995 for the tax years 1991 through 1993.

All four water districts have waived, in writing, the confidentiality provisions of RCW 82.32.330 *inter se* for the limited purpose of the hearing and the determination.

The water districts said they have a contract with [city] to buy [city] water. They said the contract requires each member<sup>2</sup> to pay a percentage amount to [city] for capital improvements. [city] does not specify the amounts allocable to capital improvements in its bills to the water districts. The water districts do not itemize their bills to their ratepayers. Nonetheless, the water districts said their ratepayers had imputed knowledge of the payments to [city] and that those payments met the contract’s requirements for capital improvements because the rates were published annually before adoption of the district budget.

The water districts argue they have an ownership interest in the physical plant of the City of . . . Water Department because of their payments for capital improvements. The water districts do not hold any title to the physical plant or other capital assets of [city]. The water districts point to “City of . . . Annual Purveyor Statements” in which [city] allegedly refers to the water districts’ payments as “investments” and are presented as “purveyor assets.” The water districts also say that [city] recognizes the water districts’ ownership interest in [city] water department by maintaining a “Purveyor Facilities Account” and separate accounting of purveyor assets.

The water districts also argue they are “municipal corporations” within the meaning of that term as used in RCW 82.04.417. They argue that Article 11, Section 10 of the Washington State

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

<sup>2</sup> No contract was produced to support their claims. Each water district is apparently a “member.”

Constitution authorizes “corporations” for municipal purposes to be created by general laws, not by special laws, and that RCW 57.04.020 (authorizing water districts) is just such a general law.

The water districts claim several other water districts were granted similar tax refunds before the Department issued Det. No. 96-255, 16 WTD 138 (1996). The Audit Division denied the water districts’ refund claims on the basis of Det. No. 96-255. The water districts claim inconsistent treatment. The water districts argue their refund claims were filed before the Department issued Det. No. 96-255. Consequently, they say Det. No. 96-255 should not apply retroactively.

#### ISSUES:

1. Whether the water districts are “municipal corporations” or “quasi municipal” corporations as those terms as used in RCW 82.04.417; and
2. Whether the water districts’ payments to [city] are “charges, payments or contributions representing a share of the cost of capital facilities constructed or to be constructed;” and
3. Whether Det. No. 96-255 applies to refund claims that were filed before the Department issued Det. No. 96-255.

#### DISCUSSION:

The statute on which the issues in this determination turn is RCW 82.04.417. RCW 82.04.417 was repealed effective July 1, 1993. The text of the statute is given here in order to discuss the issues that follow:

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.

#### **Whether the water districts are “municipal corporations” or “quasi municipal corporations” as those terms as used in RCW 82.04.417.**

The first question is whether water districts are municipal or quasi municipal corporations as those terms are used in RCW 82.04.417. Water districts are authorized in and are governed by Title 57 RCW. RCW 57.04.060 provides, in pertinent part:

If at the election a majority of the voters voting upon the proposition vote in favor of the formation of the district the county legislative authority shall so declare in its canvass of

the returns of the election to be made within ten days after the date of the election, and the district shall then be and become a municipal corporation of the state of Washington, and the name of the district shall be the name of the district as provided in the petition and the ballot.

(Emphasis supplied.)

It is unnecessary to consider the water districts' argument because RCW 57.04.060 answers the question. Because the resolution of this issue does not in itself determine the water districts' refund claims, we now move to the second issue.

**Whether the water districts' payments to Seattle are "charges, payments or contributions representing a share of the cost of capital facilities constructed or to be constructed."**

In order to understand the claimed deduction, it is first useful to review how the public utility tax is intended to work. The public utility tax is codified in chapter 82.16 RCW. It is similar in concept to the business and occupation (B&O) tax, which is codified in chapter 82.04 RCW. The B&O tax applies to every person engaged in business in Washington except where the legislature expressly provides an exemption from taxation. See, RCW 82.04.220. RCW 82.04.310 exempts public utilities from the B&O tax if the activity is separately taxed under chapter 82.16 RCW.

The public utility tax is imposed on every person for the act or privilege of engaging in Washington in any of the businesses identified in RCW 82.16.020, including the water distribution business. RCW 82.16.020(1)(g). We have previously confirmed that water districts must pay the public utility tax. Det. No. 90-340, 11 WTD 81 (1990). The measure of the tax is the gross income of the business. "Gross income" is defined in RCW 82.16.010(12) to mean:

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.

Income is broadly defined and allows no exclusions before the imposition of the tax. In short, the public utility tax is imposed on gross income, not on net income.

The tax deduction sought by each of the four taxpayers was found in RCW 82.04.417 (quoted above), which provided that the public utility tax would not apply to "amounts or value paid or contributed to any . . . municipal or quasi municipal corporation of the state of Washington" representing a share of the cost of capital facilities. The statutory scheme of chapter 82.16 RCW does not allow the water districts to deduct from their gross income, amounts the water districts pay to [city]. We think it unlikely that [city] allows other municipal corporations to become co-owners of its water system. We conclude it is more likely that the water districts simply

purchase water from [city]. How [city] books its receipts does not entitle the water districts to a deduction. The water districts may not deduct that portion of their gross income or their receipts that represent a share of the cost of [city's] capital facilities. See, Det. No. 96-255, 16 WTD 138 (1996).

We conclude that RCW 82.04.417 was intended to allow the water districts to deduct amounts that are received by the water districts from their ratepayers and are clearly identified as being for their own capital facilities.<sup>3</sup> Each district bills its customers for water. The districts are not assessing their customers for [city] capital improvements. In this regard, we adhere to Det. No. 96-255, 16 WTD 138 (1996), which controls these four consolidated appeals.

The petitions are denied on this issue.

**Whether Det. No. 96-255 applies to refund claims that were filed before the Department issued Det. No. 96-255.**

The water districts cited no authority to support their claims that Det. No. 96.255 is not applicable to this appeal. Det. No. 96-255, 16 WTD 138 (1996) was published before the November 19, 1998 hearing of these four water districts and the date of issuance of this determination. RCW 82.32.410 allows the Director of the Department of Revenue to designate certain determinations as precedents, which was done. That determination represents the Department's position on the issue raised by these water districts.

Additionally, we note that RCW 82.04.417 remained substantially unchanged until its repeal in 1993. The Supreme Court said, in Kitsap-Mason Dairymen's Ass'n. v. Washington State Tax Comm'n., 77 Wn.2d 812, 818, 467 P.2d 312 (1970):

The pertinent statutes and rules have not been changed materially since the Revenue Act was adopted in 1935. Even assuming the auditors misconstrued the law, the erroneous construction is not controlling merely because of subsequent legislative inaction. *Latimer v. Western Mach. Exch.*, 40 Wn.2d 155, 241 P.2d 923 (1952). This is

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<sup>3</sup> Seattle v. State, 12 Wn. App. 91, 527 P.2d 1404 (1974) does not assist the water districts. In that case, Seattle City Light sought to deduct amounts received from its customers before the enactment of RCW 82.04.417, where those payments were made pursuant to separate billings for the purpose of converting from an overhead to an underground electric power distribution system. The Court of Appeals held that the City of Seattle was entitled to a refund or credit for excise taxes paid on revenue received from customers of its Department of Lighting, where such revenue was received exclusively for the cost of conversion from an overhead to an underground electric power distribution system. The Court of Appeals also said that the taxable "gross income" within the purview of chapter 82.16 RCW must accrue from the performance of the public service, and not from customer contributions toward the capital costs of constructing part of the electrical distribution system. The Court of Appeals concluded that, in the 1974 case, the customers' payments were not connected with the general obligation of all the utility's ratepayers to pay the monthly rate for services rendered. In contrast, the water districts here simply bill their ratepayers and, here, attempt to carve out a portion of those payments and attribute them to capital construction of a completely different municipal corporation. The water districts cannot show that any of the amounts they receive from their ratepayers are for anything other than the performance of a public service.

particularly true when there is nothing to indicate that the legislature was aware of such administrative interpretation.

This is not a case in which auditors changed their interpretation of a statute or rule. It is one in which they overlooked through ignorance, neglect or inadvertence Kitsap's error in computing the tax. The fact that the oversight only recently has been discovered does not relieve Kitsap of its liability for the correct tax during the audit period now under consideration.

We also note that RCW 82.32.330 prohibits the Department from discussing taxpayer information of other taxpayers.

The petitions are denied on this issue.

Because we deny the requests for refunds, it is unnecessary to discuss the timeliness of the claims for refunds.

#### DECISION AND DISPOSITION:

The petitions are denied.

Dated this 30<sup>th</sup> day of April 1999.