

BEFORE THE BOARD OF TAX APPEALS  
STATE OF WASHINGTON

PARKLAND LIGHT AND	)	
WATER COMPANY,	)	
	)	
Appellant,	)	Docket No. 89-9
	)	
v.	)	Re: Excise Tax Appeal
	)	
STATE OF WASHINGTON	)	FINAL DECISION
DEPARTMENT OF REVENUE,	)	
	)	
Respondent.	)	
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This matter came before the Board of Tax Appeals (Board) for a formal hearing on July 31, 1990. Craig S. Adams, Attor-ney, appeared for Appellant, Parkland Light and Water Company (Parkland). John M. Gray, Assistant Attorney General, appeared for Respondent, Department of Revenue (Department).

This Board heard the testimony, reviewed the evidence provided through stipulations of fact, and considered the argu-ments made on behalf of both parties. This Board now makes its decision as follows:

FINDINGS OF FACT

I.

Parkland is a nonprofit corporation, organized under Chapter 24.03 RCW. As such, Parkland is legally forbidden from issuing shares of stock.

II.

Chapter 24.06 RCW is a more recent amendment to the laws of the state of Washington, which does provide and allow for nonprofit corporations to issue shares of stock.

### III.

Parkland has Articles of Incorporation and By-Laws that were in effect during the audit period, January 1, 1984, through September 30, 1987. Article III of the Articles of Incorporation provides that the Board of Trustees shall approve or disapprove membership applications accompanied by a fee for the kind of service desired.

Article VII of the Articles of Incorporation states that ". . . [t]his corporation shall have no capital stock, and shares of stock therein shall not be issued." A member has certain voting rights in the corporation provided in the By-Laws.

### IV.

Article XII of the By-Laws provides the method of obtaining membership in Parkland, that the applicant shall pay the regular membership fee and afterwards pay the regular water or power dues. Article XIV of the By-Laws describes how certificates of membership are assignable if approved by Parkland's Manager or Board of Trustees.

### V.

The parties stipulated:

Parkland requires, as a precondition to extending service to any person, that that person pay a membership fee. These membership fees have been taxed because they do not fall subject to the exemptions provided for in WAC 458-20-106. One of the exemptions in that section exempts those transfers of capital assets by an individual to a corporation in exchange for capital stock.

Stipulated Facts, at 1.

#### VI.

The Department taxed these membership fees following an audit of the records of Parkland for the period beginning on January 1, 1984, through September 30, 1987. Parkland appealed the assessment, and the Department upheld the assessment in Determination No. 85-112A. The Department denied the exemption on the basis that Parkland did not make stock transfers of capital assets.

#### VII.

The membership fees paid to Parkland during the audit period were \$55 for electrical service and \$1,250 for water service. The membership fees were not used to pay for extensions of electrical or water service. If extensions were required, the member had to pay those costs in addition to the membership fees.

#### VIII.

When Parkland charges a membership fee, the monies are transferred to the company books as a members equity account, which is part of the general fund used toward the

entire operation. The membership fee, once paid, gives each member a participatory voting right in the company. That is, the prospective member transfers cash or money in the form of membership and, in return, the member receives an "ownership interest" in Parkland.

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#### IX.

Article XXII of the By-Laws, entitled Capital Credits, provides that all amounts in Parkland, which are in excess of the operating costs and expenses, are to be deemed the member's capital and, as such, deemed to be a segregation of retained earnings. At the end of each year, the corporation is to credit to a capital account for each member all such retained earnings. There is, in addition, a provision for the payment of such retained earnings. The By-Laws provide that upon dissolution or liquidation, amounts existing after all debts have been paid would be refunded to each member.

#### X.

The membership fee is, in addition to any costs of labor or material, used to effectuate the hook-up. That is, a prospective member must pay the membership fee and then, in addition, must pay the scheduled cost for water meters, pipe, and labor or other costs of installation. As such,

the member-ship fee is separate and distinct from "hook-up" charges.

#### XI.

Once membership in Parkland has been paid, an assignee of such member would become a member in Parkland without payment of additional membership fees. If a member conveys the premises to another person, the conveying member loses membership in Parkland. If only a portion of the premises is conveyed, the purchaser must buy a membership in their own name. Lessees of a member's premises can be billed directly for service after proper application through the owner. Article XIV of the By-Laws.

#### XII.

Parkland contends that WAC 458-20-106 is unconstitutional and violative of the equal protection clause of the fourteenth amendment to the United States Constitution, the special privileges and immunities clause of article 1, section 12 of the Washington State Constitution, as applied to nonprofit, nonstock corporations formed under Chapter 24.03 RCW, the Washington NonProfit Corporation Act, as opposed to identical nonprofit, stock corporations formed under Chapter 24.06 RCW, the NonProfit Miscellaneous and Mutual Corporation Act.

#### XIII.

The Department states the issue as:

. . . Are membership certificates, issued by a non-profit corporation in return for membership fees, so equivalent to capital stock that the taxation of the membership fees is a violation of the equal protection clauses of the United States Constitution (U.S. Const. amend. XIV, { 1) or of the Washington Constitution (Wash. Const. Art 1, { 12)?

Department of Revenue's Brief, at 1-2.

XIV.

WAC 458-20-106 provides in part:

A casual or isolated sale is defined by RCW 82.04.040 as a sale made by a person who is not engaged in the business of selling the type of property involved. Any sales which are routine and continuous must be considered to be an integral part of the business operation and are not casual or isolated sales.

. . .  
The retail sales tax applies to all casual or isolated retail sales made by a person who is engaged in the business activity; that is, a person required to be registered under WAC 458-20-101. . . .

. . .  
A transfer of capital assets to or by a business is deemed not taxable to the extent the transfer is accomplished through an adjustment of the beneficial interest in the business. The following examples are instances when the tax will not apply.

(1) Transfers of capital assets between a corporation and a wholly-owned subsidiary, or between wholly-owned subsidiaries of the same corporation.

(2) Transfers of capital assets by an individual or by a partnership to a corporation, or by a corporation to another corporation in exchange for capital stock therein.

(3) Transfers of capital assets by a corporation to its stockholders in exchange for surrender of capital stock.

(4) Transfers of capital assets pursuant to a reorganization under 26 USC Section 368 of the Internal Revenue Code, when capital gain or ordinary income is not realized.

(5) Transfers of capital assets to a partnership or joint venture in exchange for an interest in the partnership or joint venture; or by a partnership or joint venture to its members in exchange for a proportional reduction of the transferee's interest in the partnership or joint venture.

(6) Transfer of an interest in a partnership by one partner to another; and transfers of interests in a partnership to third parties, when one or more of the original partners continues as a partner, or owner.

The burden is upon the taxpayer to establish the facts concerning the adjustment of the beneficial interest in the business when exemption is claimed.

#### XV.

Any Conclusion of Law which should be deemed a Finding of Fact is hereby adopted as such.

From these findings come the following

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#### CONCLUSIONS OF LAW

##### I.

The Board has jurisdiction over the persons and subject matter of this proceeding.

##### II.

WAC 458-20-106 provides that a transfer of capital assets to or by a business is deemed not taxable to the

extent the transfer is accomplished through an adjustment of the beneficial interests in the business. The examples following the statement of the rule are instances when the tax will not apply. The examples are not exclusive, however. The burden is upon the taxpayer to establish the facts concerning the adjustment of the beneficial interest in the business when exemption is claimed.

### III.

The Department contends that while Parkland members have certain voting rights and participation in management, they cannot participate in profits and have no stock. There is no provision for a full or pro rata refund of the membership fee to a decedent member's estate.

The Department contends that there are differences between stock and memberships. Capital assets enable a taxpayer to engage in business; capital assets are not the gross proceeds from sales. Capital stock is owned by the shareholder and is evidence of ownership. Membership fees are taxed under RCW 82.04.4282. Bona fide fees are deducted from the measure of tax amounts, unless such fees or dues are in exchange for any significant amount of goods or services without any additional charge, or if the dues are graduated upon the amount of goods or services rendered. Parkland's membership fees must be paid before electrical or



water service is supplied; there is no other benefit from being a member in Parkland.

#### IV.

WAC 458-20-106 does not distinguish between the terms "stock" and "certificate of membership". The focus of the rule is upon a "transfer of capital assets to or by a business . . . through an adjustment of the beneficial interest in the business." We conclude that the rule attempts to prevent taxation of transfers of beneficial interest grounded upon a reasonable basis, and Parkland has not shown otherwise.

#### V.

Are the assets transferred to Parkland by an applicant for membership "capital assets" which adjust the "beneficial interest in the business"? "Capital assets" are defined as: "All capital invested plus surplus or undivided profits. Assets of a permanent or fixed nature or employed in carrying on business or trade." (Citations omitted.) Black's Law Dictionary 263 (4th rev. ed. 1968). A "beneficial interest" is defined as: "Profit, benefit, or advantage resulting from a contract, or the ownership of an estate as distinct from the legal ownership or control." Id. at 199.

The By-Laws of Parkland provide an insight into the nature of the corporation. Article XXII of the By-Laws states:

The furnishing of electric energy and water shall be so conducted that all members through their patronage furnish capital for Parkland Light and Water Company. . . . All amounts in excess of the operating costs and expenses at the time of receipt by the Corporation shall be the members's capital and deemed to be a segregation of retained earnings. The Corporation shall at the end of each year credit to a capital account maintained for each member all such retained earnings. . . .

If at any time prior to dissolution or liquidation the Board of Trustees shall determine that the financial condition of the Corporation will not be impaired thereby, the capital then credited to the members accounts may be retired in full or in part. . . .

In the event of dissolution or liquidation of the Corporation, after all outstanding indebtedness of the Corporation shall have been paid, outstanding capital credits shall be retired.

The By-Laws provide that all members furnish capital to Parkland. The membership fees are not used to pay for extensions of electrical or water service. All amounts exceeding costs and expenses are credited to each member's capital account. If Parkland is dissolved or liquidated, the capital accounts are retired. This arrangement is a contribution to "capital assets" of Parkland. The capital account of each member is adjusted annually to reflect each year's experience. The benefits of this arrangement inure to the members upon dissolution or liquidation. The initial

"fees" paid by each member-applicant are "capital assets" within the meaning of WAC 458-20-106.

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#### VI.

We conclude that Parkland, through the stipulated evidence, has met its evidentiary burden to fall within the disputed portion of WAC 458-20-106 in this instance.

#### VII.

Parkland's contention that WAC 458-20-106 is invalid based upon constitutional grounds need not be resolved; Park-land qualifies under the disputed portion of the rule itself. In the alternative, if Parkland does not qualify under the disputed portion of the rule, we would find the rule consti-tutional and affirm the Department's determination.

#### VIII.

State v. Nixon, 10 Wn. App. 355, 517 P.2d 212 (1973), describes the state and federal constitutional clauses in question to be substantially identical.

#### IX.

Parkland does not contend that it is a part of a suspect class, or that the dispute involves a fundamental right. Therefore, the Department's rule is reviewed with

minimal rather than strict scrutiny. Yakima County Deputy Sheriff's Ass'n v. Board of Commissioners, 92 Wn.2d 831, 834, 601 P.2d 936 (1979).

X.

Three steps are involved when measuring the constitution-ality of a legislative, or quasi-legislative, classification with minimal scrutiny:

First, does the classification apply alike to all members within the designated class? . . .

Second, does some basis in reality exist for reasonably distinguishing between those within and without the designated class? More specifically, do reasonable grounds exist to support the classifica-tion's distinction between those within and without the class? . . .

Third, does the challenged classification have any rational relation to the purposes of the challenged statute? More specifically, does the difference in treatment between those within and without the designated class serve the purposes intended by the legislation?

(Citations omitted.) Deputy Sheriff's Ass'n, supra at 835-36. The party challenging the classification has a heavy burden of overcoming the presumption of a rule's constitutionality. Id. at 835.

XI.

Parkland contends that WAC 458-20-106 fails to meet the first requirement because the rule does not apply alike to all nonprofit corporations. Nonprofit corporations are distin-guished on stock ownership or issuance alone. Under

Chapter 24.03 RCW, a nonprofit corporation is not allowed to issue stock; under Chapter 24.06 RCW, a nonprofit corporation can issue stock. Transfers of capital assets to a Chapter 24.06 RCW corporation for stock is a nontaxable transaction; transfers of capital assets to a Chapter 24.03 RCW corporation in exchange for membership is a taxable transaction. Parkland contends that the only distinction between the two is on the basis of stock issuance alone; therefore, the first requirement is not met.

#### XII.

As discussed previously, WAC 458-20-106 applies alike to all nonprofit corporations. The rule simply states that a transfer of capital assets to or by a business is deemed not taxable to the extent the transfer is accomplished through an adjustment of the beneficial interest in the business. In this case, "beneficial interest" can be represented by either stock or a certificate of membership.

#### XIII.

WAC 458-20-106 excludes the taxation of capital assets for a beneficial interest in the business. The exclusion applies to profit and nonprofit corporations without distinction. Thus, Parkland's contention that the rule creates an unreasonable distinction is not supportable. Additionally, the rule does not create a disparity in

treatment between a nonprofit corporation which issues stock and one which does not issue stock. We conclude that the rule creates a distinction that is based upon a reasonable basis, and Parkland has not shown otherwise.

XIV.

Summary: We conclude that Parkland's described membership contributions fall within the exclusion of WAC 458-20-106. Having so concluded, the determination of the Department should be reversed. In the alternative, we conclude that WAC 458-20-106 is constitutional on its face.

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XV.

Any Finding of Fact which should be deemed a Conclusion of Law is hereby adopted as such.

From these conclusions is entered the following

DECISION

The Determination of the Department of Revenue is reversed.

DATED this \_\_\_\_ day of \_\_\_\_\_, 1990.

BOARD OF TAX APPEALS

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RICHARD A. VIRANT, Chair

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LUCILLE CARLSON, Member

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A timely Petition for Reconsideration may be filed to this Final Decision within ten days pursuant to WAC 456-09-955.