

Cite as Det. No. 14-0305, 34 WTD 175 (2015)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Letter Ruling of)	<u>D E T E R M I N A T I O N</u>
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)	No. 14-0305
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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.

M. Pree, A.L.J. – Three community solar projects (CSPs) object to a ruling that they must register, report, and possibly pay business and occupation (B&O) tax on incentive payments they receive from public utility districts (PUDs). Because they are engaged in business, the CSPs must register and report the incentive payments as gross income subject to B&O tax. We deny the petitions.

ISSUES

1. Under RCW 82.32.030, RCW 82.04.140, and RCW 82.04.150, are CSPs, which obtain incentive payments under RCW 82.16.110(2)(a)(i), engaged in business, and therefore, required to register with the Department?
2. Under RCW 82.04.080, WAC 458-20-101 (Rule 101), and WAC 458-20-273 (Rule 273), must the CSPs report their incentive payments from PUDs as gross income?

FINDINGS OF FACT

[Taxpayers are] three Washington CSPs as defined by RCW 82.16.110(2)(a)(i). Each of the three CSPs is owned in partnership by individual investors with a nonprofit organization exempt from federal income taxation under Internal Revenue Code Sec. 501(c)(3).¹ The individual owners invested funds, which the CSP used to purchase and install solar panels manufactured in Washington on property owned by government entities (hosts) in a PUD. The solar panels

¹ 26 U.S.C. Sec. 501(c)(3) of the federal Internal Revenue Code of 1986, as amended, as of January 1, 2014.

generated electricity. The nonprofit organizations acted as the CSPs' applicants to obtain an agreement with the local PUD.

The CSPs entered agreements with the PUDs whereby the PUDs would measure and purchase the electricity generated by each CSP. The PUDs agreed to pay the CSPs an incentive payment at a rate of \$1.08 per kilo-watt hour generated. The CSPs incentive payments exceed \$28,000.00 per year. After the PUDs paid the CSPs, each CSP paid its individual investors a share of its incentive payment based upon each investor's proportionate investment in the CSP.

The administrator for the CSPs wrote the Department of Revenue (Department) and asked whether the CSPs were required to register with the Department, and whether the CSPs were liable for any Washington state excise taxes. The Department's Taxpayer Information and Education Section (TI&E) replied that if the CSP received more than \$12,000 in gross income, including the incentive payments, the CSPs were required to register with the Department. TI&E stated the income from the incentive payments is subject to B&O tax under the service and other activities classification. TI&E indicated the CSPs may be eligible for the small business B&O tax credit. . . .

The CSPs disagreed with TI&E's ruling, and appealed. The CSPs contend they are not engaged in business and, therefore, are not required to register. The CSPs note they do not lease property. They state they do not sell electricity. Each CSP agreed to convey its solar equipment on July 1, 2020, to the host where the equipment was installed.

Investors could benefit financially under the CSP joint ventures or partnerships with the nonprofits.² Under the contracts for ownership between the investors and the nonprofits setting up the CSPs, the investors were entitled to their proportionate share of the incentive payments, but understood, "the return of funds of the investor is dependent upon the [kilo-watt hours] generated by the CSP and the rules in WAC 458-20-273." . . .

ANALYSIS

The CSPs argue they are not engaged in taxable business activities in Washington. RCW 82.04.220 levies a B&O tax "for the act or privilege of engaging in business activities" in Washington. "Engaging in business" means commencing, conducting, or continuing in business. RCW 82.04.150. Business activities subject to tax include "all activities engaged in with the object of gain, benefit, or advantage . . . directly or indirectly." RCW 82.04.140. The courts of this state have recognized "[t]he legislative purpose behind the B&O tax scheme is to tax virtually all business activity in the state." *Impecoven v. Dep't of Revenue*, 120 Wn.2d 357, 363, 841 P.2d 752 (1992). As a general proposition, "[t]axation is the rule and exemption is the exception." *O'Leary v. Dep't of Revenue*, 105 Wn.2d 679, 682, 717 P.2d 273 (1986), quoting *Budget Rent-A-Car of Washington-Oregon, Inc. v. Dep't of Revenue*, 81 Wn.2d 171, 174, 500 P.2d 764 (1972).

² For instance, one website estimated the investor's return on a 2012 investment of \$500.00: "The average annual incentive payment is estimated to be \$91.00 per each \$500.00 invested, for a total return on investment of about 46% over the eight years." From <http://twispworks.org/twispworks-community-solar-project> (last viewed August 14, 2014).

Washington courts have interpreted the definition of “business” in RCW 82.04.140 broadly. See *Young Men’s Christian Ass’n v. State*, 62 Wn.2d 504, 383 P.2d 497 (1963); *City of Seattle v. State*, 59 Wn.2d 150, 367 P.2d 123 (1961). These courts have found a business need not generate a profit to be engaged in taxable business activities. *Id.*; see also *Budget Rent-A-Car*, 81 Wn.2d at 174 (“Whether a profit is realized on the transactions is immaterial, for the tax is on the gross revenues received in the course of doing business.”). This is because the plain meaning of the words used to define “business” in RCW 82.04.140, such as “gain,” “benefit,” and “advantage,” “convey a meaning wider in scope than does the word ‘profit.’” *City of Seattle*, 59 Wn.2d at 153.

In our case, the CSPs act under RCW 82.16.110(2)(a)(i) to obtain incentive payments from the PUDs for the owners. The [individual investors] benefit by recovering their investment and receive a return on their investment depending upon the electricity generated. [Investors] provide funds in hopes of generating gain from their investment. Even if they do not earn a profit from this investment, the object of creating the CSPs is to generate a gain or advantage sufficient to be a “business” for tax purposes. We conclude the CSPs are engaged in business.

We must next determine the tax treatment of the CSPs’ activities. Washington’s B&O tax applies to various tax classifications, including making sales at retail pursuant to RCW 82.04.250, and providing services pursuant to RCW 82.04.290. Persons engaged in business taxable under RCW 82.04.290 are subject to B&O tax measured by the “gross income of the business.” “Gross income of the business” means the value proceeding or accruing by reason of the transaction of the business engaged in and includes . . . other emoluments however designated, all without any deduction . . . on any other expense whatsoever paid . . .” RCW 82.04.080(1).

The PUDs pay the CSPs incentive payments for the electricity generated. The incentive payments constitute gross income under RCW 82.04.080. RCW 82.04.220 imposes B&O tax on the gross income of the business. Incentive payments received for the electricity generated by a CSP’s system constitute gross income subject to the B&O tax. Rule 273(701)(b).

Because the CSPs thought they were not engaged in business and their incentive payments were not taxable, they concluded they were not required to register. Because they were engaged in business and received incentive payments subject to B&O tax, we reach a different conclusion.

Persons engaged in business in Washington have a duty to register, under RCW 82.32.030(1), if they perform any act upon which tax is imposed. However, registration is not required when a person’s “gross income of the business, from all business activities [subject to B&O tax], is less than twelve thousand dollars per year.” RCW 82.32.030(2)(a); Rule 101(2)(a)(i).³

. . . Rule 273(702) requires a nonutility CSP receiving incentive payments under the incentive program to register with the Department unless its annual gross income is below \$12,000.00, the exemption amount for requiring registration. Because the incentive payments made to each CSP exceeds \$12,000.00 per year, we conclude the CSPs must register with the Department.

³ Rule 101(2) explains that a business whose gross income from all business activities is under the annual exemption amount is not required to register, so long as other requirements are met. That exemption amount is currently \$12,000.00 gross income. Rule 101(2)(a)(i).

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Even though the CSPs must register and report their gross income, B&O tax may not be due. This is because the small business credit provided by RCW 82.04.4451 may apply to their B&O tax. Consequently, the CSPs may be able to apply the small business tax credit to offset their B&O tax liability. *See* Rule 273(703). If the CSPs had gross income in excess of the small business credit, the category under which they would report the B&O tax would be “service and other.” Rule 273(704).

DECISION AND DISPOSITION

We deny the CSPs’ petitions. Each CSP must register and report its incentive payments as gross income. The incentive payments are gross income subject to B&O tax under the service and other activities classification.

Dated this 24th day of September, 2014.