WASHINGTON STATE PUBLIC UTILITY TAX DEDUCTION FOR CAPITAL EXPENDITURES BY NON-PROFIT WATER PURVEYORS

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The Washington State Department of Revenue has conducted a recent audit of a nonprofit water purveyor which focused on the deduction for capital expenditures for these entities under RCW 82.16.050(12).

In this audit the taxpayer was assessed the Public Utility Tax on all of its water revenues except for its *actual* expenditures on capital items. The issue is whether it is entitled to a deduction on unspent revenue earmarked for capital purposes.

Note that the deduction for capital items applies only to nonprofit water associations – it is not available to water districts, municipalities, or for-profit purveyors. The statutory language for the deduction is as follows:

> (12) Amounts derived from the distribution of water by a nonprofit water association and *used* for capital improvements by that nonprofit water association. . . . RCW 82.16.050(12)

To nonprofit purveyors who have been taking the deduction for all capital revenues - including unspent revenues committed or earmarked for capital items - this decision may come as a surprise.

This issue has the potential for significant financial consequences. Capital expenditures in the water business tend to fluctuate. Consider the following hypothetical example:

> A purveyor with a steady stream of income earmarked for capital spending accumulates funds over several years. When enough money has been accumulated, the purveyor builds a large reservoir. The purveyor has no significant capital projects in the ensuing five years, and is audited in the fifth year. The purveyor is assessed tax on all its water revenue and no deduction is given for the reservoir because it was built in a closed year. No deduction was given for revenue earmarked for capital spending.

We think that there is a definite tax risk for nonprofit water purveyors who simply deduct unspent capital revenues and are audited by the DOR.

Those purveyors that take this approach should review the situation with their tax advisor, determine if changes are needed, and do some planning to limit exposure in the event of an audit.

If you are interested in learning more about this subject, please contact Michael Jonson at mike@jonson-jonson.com or Richard Jonson at richard@jonson-jonson.com

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