OGDEN MURPHY WALLACE
P.L.L.C.
ATTORNEYS AT LAW

# CASE REPORT

**UTILITY TAXES - B&O TAXES. Gross income for purposes of calculating city utility tax included income derived from "non-utility" business activities.** ***Puget Sound Energy v. City of Bellingham,*** **No. 65928-6, Court of Appeals Division I (Aug. 29, 2011).**

**I. Facts.** As the result of an audit conducted on its behalf, the city of Bellingham assessed tax and penalties against Puget Sound Energy, Inc. (PSE), which provides electric light and power to customers living within the city. PSE thereafter sought a judgment declaring the city's tax assessment illegal and ordering a refund of the taxes and penalties imposed. During the audit period, PSE paid city utility tax on the revenue it received from both the "per kilowatt hour energy charges" and the "basic or customer charges" paid by its Bellingham customers. However, PSE paid city B&O tax, rather than city utility tax, on other revenue that it received. For example, PSE paid city retail B&O tax on the revenue it received from business activities defined by PSE as "sales and leases of tangible personal property to customers located in Bellingham." PSE also paid city B&O tax under the "service and other" classification on the revenue that it received from billing initiation charges, connection and reconnection charges and disconnection visit charges, and late payment fees. After the audit, the city issued an assessment against PSE in the amount of approximately $600,000.00 in unpaid city utility tax and approximately $200,000.00 in penalties.

**II. Applicable Law and Analysis**. Although PSE contended that its "non-utility" activities were not subject to the city utility tax, the Court of Appeals disagreed. Bellingham's utility tax ordinance levied a six percent tax against "every person engaged in or carrying on the business of selling or furnishing electric light and power." Finding that Bellingham's utility tax ordinance was not so restrictive as suggested by PSE, the court concluded that "the business" of selling or furnishing light and power is not limited to the actual provision of electricity. Rather, it encompasses "the entire commercial enterprise" of selling or furnishing electric light and power. Similarly, the Court stated that the tax is imposed upon "the total gross income from such business," not upon the total gross income obtained solely from the provision of the electricity itself. Given that PSE was unable to explain why activities such as the leases, connection charges, and late fees were unrelated to its business of selling electric light and power, the court held that PSE failed to satisfy its burden of proving the tax assessment was improper. Bellingham's tax assessment and penalties were affirmed.

In addition, the Court disagreed with PSE's claims that the city's tax assessment violated the statutory rate limitation and uniformity requirement set forth in RCW 35.21.710[1] and

[1] RCW 35.21.710 provides that "any city which imposes a license fee or tax upon business activities consisting of the making of retail sales or tangible personal property which are measured by gross receipts or gross income from such sales, shall impose such tax at a single uniform rate upon all such business activities." That rate must not exceed 0.2 percent.

constitutional limitations imposed by the equal protection clause of the United States Constitution and the privileges and immunities clause of the Washington State Constitution. The court held that RCW 35.21.710 was inapplicable because the revenue subject to the assessment was not obtained through "retail sales" and, therefore, was not properly subject to the city B&O retail tax. Moreover, the court rejected PSE's argument that because many of its "non-utility" activities are subject to state B&O tax, rather than state utility tax, the city's classifications should also be the same. Recognizing that the city is not required to classify for taxation purposes the activities of PSE in the same manner as does the state, the court held that the city was free to subject PSE's activities to the city utility tax. Similarly, PSE failed to demonstrate that the city improperly treated it unlike others in the same class for purposes of the equal protection claim. The court specifically stated that an electric utility business is not within the same class as retailers and service providers, which are subject to the city B&O tax. Thus, as long as the city's taxation of PSE was consistent with its taxation of other utilities, the equal protection and privilege and immunities clause violations were not proven.

Finally, the court concluded that the city's tax assessment properly included in PSE's gross income the revenue from "utility tax charges" that PSE collected in order to pay the city utility tax. The court reasoned that because the revenue PSE receives by virtue of passing the city utility tax on to its customers is "value proceeding or accruing" to PSE, the inclusion was proper pursuant to Bellingham's definition of gross income.

**III. Conclusion.** This decision affirms that cities which have adopted broad definitions of those business activities subject to utility tax may impose such utility tax on revenues derived from business activities beyond those directly related to the provision of the utility service itself. Because each city's ordinance independently defines the business activities that are subject to its utility tax, please do not hesitate to consult with your City Attorney if you have additional questions regarding the types of business activities which may be subject to your city's utility tax.