Cite as Det. No. 05-0245, 26 WTD 16 (2007)

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. 05-0245
. . .	)	Registration No. . . .
	)	FY . . ./Audit No.. . .
	)	FY . . ./Audit No. . . .
	)	Docket No. . . .

RULE 179; RCW 82.16.010: PUBLIC UTILITY TAX – LIGHT AND POWER BUSINESS – GROSS INCOME – OPERATIONS INCIDENTAL THERETO. Where a taxpayer's business model required that it routinely over-purchase electricity transmission capacity from a supplier, income received from the sale of excess electricity transmission capacity was derived from an operation incidental to Taxpayer's business of purchasing, transmitting, and distributing electricity to customers. Therefore, it was taxable under the light and power rate of the public utility 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.

Okimoto, A.L.J. – A public utility district protests . . . public utility taxes assessed on income derived through selling excess transmission capacity. We deny Taxpayer's petition . . . .[1]

ISSUES

1) Is public utility tax due on amounts received by a public utility district from selling off excess transmission capacity [which it] purchased from [a supplier]?

. . .

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410. Nonprecedential portions of this determination have been redacted.

FINDINGS OF FACT

[Taxpayer] operates an electricity distribution business in [Washington]. Taxpayer owns poles and power lines . . . and provides power to both residential and business users. Taxpayer purchases electricity from a variety of sources and sells and distributes that electricity along poles and power lines to customers in residential and business areas. The Audit Division (Audit) of the Department of Revenue (DOR) examined Taxpayer's records for the period January 1, 2000, through December 31, 2003. That examination resulted in . . . two partial audit assessments being issued for additional taxes, interest and penalties . . . . Taxpayer appealed and both remain due.

Receipts from sale of excess transmission capacity

Taxpayer does not have electricity generating capacity. Therefore, in order to fulfill its electricity distribution business obligations, Taxpayer must purchase electricity from several different sources throughout the year. Some sources are relatively close, but some are located in other states. Consequently, in order to get Taxpayer's purchased electricity from its source to Taxpayer's retail electricity distribution system, Taxpayer must purchase transmission capacity. Taxpayer's retail electricity distribution system is significantly different from the [supplier's] interstate transmission system. Taxpayer's relatively small and local poles run along city streets and the power lines go to individual customers. In comparison, the [supplier's] large transmission lines run through wide right of ways and [extend] over hundreds of miles. Taxpayer pays [a monthly fee] to the [supplier] to procure a specified amount of transmission capacity over [the supplier's] lines each month. However, because Taxpayer has no way of knowing the exact amount of transmission capacity that it will need in any given month (because electricity usage varies based on the weather and other factors), it routinely overbuys transmission capacity. As each scheduled month approaches, however, Taxpayer is able to better estimate its transmission capacity needs. Consequently, when Taxpayer has overbought, it normally resells excess transmission capacity to third party purchasers. The third parties use the [supplier's] capacity to transmit electricity to their own distribution systems.

Audit assessed public utility taxes on this income at the light and power business rate. . . .

ANALYSIS

RCW 82.16.020 imposes a public utility tax for the act or privilege of engaging within this state in the light and power business. The tax shall be equal to the gross income of the business, multiplied by the applicable rate. RCW 82.16.020(1)(b).

RCW 82.16.010(5) defines "Light and power business" as:

> 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.

RCW 82.16.010(12) further defines gross income for public utility tax purposes:

> "Gross income" means the value proceeding or accruing from the performance of the particular public service or transportation business involved, including operations incidental thereto . . . .

In Det. No. 00-080, 20 WTD 204 (2001), we noted that courts have generally limited the term "gross income" under RCW 82.16.020(12) to include only income derived from operating the public utility business being undertaken. In *King County Water Dist. No.68 v. Tax Comm'n,* 58 Wn.2d 282, 362 P.2d 244 (1961)(hereinafter *King County*), the Washington State Supreme Court addressed the question of whether payments for capital expenditures were to be included in the measure of the public utility tax. In that case, a water district had charged two existing customers for the cost of extending water mains to their properties, and had also charged other new customers for the cost of installing water meters and inspecting water main extensions to properties that were constructed by customers. The water district billed and received payment for the services provided to the customers. In finding that the payments were excludable from the gross income of the utility the court stated:

> The issue posed requires that we determine whether the statute makes a distinction between nonoperating and operating revenue of a water utility business. The respondent argues first, that the transactions in the instant case were not within the operation of a water distribution business as defined under RCW 82.16.010(4). We agree. The statute specifically provides that a "'Water distribution business' means the business of operating a plant or system for the distribution of water for hire or sale."
>
> This presupposes the existence of a plant to operate. Constructing, installing, and inspecting facilities for the purpose of operating a plant do not constitute operations of such facilities as expressly provided for under this statutory definition. Thus it follows that money received as reimbursement for the cost of construction, installing, and inspecting facilities for the purpose of operating a water distribution system would not be within the operation of the Water District's distribution business.
>
> The respondent further argues that contributions for capital construction in the instant case do not come within the definition of "gross operating revenue."[2] We agree. RCW 82.16.010(12) provides that "'Gross operating revenue' means the value proceeding or accruing from the performance of the particular public service . . . business . . . including operations incidental thereto . . ."

58 Wn.2d, at 285-6 (footnote added).

[2] At the time of that decision, the public utility tax applied to "gross operating revenues" accruing from the performance of the utility. Although the statute was later changed to remove the reference to "operating" income, the definition of gross income was not changed. No court has considered that change alone significant in deciding what income is taxable. *Kennewick v. State*, 67 Wn.2d 589, 595, 409 P.2d 138 (1965).

The court further found that the income was not derived from an operation incidental to a water distribution business because: "The phrase 'including operations incidental thereto' is governed by the specific words 'performance of the . . . business . . .' which was not being performed under the statutory definition, *supra*, at the time the payments in question were made." 58 Wn.2d at 286.

Similarly, in the same year, *Seattle v. State*, 59 Wn.2d 150, 367 P.2d 123 (1961) (hereinafter *Seattle I*), held that revenue received by a utility from prospective customers for the construction of extension facilities allowing the prospective customers to hook up to the water service were not part of the gross operating revenue received for the delivery of water. Therefore, under the principle enunciated in *King County*, *supra*, the funds were not received for water distribution and, hence, were not to be included in the measure of the public utility tax.

In *Seattle v. State*, 12 Wn.App. 91, 527 P.2d 1404 (1974) (hereinafter *Seattle II*), the issue was whether income received by a utility for the costs of placing electrical wiring underground was part of the taxable operating revenue of the utility. The costs were billed either directly to the customers desiring the undergrounding or to a Local Improvement District organized for that purpose. The Court of Appeals emphasized that funds received "exclusively" for the cost of conversion from overhead to underground wiring were not operating income. *Id.* at 96. The program was undertaken by residents who desired uncluttered views, not for the distribution of electricity they didn't already have. Those payments were not part of the utility's regular charge for electric service, but were separately billed. The court held such income was not taxable, and was analogous to the charges for hook up to individual property owners that were not taxable under *King County* and *Seattle I*.

The Court of Appeals went on to say:

> It is clear to this court from the statutes and from the opinion in *King County Water Dist. 68 v. Tax Comm'n, supra*, that the taxable "gross income" which is within the purview of RCW 82.16 must accrue from the performance of the public service, in this case the operation of a plant or system to supply electrical energy . . . .

Seattle II, 12 Wn. App. at 96.

In this case, Audit acknowledges that Taxpayer's receipts from the sale of excess transmission capacity purchased from [the supplier] are not from the business of operating a plant or system for the generation, production, or distribution of electrical energy for hire. Audit also concedes that the receipts are not from the sale and/or for the wheeling of electricity for others. Instead, Audit refers to the definition of gross income contained in RCW 82.16.010 and contends that the receipts are derived from an operation incidental to Taxpayer's system for distributing electrical energy for hire or sale. We agree.

Taxpayer is in the light and power business. It operates a system for purchasing, transmitting and distributing electricity to retail customers, all of whom reside in [Washington]. Because it

generates no electricity itself, Taxpayer's business model requires that it must purchase large quantities of electricity from electricity suppliers located both within and without the state. In addition, Taxpayer must also purchase transmission capacity from the [supplier] which enables it to receive the electricity that it purchases from suppliers. Furthermore, because electricity can not be stored, it is essential that Taxpayer overbuy transmission capacity on the [supplier] system so that it will always have sufficient capacity to accommodate its needs. Surplus transmission capacity that can later be resold to other third parties directly results from Taxpayer's business operation model. Such is a natural and recurring consequence of Taxpayer's electricity purchasing, transmitting, and distributing operation. Based on these facts, we conclude that Taxpayer's receipts from selling excess [supplier] transmission capacity is derived from an electricity purchasing operation that is incidental to Taxpayer's public service business of purchasing, transmitting, and distributing electricity to customers. Accordingly, this income is properly taxed at the light and power rate of the public utility tax. Taxpayer's petition is denied on this issue.

Next, Taxpayer argues that its sales of excess [supplier] transmission capacity is deductible from public utility tax as an exchange. WAC 458-20-179 (Rule 179) provides:

> (11) Exchanges by light and power businesses. There is no specific exemption which applies to an "exchange" of electrical energy or the rights thereto. However, exchanges of electrical energy between light and power businesses do qualify for deduction in computing the public utility tax as being sales of power to another light and power business for resale. An exchange is a transaction which is considered to be a sale and involves a delivery or transfer of energy or the rights thereto by one party to another for which the second party agrees, subject to the terms and conditions of the agreement, to deliver electrical energy at the same or another time.

In this case, Taxpayer's sale of excess [supplier] transmission capacity is not an exchange because Taxpayer has not exchanged a commodity, but only the rights to a service being performed by the [supplier]. Furthermore, Taxpayer has not exchanged that service for a promise to receive a similar service at another time or location. Taxpayer has received cash. Therefore, we conclude that the sale of excess [supplier] transmission capacity is not deductible as an exchange. . . .

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 14th day of October 2005.