SANITIZED DEC. 04-052 B – BY GEORGE V. PIPER – SUBMITTED FOR DECISION 12/13/04 – ISSUED 01/18/05

SYNOPSIS

BUSINESS AND OCCUPATION TAX -- WATER UTILITY -- A homeowner's association qualifies as a "person" subject to business and occupation tax under W. Va. Code § 11-13-1(b)(1) [1989].

BUSINESS AND OCCUPATION TAX -- WATER UTILITY -- Definition of "business" in W. Va. Code § 11-13-1(b)(6) [1989] includes a homeowners' association which operates a utility created for the purpose of keeping water rates low for property owner/members and to further enhance the value of their properties, because the same constitutes an economic benefit either direct or indirect, even if the Petitioner was not initially created with the object of gain or economic benefit.

BUSINESS AND OCCUPATION TAX -- WATER UTILITY -- The exemption in W. Va. Code § 11-13-3, 3rd paragraph, (c) [1983] extends only to fraternal societies, fraternal organizations, and fraternal associations organized and operated for the exclusive benefit of their members and not for profit.

BUSINESS AND OCCUPATION TAX -- WATER UTILITY -- In any event, Petitioner does not qualify for the exemption in W. Va. Code § 11-13-3, 3rd paragraph, (c) [1983] because its water utility sells to entities other than its members.

BUSINESS AND OCCUPATION TAX -- WATER UTILITY -- W. Va. Code § 11-13-2d [1995] is applicable to late fees collected by Petitioner's water utility from its customers, because the same constitute gross receipts from the public utility business. Syllabus point 3, Appalachian Electric Power Co. v. Koontz, 138 W. Va. 84, 76 S.E.2d 863 (1953).

BUSINESS AND OCCUPATION TAX -- WATER UTILITY -- Financial hardship is never a mitigating or negating factor as to a properly issued tax assessment; however, this tribunal will limit the tax liability to the customary three (3)-year period, rather than a five (5)-year period, based upon the complexity of the legal issues presented and the good faith of the Petitioner.

FINAL DECISION

The Auditing Division of the West Virginia State Tax Commissioner's Office conducted an audit of the books and records of the Petitioner. Thereafter, on December 9,

2003, the Director of this Division of the Commissioner's Office issued a West Virginia business and occupation tax assessment against the Petitioner. This assessment was issued pursuant to the authorization of the State Tax Commissioner, under the provisions of Chapter 11, Articles 10 and 13 of the West Virginia Code. The assessment was for the period of May 1, 1998 though April 30, 2003, for tax, interest through December 31, 2003, and no additions to tax, for a total assessed liability. Written notice of this assessment was served on the Petitioner.

Thereafter, by mail postmarked January 23, 2004, the Petitioner timely filed with this tribunal, the West Virginia Office of Tax Appeals, a petition for reassessment. *See* W. Va. Code § 11-10A-8(1) [2002].

Subsequently, notice of a hearing on the petition was sent to the Petitioner and a hearing was held in accordance with the provisions of W. Va. Code § 11-10A-10 [2002] and 121 C.S.R. 1, § 61.3.3 (Apr. 20, 2003).

FINDINGS OF FACT

- 1. On April 9, 1976, a "Declaration of Conditions, Covenants, Restrictions, and Easements" by "the Declarant" was made of record in the Office of the County Clerk of the County Commission in Deed Book 297 at page one (1).
- 2. The Declarant made known therein that it had incorporated under the laws of the State of West Virginia, as a non-profit corporation, the Petitioner, for the purpose of exercising the assigned powers of maintaining and administering the community properties

and facilities, and administering and enforcing the covenants and restrictions and collecting and disbursing the assessments and charges hereinafter created.

- 3. In Article III the Declarant stated that the term "Owner" meant those persons or entities of record which hold a free simple title to any lot which is part of the properties, but excluding those having such interests merely as security for the performance of an obligation.
- 4. In Article V, Section 2, voting rights were restricted to those members (person or entity) who own lots (one vote for each lot).

5. In Article VI, Section 3(b) it states:

In addition, all water usage shall be metered at the location of each individual residence, cottage or cabin, or other improvement, and from and after July 16, 1977, the Board of Directors of the Association shall determine the nonprofit cost of producing and distributing the water to the Properties on a pergallonage basis and shall establish a rate for the non-profit production and distribution of the water distributed to the Properties. After the rate has been established by the Board of Directors, they shall provide each and every owner with a copy of said rate and shall post a copy of the same in the office of the Association and thereafter all owners shall be billed and shall pay for any water usage in excess of the minimum hereinbefore provided for at the per gallon rate established by the Board of Directors. From and after July 16, 1981, the minimum gallonage and rate may be increased or decreased by vote of the owners, as hereinafter provided for the next succeeding three (3) years and at the end of each such period of three (3) years for each succeeding period of three (3) years. In all events the Board of Directors of the Association and the Owners shall attempt to establish a rate for the non-profit production and distribution of the water distributed, and in no event, shall the Board of Directors or the Owners

set a rate which is insufficient to provide for the reasonable operation and maintenance of said system.

- 6. The Petitioner operated a water utility during the audit period.
- 7. The field audit determined the water system's revenues by reviewing the financial statements prepared by the Petitioner.
- 8. The water utility bills and accounts are managed separately and apart from the homeowners' association's other revenue accounts.
- 9. The Petitioner is a homeowner's association that has approximately _____ members.
 - 10. Located adjacent to the residential area is a hotel/resort complex.
 - 11. The average water bill for the Petitioner's customers is \$ a quarter.
- 12. Besides the members' lots, five lots are located outside of the original development which are non-voting members of the association to whom Petitioner's utility provides water.
- 13. The hotel/resort complex is not a member of the Petitioner's homeowner's association.
 - 14. The hotel/resort complex is a water customer of the association.
- 15. A certified public accountant, retained by the Petitioner, testified that the Petitioner does not currently have funds to pay the assessment.
- 16. The certified public accountant further testified that the average bill charged for water by the Petitioner is relatively low.
- 17. The Petitioner can apply to the Public Service Commission to increase its rate to pay the assessment.

18. During the audit period, Petitioner's water utility sold water to both residential and commercial customers.

DISCUSSION

The first issue to be decided is whether the Petitioner qualifies as a "person" subject to the West Virginia business and occupation tax.

W. Va. Code § 11-13-1(b)(1) [1989] states:

'Person' or the term 'company,' herein used interchangeably, includes any individual, firm, co-partnership, joint venture, association, corporation, trust or any other group or combination acting as a unit, and the plural as well as the singular number, unless the intention to give a more limited meaning is disclosed by the context.

(emphasis added)

Clearly, the Petitioner, as an association, is a "person" as defined under the West Virginia business and occupation tax statute.

The second issue that must be determined is whether the Petitioner is also engaged in "business." "Business" is defined in W. Va. Code § 11-13-1(b)(6) [1989] to include "all activities engaged in or caused to be engaged in with the object of gain or economic benefit, either direct or indirect." Although the Petitioner fails to equate this definition with the economic benefit that is derived by the association and/or the members of the association from having lower water rates than the surrounding communities and from further increasing the property values by having a water service in the area, the economic benefit is self-evident and is not in any way undermined by the fact that Petitioner was not created with the object of gain or economic benefit, either direct or indirect.

The third issue is whether Petitioner's public utility business activities are exempt. The only purportedly applicable provision is W. Va. Code§ 11-13-3, 3rd paragraph, (c) [1983], which states that "[t]he provisions of this article shall not apply to:...(c) fraternal societies, organizations and associations organized and operated for the exclusive benefit of their members and not for profit[.]" The word "fraternal," in W. Va. Code § 11-13-3, 3rd paragraph, (c), modifies all three of the terms, "societies," "organizations," and "associations," not just "societies," the first word listed. *See, e.g., Tankovits v. Glessner,* 211 W. Va. 145, 150-51, 563 S.E.2d 810, 815-16 (2002) (meaning of ambiguous general words are to be limited by nearby specific words, under similar statutory construction principles of *ejusdem generis* and *noscitur a sociis*). *See also* 2A C. Sands, *Sutherland's Statutes and Statutory Construction* § 47.26 (19__) (under statutory construction principle of *reddendo singular singulis*, ambiguous general words are to be limited when literal meaning of term in isolation would clearly be too far-reaching, looking at the statute as a whole).

In addition, "[w]here a person claims an exemption from a law imposing a license or tax, such law is strictly construed against the person claiming the exemption." Syllabus point 5, CB&T Operations Co. v. Tax Comm'r, 211 W. Va. 198, 564 S.E.2d 408 (2002) (internal quote marks and citations omitted).

The Petitioner, <u>initially</u>, may have constituted a "fraternal association," which, by ordinary definition, implies a brotherly, benevolent, or social purpose for its members. Its stated purpose was to provide enforcement of covenants, the maintenance of roads, and to operate a water system for the benefit of <u>only</u> its members/owners. However, the exemption provided by in W. Va. Code § 11-13-3, 3rd paragraph, (c) [1983] is not applicable for the time period here, because the Petitioner is not operated for the exclusive benefit of its

members. Instead, water is being sold to the hotel/resort location, which is separate from the Petitioner homeowners' association and is not a member thereof.

The fourth issue is whether late fees collected by the Petitioner from its public utility business customers are subject to the business and occupation tax on such a business. They certainly are. Syllabus point 3, *Appalachian Elec. Power Co. v. Koontz*, 138 W. Va. 84, 76 S.E.2d 863 (1953).

The fifth issue to be decided is whether this tribunal should, as a last resort, abate this assessment because (1) Petitioner and its Board of Directors always believed in good faith that Petitioner was organized, structured, and designed solely for the benefit of its members and relied in good faith upon its non-profit status, and (2) to impose this tax would impose an undue hardship on the Petitioner, which, at present, has no money to pay the assessment.

There is no legal precedent to reduce or to negate any tax assessment because of one's mistaken beliefs or because undue financial hardship exists; however, in this particular instance this tribunal notes that the tax auditor performed a five (5)-year audit, instead of the normal three (3)-year audit, although Petitioner clearly was a non-filer due to the complexity of the issues of law presented.

Accordingly, this tribunal holds that the Petitioner is liable for the tax for only the normal three-year period, May 1, 2000 through April 30, 2003.

The Petitioner may, of course, contact the Respondent's Compliance Division about a possible installment payment plan.

CONCLUSIONS OF LAW

Based upon all of the above it is **HELD** that:

- 1. In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is upon a petitioner-taxpayer, to show that the assessment is incorrect and contrary to law, in whole or in part. See W. Va. Code § 11-10A-10(e) [2002] and 121 C.S.R. 1, § 63.1 (Apr. 20, 2003).
- 2. The Petitioner-taxpayer in this matter has failed to carry the burden of proof with respect to the issue of whether it, as a public utility, should be exempt from the business and occupation tax. See 121 C.S.R. 1, § 69.2 (Apr. 20, 2003).
- 3. The normal three-year assessment period applies here, due to the good faith misunderstanding by the Petitioner with respect to the complex legal issues.

DISPOSITION

WHEREFORE, it is the FINAL DECISION of the WEST VIRGINIA OFFICE OF TAX APPEALS that the tax assessment issued against the Petitioner for the modified period of May 1, 2000 through April 30, 2003, for tax, interest, and no additions to tax, should be and is hereby AFFIRMED.