

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u>
<u>I</u> <u>O</u> <u>N</u>)	
For Refund of)	No. 88-361
)	
. . .)	Registration No. .
. .)	
)	

[1] **RULE 17901:** RCW 82.16.055 -- PUBLIC UTILITY TAX -- DEDUCTION --ELIGIBLE PROJECTS -- MEASURE OF DEDUCTION. The deduction provided by RCW 82.16.055(1)(a) is not for the total cost of an eligible project, but only for those project costs for the production at the plant for consumption within the state of Washington of electrical energy produced or generated from cogeneration or renewable energy resources. Project costs incurred because of Forest Service requirements, costs incurred to mitigate effects on fish and wildlife, costs to provide access to recreation areas, and costs for transmission or distribution are not deductible. Costs for clearing land for the reservoir bottom and powerhouse were found deductible.

[2] **RULE 17901:** RCW 82.16.055 -- PUBLIC UTILITY TAX -- DEDUCTION --INTEREST. Debt service costs related to deductible construction costs are deductible production expenses. A deduction of a percentage of ongoing interest permitted at the same ratio deductible construction costs bear to the total costs for the project.

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.

TAXPAYER REPRESENTED BY: . . .
. . .

DATE OF HEARING: March 22, 1988

NATURE OF ACTION:

The taxpayer requests a correction of assessment and refund authorized by RCW 82.16.055(1)(a)(ii) from the public utility tax paid from 1984 through 1987.

FACTS AND ISSUES:

Roys, A.L.J. -- The taxpayer applied for a deduction under RCW 82.16.055(a) on December 1, 1986 for the PUD's . . . Hydroelectric Project. . . . The petition alleged that the Project provided electrical energy to consumers at a cost which was substantially less than the cost of power from new, similarly available conventional fossil fuel or nuclear-power electric generation facilities. The Department concluded that the project met the criteria for deduction.

The Department reviewed the taxpayer's records and identified \$ X as capital costs eligible for the statutory deduction. The department excluded from capital costs the following construction costs:

<u>Item</u>	<u>Amount</u>
Stage I	\$ X
Bridge	X
Log Boom	X
Roads	X
Land Clearing	X
. . . Settlement	X
. . . Pipeline	X
. . . Pipeline	X
Boat Ramps	X

The taxpayer agrees that Stage I of the Project should be excluded for deduction purposes because it was not constructed after June 12, 1980, the date the deduction became applicable. The taxpayer contends, however, that the remaining items should be deductible (\$ X in total costs). The taxpayer contends each item is an integral part of the Project, without which it either could not have been built or licensed, or could not be operated safely. The costs were disallowed because the Department found they were not costs for production at the plant.

The Department also concluded that interest expense occurring after the plant commenced operation could not be deducted as a component of the cost of power production. The Department found interest was not a direct plant operating cost. The Department allowed a deduction for the portion of interest that was capitalized during construction, but not that which was amortized after construction.

The taxpayer disagrees with the Department's interpretation of a direct cost. The taxpayer stated interest expense is incurred solely as payment on bonds utilized to finance the cost of

construction of the . . . Project and represents the largest single component of power production cost of the Project. The taxpayer contends the cost of production of a power plant includes maintenance and operation expenses (M&O), plus capital costs (depreciation) and interest expense. Since the greatest cost of development of any renewable energy resource is the cost of construction and financing, the taxpayer stated the department's decision that debt service is not a cost of production "effectively eviscerates the purpose, meaning and benefit afforded by the legislature in its passage of Chapter 14, Laws of 1980." (Petition p. 4)

The refund or credit amounts requested are:

1984	\$	X
1985		X
1986		X
1987		X
	\$	<u>X</u>

DISCUSSION:

[1] RCW 82.16.055(1)(a) provides a deduction from the public utility tax for:

An amount equal to the cost of production at the plant for consumption within the state of Washington of:

. . . .

(ii) Electrical energy . . . produced or generated from renewable energy resources such as . . . hydroelectric energy. . . .

Subsection (5) of RCW 82.16.055 provides that the department of revenue, after consultation with the appropriate governing body of the utility, shall determine the eligibility of individual projects and measures for deductions. WAC 458-20-17901 (Rule 17901) is the administrative rule which implements the statute.

Rule 17901 states that the department will rule upon eligibility for cogeneration deductions and the attendant cost of energy production for purposes of determining deductibility from the public utility tax upon an individual project basis by:

using the cost figures reported on the appropriate Federal Energy Regulatory Commission (FERC) schedules that are required to be filed by public and private electric utilities and by private gas utilities. The allowable deductions consist of production expenses, eligible fuel costs and book depreciation of capital costs.

RCW 82.16.055(5) provides that the department of revenue shall determine the eligibility of individual projects and measures for deductions. The taxpayer contends that the entire cost of construction of Stage II of the . . . Project should be included in calculating the deduction for depreciation of capital costs. The taxpayer emphasized the reference to "eligible projects" and contends there is no indication of any intent to exclude segments of any projects from the benefits of the statutory deduction. The taxpayer contends the reference to "measures" in the statute refers to items to be installed on buildings to improve the efficiency of energy use, such as insulation.

We agree with the taxpayer that the reference to "measures" in subsection 5 does not have to do with "projects." Legislative intent is to be determined from the statutory text as a whole, interpreted in terms of the general object and purpose of the legislation. State v. Sponburgh, 84 Wn.2d 203, 210 (1974).

Subsection 2 of 82.16.055 states that the section applies to "new facilities for the production or generation of energy from cogeneration or renewable energy resources or measures to improve the efficiency of energy end use on which construction or installation is begun" (Emphasis added.) Subsection 4 also refers to "measures or projects." Subsection 5 provides that the Department shall determine the eligibility of individual projects and measures for deduction. We interpret measures to have the same meaning throughout the statute, i.e., something which is done to improve the efficiency of energy end use. Rule 17901 lists several measures that are eligible for deduction.

In the present case, the Department's audit division determined Phase II of the project was eligible for deduction because it would produce electric energy more cheaply than nuclear energy or fossil fuels and because it was within the time guidelines of the statute. We do not agree with the taxpayer, however, that once that decision was made, the Department had no authority to determine that only a portion of the project was eligible for the deduction.

Statutes are to be construed, whenever possible, so that "no clause, sentence or word shall be superfluous, void, or insignificant." United Parcel Service, Inc., v. Department of Rev., 102 Wn.2d 355, 361-62 (1984 (citations omitted)). "Where the Legislature used certain statutory language in one instance, and different language in another, there is a difference in legislative intent." Id. at 362.

In this case, the deduction statute provides the department shall determine the eligibility of individual projects, but the amount to be deducted from gross income is not stated as the cost of the individual project. Instead, a deduction is permitted for "[a]n amount equal to the cost of production at the plant for consumption

within the state of Washington" of electrical energy produced or generated from cogeneration or renewable energy resources. The audit section relied on the applicable statutory language in determining that certain costs were not deductible because they were not for production of electricity at the plant.

The taxpayer relies in part on the FERC Accounting and Reporting Requirements for Public Utilities and Licensees, paragraph 15,058, which states the reporting requirements for the accounts for structures and improvements. Subsection C states:

Minor buildings and structures, such as valve towers, patrolmen's towers, telephone stations, fish and wildlife, and recreation facilities, etc., which are used directly in connection with or form a part of a reservoir, dam, waterway, etc., shall be considered part of the facility in connection with which constructed or operated and the cost thereof accounted for accordingly.

The taxpayer noted that the . . . Project is spread over a large area; the dam and generators are separated by several miles. The taxpayer contends the excluded costs were incurred in the overall construction of the plant and are part of the costs of production. The taxpayer's petition included some of the following facts relating to the excluded costs:

1) Log Boom--The taxpayer stated the log boom is an essential safety feature of the dam. The boom is intended to keep logs, trees, boats and other floating materials from being swept into the spillway and intake structures;

2) Land Clearing--The land clearing was required by the taxpayer's federal authorization for Project construction, FERC License No. One thousand acres were cleared for the reservoir bottom, dam abutments, powerhouse, pipelines, and associated structures as required by Article 46. Article 12 of the License required clearing of transmission line rights-of-way. The costs of clearing and grading of land and rights-of-way, and the damage costs associated with construction and installation of plant, are part of the capital cost subject to depreciation under the standard FERC Accounting and Reporting Requirements for Public Utilities and Licensees;

3) Roads--The construction of Stage II of the Project resulted in the inundation of roads which had been used for recreation and transportation of timber from U.S. Forest Service lands. The Forest Service required that the new reservoir not be filled until replacement roads were completed;

4) . . . Bridge--The bridge is part of one of the replacement roads which provides access to the recreation and timber areas. All roads and bridges were built in accordance with the Project License;

5) . . . Settlement-- . . . Construction Company performed work on the . . . Project including reservoir clearing and road building. [Construction company] claimed additional payments were due, primarily as a result of changes and stoppages ordered by the Forest Service. The taxpayer and [construction company] settled the claims and lawsuit by a payment of \$ X to [construction company]. The taxpayer capitalized the claim settlement on its books along with other Project construction expenses. The taxpayer contends all of the settlement payment, including taxes and overhead, should be subject to depreciation as a capital cost;

6) Boat Ramps--FERC License Article 52 required the taxpayer to adopt a recreation plan for the . . . Project which was acceptable to the Forest Service and other intervening public agencies. The boat ramps were included in the recreation plan approved by FERC and are considered a part of the power facility under FERC accounting and reporting procedures.

7) . . . Pipeline and . . . Pipeline--The . . . Pipeline runs from the District's Francis Turbines to . . . , the City of . . .'s water reservoir. The taxpayer stated that the pipeline was required for project construction under the Federal Power Act and the Treaty of . . . to mitigate project effects on the fish habitat in the . . . River. The taxpayer entered into settlement agreements with the . . . Tribes and several federal agencies. The FERC Order approving the settlements required the return of minimum stream flows to the . . . River through the . . . Pipeline and [the city]'s existing diversion tunnel to permit the minimum stream flows at all places below an existing diversion dam. The city's wood pipeline running between the diversion dam and . . . was unable to withstand the pressure of the water to be returned to the river and was replaced with a new concrete structure. The cost of the concrete structure is included as " . . . Pipeline." The . . . Pipeline serves a dual function of providing water for the City's reservoirs and a conduit for return of water to the . . . River at the diversion dam. The water generates electricity through two Francis turbines.

Although all of the excluded items were required as part of the total Project, and all were items treated as part of the facility

according to FERC accounting requirements, we do not agree that all were costs incurred to produce electrical energy. We agree with the auditor's conclusion that costs incurred because of Forest Service requirements, costs incurred to mitigate effects on fish and wildlife, and costs to provide access to recreation areas are not deductible. Specifically, we affirm the denial of a deduction for the following costs: bridge, roads, . . . settlement, . . . Pipeline, . . . Pipeline and boat ramps.

The costs incurred for the land clearing were incurred in part for the pipelines, associated structures and transmission line rights-of-way. Land clearing costs for distribution or transmission are not deductible.

The costs for the land clearing for the reservoir bottom and powerhouse present a closer question. These costs were denied in part because the audit section concluded costs for land or improvements to land are not depreciable costs. From an accounting standpoint, costs of clearing, grading, or otherwise improving the land after its acquisition generally are treated as increases in the cost of land. See, e.g., MOSICH & LARSEN, INTERMEDIATE ACCOUNTING 442 (Fifth edition 1982).

According to the FERC Accounting and Reporting Requirements for Public Utilities and Licensees, however, costs for clearing and preparing land are included in the account for reservoirs, dams, and waterways rather than in the account for land and land rights. Rule 17901 states the allowable deductions consist of production expenses, eligible fuel costs and book depreciation of capital costs. As the land costs are depreciable capital costs according to the FERC Accounting and Reporting Requirements, and as the costs are incurred for the production of electricity at the plant, we agree that costs for the land clearing for the reservoir bottom and powerhouse are allowable deductions as defined by Rule 17901. Accordingly, the taxpayer's petition is granted as to allowing a deduction for part of the land clearing costs.

Also, we find the cost incurred for the log boom was a cost incurred primarily to produce electricity at the plant. The taxpayer's petition is granted with regard to that item.

[2] Interest-- The audit division allowed a deduction for interest costs incurred while construction was in progress. Generally accepted accounting standards permit such interest to be capitalized. Ongoing interest may not be capitalized and was not allowed as a deduction.

The taxpayer has provided statements from a bond underwriter and an independent C.P.A. which support the position that interest on debt service is a necessary part of the overall cost of the power production. Also, the taxpayer provided the following definition

of "System Costs" from the "1987 Resource Strategy," Bonneville Power Administration, May, 1987, at III-5:

"System Costs" measure the costs of electric power faced by the region's electricity consumers (e.g., costs to operate the power system, including debt service costs for new generation, conservation, transmission, and distribution investment, operating costs, consumer costs for conservation measures, and quantifiable environmental costs). These are the costs that are estimated in testing the cost-effectiveness of a particular project or measure.

We agree that the debt service costs related to deductible construction costs are part of the cost of power production and are deductible "production expenses." A deduction of a percentage of the ongoing interest will be permitted. The percentage shall be the same percent deductible construction costs are to the total costs for the project. In other words, interest which relates to the construction of the power plant, the land clearing for the reservoir bottom and powerhouse, and the log boom is deductible. Interest which relates to the roads, bridge, . . . settlement, boat ramps, pipelines and land clearing for distribution or transmission is not deductible.

DECISION AND DISPOSITION:

The taxpayer's petition is granted as to the deduction for the costs for the log boom, land clearing for the reservoir bottom and powerhouse and for the related ongoing interest, as provided herein. The petition is denied as to the request for a deduction for the remaining project costs and related interest. The taxpayer should provide a breakdown, or a reasonable allocation, of the land clearing costs related to the land clearing for the reservoir bottom and powerhouse to the audit section for verification and determination of the costs and related interest that are deductible.

DATED this 9th day of September 1988.