Cite as Det No. 12-0216, 32 WTD 134 (2013)

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. 12-0216
. . .	)	
	)	Registration No. . . .
	)	Document No. . . .
	)	Audit No. . . .
	)	
	)	Docket No. . . .

RCW 82.04.080: GROSS INCOME OF THE BUSINESS – FEES – NONPROFIT – WATER ASSOCIATION. Up-front fees paid by new members to a nonprofit water association that grant those new members voting rights and other membership rights, including the right to hook-up and receive water, constitute "gross income of the business" and are taxable to the nonprofit water association at the service and other activities business and occupation ("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.

Weaver, A.L.J. – A nonprofit water association appeals the assessment of service and other activities business and occupation ("B&O") tax on up-front amounts it receives from new members in order to join its association, arguing that those up-front amounts are "transferable deposits" and are not gross income to the business. Taxpayer's petition is denied.[1]

ISSUE

Whether, under RCW 82.04.080, the amounts received by a nonprofit water association from new members granting those members a right to access water constitute "gross income of the business" subject to the Service and Other Activities classification of the B&O tax.

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

FINDINGS OF FACT

[Taxpayer] is a nonprofit water association located in . . . Washington. Taxpayer was formed … for the purpose of providing its members with clean drinking water. . . .

In 2011, the Audit Division of the Department of Revenue ("Department") examined Taxpayer's books and records for the period January 1, 2007, through March 31, 2011. During the audit, the Audit Division questioned Taxpayer on a line item identified as "Membership Dues & Assessments." The Audit Division ascertained from Taxpayer that the funds in the Membership Dues & Assessments account were up-front fees paid by new members in order join Taxpayer's association.

Taxpayer's [new members sign a water user's agreement which states] what its members receive in exchange for their up-front membership fee. . . . The cost of new memberships was $. . . per location. The membership fee gives a member a right to vote and a right to hook-up to Taxpayer's water source.

Taxpayer asserts that not all members actually connect to the water system. Taxpayer states that the up-front fees collected from new members in the "Membership Dues & Assessments" account are used for capital improvements. Taxpayer claims that there is a separate "hook-up" fee that must be paid when a new member wants access. After joining Taxpayer's association, all members are required to pay a monthly fee. . . .

Taxpayer asserts that if a member sells his or her property, the member is allowed to transfer his or her membership to the new property owner. In the event a landowner chooses to leave the association, Taxpayer states that its members can sell their memberships back to Taxpayer at a future date for a refund of those upfront fees. Taxpayer further states that in the event of a foreclosure on a member's real estate, a member can request and receive a refund of its upfront fees by selling the membership interest back to Taxpayer. Taxpayer claims that the memberships are separate personal property of the members and are in no way attached to the members' land.

Taxpayer takes the position that the up-front membership fees are not a payment for services, but are instead a "transferable deposit" with the water association. According to Taxpayer, the membership rights associated with such a deposit continue in perpetuity unless owners sell their interests back to the association or the association dissolves. Memberships are limited, because the State of Washington sets limits on the capacity of water distributed by Taxpayer.

On July 21, 2011, at the conclusion of the audit, the Audit Division issued an assessment in the amount of $. . . , which was comprised of $. . . in service and other activities business and occupation tax, applicable small business credits of $. . . and $. . . , and interest totaling $. . . , for a total of $. . . . Taxpayer appeals the assessment on the "Membership Dues & Assessments" line item, claiming that those fees are purchases of membership interests and are therefore refundable deposits that are not subject to excise taxation.

ANALYSIS

The State of Washington imposes the business and occupation ("B&O") tax on every person in the state for the privilege of engaging in business. RCW 82.04.220. This includes "all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or another person or class, directly or indirectly." RCW 82.04.140. An "association" such as the water association in this case is included within the definition of "persons" subject to tax under this state's tax structure. RCW 82.04.030; *see also* Det. No. 94-219, 15 WTD 55 (1995). The B&O tax is "'extensive and is intended to impose . . . tax upon virtually all business activities carried on in this State.'" *Analytical Methods, Inc. v. Dep't of Revenue*, 84 Wn. App. 236, 241, 928 P.2d 1123 (1996) (quoting *Palmer v. Dep't of Revenue*, 82 Wn. App. 367, 371, 917 P.2d 1120 (1996)). Therefore, every person engaged in business in Washington, including Taxpayer, is subject to B&O tax unless entitled to an exemption.

The measure of the B&O tax is the "gross proceeds of sales, value proceeding or accruing, or gross income of the business." RCW 82.04.080. "Gross income of the business" means:

> . . . the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost of tangible property 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.

RCW 82.04.080. In this case, Taxpayer sells the right to membership in its water association to new members for an up-front membership fee. "Fees" are specifically listed in RCW 82.04.220 as "gross income of the business" and are subject to B&O taxation. Taxpayer claims that the amounts it receives from new members are not actually fees, but are "transferable deposits" and are therefore exempt from excise taxation. While Taxpayer cites no legal authority, it appears that Taxpayer is arguing that the amounts it receives from new members are "transferable deposits" and that these amounts do not constitute gross income of the business. We disagree.

Taxpayer concedes that the up-front fees from new members grant those members certain rights in perpetuity. Those rights include the right to vote in the association, the right to sell the membership along with the sale of real estate and, the right to hook-up and receive water. Clearly, new members receive certain benefits in return for their up-front payment and Taxpayer receives value in return for those benefits. Taxpayer states that the up-front amounts it received from new members were placed into a "Membership Dues & Assessments" account that Taxpayer uses to make capital improvements. Taxpayer has not alleged that there are any restrictions on its right to use the funds in the "Membership Dues & Assessments" account. Whether the amounts received are called "fees" or "transferable deposits," they are certainly value received by Taxpayer as a result of a business transaction. The fact that members theoretically can sell their membership interest back to Taxpayer in the future does not change

the fact that the up-front fees are "gross income of the business" as that term is defined in RCW 82.04.080.

Having held that the up-front fees received by Taxpayer constitute gross income of the business, those fees are subject to B&O taxation unless there is an applicable exemption. In this case, Taxpayer does not identify any such exemption in any statute or rule. Indeed, to assist nonprofit water associations with proper tax reporting the Department issued a Special Notice to the industry. That Special Notice states that:

> Nonprofit water associations are taxed in two ways:
>
> 1) Amounts derived from the distribution of water are subject to the Water Distribution Business classification of the public utility tax.
> 2) Amounts received from extending water service to new customers and similar charges made prior to the delivery of water, often referred to as "hook-up" fees, are subject to the Service and Other Activities classification of the business and occupation tax.

Special Notice, *Tax Reporting for Nonprofit Water Associations*, issued July 6, 1988 (reissued August, 2008). Taxpayer argues that its up-front fees are not "hook-up" fees, as it charges a separate hook-up fee that it concedes is subject to B&O taxation.

However, we do not read the Special Notice to say that only "hook-up" fees are subject to B&O taxation. We read the Special Notice as designating "amounts derived from distribution of water" to the public utility tax ("PUT") and that gross income received that is not "derived from distribution of water" is subject to B&O taxation at the service and other activities rate. Taxpayer and the Audit Division agree that the fees in question are not "amounts derived from distribution of water" and are therefore not subject to PUT.[2] The only issue is whether those fees are subject to B&O taxation. We agree with the Audit Division that it is not determinative that Taxpayer charges its members a specific "hook-up" fee separate and apart from its up-front membership fee. The Special Notice is consistent with the general application of RCW 82.04.080 that any amounts received by Taxpayer in return for "extending water service to new customers" or "similar charges" constitutes "gross income of the business" that is subject to the service and other activities B&O tax. Members are required to pay up-front fees to receive water service and while these fees may not technically constitute "hook-up" fees, we find that they are "similar charges" sufficient to subject them to taxation at the service and other B&O tax rate.

[2] The Special Notice does identify a deduction for amounts derived from the distribution of water by a nonprofit water association that are used for capital improvements. However, that deduction is limited to the PUT tax and is not available for B&O taxable income that is used for capital improvements, so it is inapplicable here. *See* Special Notice, *Tax Reporting for Nonprofit Water Associations*, issued July 6, 1988 (reissued August, 2008).

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 21st day of August 2012.