NO. 100560-1

SUPREME COURT
OF THE STATE OF WASHINGTON

WALTER DORWIN TEAGUE ASSOCIATES, INC.,

Appellant,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

ANSWER TO PETITION FOR REVIEW

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Rules

Regulations

I. INTRODUCTION

Walter Dorwin Teague Associates, Inc. (Teague), a Washington business, continues to insist that Washington has no legal authority to tax the income it received for designing aircraft interiors for Boeing, which used those designs to manufacture aircraft in Washington. The courts below properly rejected Teague's argument because it conflicts with the express terms of the governing statute. Washington's apportionment statute, RCW 82.04.462(3)(b)(i), specifies the method for allocating revenue among the states in which a taxpayer does business, ensuring that Washington taxes only its fair share of interstate transactions.

The trial court and the Court of Appeals agreed that the Department of Revenue had correctly applied the apportionment statute and the Department rule, which direct attribution of apportionable income to the state "where the customer received the benefit of the taxpayer's service." RCW 82.04.462(3)(b)(i); WAC 458-20-19402(301).

Teague seeks this Court's review on the flawed premises that RCW 82.04.462(3)(b)(i) is ambiguous and the Court of Appeals purportedly failed to apply the plain language of WAC 458-20-19402. Both are untrue. A statute is not ambiguous merely because it does not address every conceivable scenario. The apportionment statute expressly attributes income based on where the "customer," not the customer's customer, received the benefit of taxpayer's services. The rule is consistent with this framework. Even if there were any ambiguity in the statute, the Court of Appeals applied the plain language of the rule. Thus, Teague's alleged conflicts under RAP 13.4(b) are illusory. While two other Court of Appeals decisions interpret the apportionment statute and rule, both are entirely consistent with the opinion below, and Teague does not argue otherwise.

Teague also fails to satisfy the remaining RAP 13.4(b) criteria for review. This case does not raise an issue of substantial public interest because it involves the application of

a statute and rule to the specific facts of Teague's business activities. This Court should deny review.

II. COUNTERSTATEMENT OF THE ISSUES

Teague designs airplane interiors for Boeing, which Boeing uses to manufacture airplanes in Washington. Did the courts below correctly apply the relevant statute and rule to attribute the gross income from these transactions to Washington because Washington is where Boeing, Teague's customer, received the benefit of those services?

III. COUNTERSTATEMENT OF THE CASE

Teague has been designing airplane cabin interiors, including seat layouts, seat geometry, and brand placement, for Boeing for over 75 years. CP 137. In that time, Teague has developed a close working relationship with Boeing such that Teague has a design studio, workshop, and other offices located in and around the Boeing facility in Everett, Washington. CP 137, 147.

Teague provides its design services to Boeing at every stage of an airplane's planning and production, starting when Boeing conceptualizes new aircraft designs. CP 146-47, 167-71. Once Boeing's board of directors approves an aircraft design, Teague provides detailed design work, such as the cabin ambience and layout. CP 147. After Boeing contracts with domestic and international commercial airlines (such as Alaska Airlines or Aero Mexico) to manufacture aircraft, Teague customizes the design in accordance with the airline's needs. CP 167-68. Boeing then uses Teague's design to build the airplanes' interiors in its manufacturing facilities, including those located in Washington State. CP 153-54. For the transactions at issue, Teague does not have a contractual relationship with Boeing's customers, the airlines. Boeing is the design authority and therefore owns the designs it purchases from Teague. CP 87, 151-52. Teague also occasionally contracts directly with airlines, generally when the airlines seek a more specialized design. CP 143-50, 164-67.

Teague submitted a refund claim to the Department of Revenue for $1,020,105 for the tax period January 1, 2011, to December 31, 2014, on the basis that it reported gross income to Washington that should have been apportioned to other states. CP 194-99. The Department agreed with Teague in part, concluding that when Teague contracted directly with airlines, gross income should be apportioned to other states where the airlines received the benefit of Teague's design services. *See id.* As a result, the Department issued a partial refund of $708,951 for taxes on the gross income Teague received when it contracted for design services directly with the airlines. CP 201-02. But the Department denied the remainder of the refund request, which represented taxes on the gross income Teague received when it contracted for design services with Boeing. *Id.*

Teague filed a tax refund action in Thurston County Superior Court under RCW 82.32.150 and RCW 82.32.180. On cross motions for summary judgment, the superior court

granted the Department's motion, affirming the Department's conclusion that Teague's income from Boeing should be apportioned to Washington. Teague appealed to the Court of Appeals, Division II, which issued a decision in favor of the Department. *Walter Dorwin Teague Assocs., Inc. v. Dep't of Revenue*, __ Wn. App. 2d __, 500 P.3d 190 (2021). Teague petitioned for review to this Court.

IV. REASONS WHY THE COURT SHOULD DENY REVIEW

The superior court and Court of Appeals correctly applied the apportionment framework established in the statute and Department rule to conclude that Teague's customer, Boeing, received the benefit of Teague's design services in Washington, where it used the designs to manufacture airplane interiors that it incorporated into airplanes, not where Boeing's customers ultimately used the airplanes.

Teague's arguments to the contrary are based on the incorrect claims that the apportionment statute is ambiguous

and the courts below ignored the Department's rule. The Court of Appeals' decision thoroughly analyzed and applied the plain meaning of RCW 82.04.462(3)(b) and WAC 458-20-19402 (Rule 19402) to the facts of this case. The Court rejected Teague's application of the rule to the facts because it "fails to give effect to the identity of the taxpayer's customer." *Teague*, 500 P.3d at 196.

Teague also fails to satisfy the RAP 13.4(b) criteria because it can point to no case with which the Court of Appeals' decision conflicts. In addition, the application of the Department's rule to a taxpayer's business activities does not raise a substantial public policy issue warranting this Court's review.

A. The Court of Appeals Correctly Focused on Where Teague's Customer Received the Benefit of Teague's Services

Washington imposes a gross receipts tax, known as the business and occupation (B&O) tax, "for the act or privilege of engaging in business activities" in this state.

RCW 82.04.220(1). "'[T]he legislature intended to impose the [B&O] tax upon virtually all business activities carried on within the state,' and to 'leave practically no business and commerce free of . . . tax.'" *ARUP Labs., Inc. v. Dep't of Revenue*, 12 Wn. App. 2d 269, 282, 457 P.3d 492 (2020) (citing *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn. 2d 139, 149, 3 P.3d 741 (2000)). The tax is measured by the application of rates against the value of products, gross proceeds of sales, or gross income of the business. RCW 82.04.220(1).

A business engaged in service activity in more than one state is entitled to apportion its gross income among the various states in which it operates. RCW 82.04.460. This concept of apportionment is rooted in the constitutional principle that a state may not tax value earned outside its borders but may tax its fair share of an interstate transaction. *See generally Goldberg v. Sweet*, 488 U.S. 252, 261, 109 S. Ct. 582, 102 L. Ed. 2d 607 (1989). In 2010, the Legislature changed the cost apportionment method to the current market based method,

known as single factor apportionment. Laws of 2010, 1st spec. sess., ch. 23, § 101(2)(b).[1] By changing the apportionment method, the Legislature intended to "require businesses 'earn[ing] significant income from Washington residents from providing services' to 'pay their fair share of the cost of services that this state renders and the infrastructure it provides.'" WAC 458-20-19402(101) (citing Laws of 2010, 1st spec. sess., ch. 23, § 101).

Washington's single factor method for apportioning service income is based on an equation. Taxpayers multiply their apportionable income by the "receipts factor." RCW 82.04.462(1). The receipts factor is a fraction, with the numerator representing the taxpayer's apportionable income attributable to Washington, and the denominator representing the taxpayer's apportionable income worldwide.

[1] Teague had originally paid B&O tax using the repealed cost apportionment method, and subsequently filed for the refund at issue based on its interpretation of the current apportionment method. CP 236.

RCW 82.04.462(2), (3)(a). The Legislature directs that for purposes of computing the receipts factor, gross income of the business generated from each apportionable activity is attributed to the state "[w]here the customer received the benefit of the taxpayer's service." RCW 82.04.462(3)(b)(i).

The statute defines "customer" as "a person or entity to whom the taxpayer makes a sale or renders services or from whom the taxpayer otherwise receives gross income of the business." RCW 82.04.462(3)(b)(viii). While the statute does not define "benefit," the Court of Appeals recently described its plain and ordinary meaning as the location where the taxpayer's customer received "the helpful or useful effect of its services." *ARUP*, 12 Wn. App. 2d at 282.

The Department promulgated Rule 19402 to provide a "framework for determining where the benefit of a service is received." WAC 458-20-19402(303). The rule reiterates the statutory inquiry of identifying "[w]here the customer received the benefit of the taxpayer's service." WAC 458-20-

19402(301)(a). The rule goes on to explain, "[i]f the taxpayer's service relates to tangible personal property, then the benefit is received where the tangible personal property is located or intended/expected to be located." WAC 458-20-19402(303)(b). For tangible personal property that will be created or delivered in the future, "the principal place of use is where it is expected to be used or delivered." WAC 458-20-19402(303)(b)(ii). The rule includes "designing specific/unique tangible personal property" as among the services that "relate to tangible personal property." WAC 458-20-19402(303)(b)(iii).

The Court of Appeals followed Rule 19402 by focusing on the touchstone inquiry—who is the taxpayer's customer and where did the customer receive the benefit of taxpayer's service? The Court correctly identified Boeing as Teague's "customer" for the income at issue. *Teague*, 500 P.3d at 195. The Court applied the rule's framework when it determined that "[t]he undisputed evidence demonstrates that Boeing expected to use the created airplane interiors designed by Teague during

the manufacturing process." *Id.* The Court affirmed the trial court's conclusion that Boeing received the helpful and useful effect of Teague's services in manufacturing the airplane interiors in Washington. *Id.*

The Court of Appeals' decision not only applies RCW 82.04.462 and Rule 19402 correctly, but in a common sense way: It attributes to Washington the income a Washington-based taxpayer (Teague) receives from a customer (Boeing) who uses the aircraft interior designs to manufacture airplanes in Washington. To suggest Washington should not be able to tax this income is illogical, and the courts below properly rejected Teague's arguments. No further review is warranted.

B. RCW 82.04.462 is Not Ambiguous, and the Court of Appeals Correctly Rejected Teague's Interpretation of Rule 19402

Teague seeks this Court's review on the erroneous premises that RCW 82.04.462 is ambiguous and the Court of Appeals failed to apply the plain meaning of Rule 19402.

Neither claim is correct. The Court of Appeals applied both the statute and rule's plain meaning and concluded that Boeing received the benefit of Teague's services where it manufactured the airplane interiors Teague designed. *Teague*, 500 P.3d at 195. Teague's interpretation of Rule 19402, in contrast, fails to address where the "customer" received the benefit of the services.

As a preliminary matter, RCW 82.04.462 is not ambiguous simply because it does not specify, for all circumstances and taxpayers, where a customer receives the benefit of a taxpayer's service. A statute is ambiguous only when it is susceptible to two or more reasonable interpretations. *State v. Gray*, 174 Wn.2d 920, 927, 280 P.3d 1110 (2012). Teague claims that any apportionment method is necessarily ambiguous and, specifically, here, because the customer could receive the benefit of the service "where the taxpayer performed the service, where the customer manufactured the goods, or where the customer sells the goods to the customer's

customer[.]" Pet. Review at 12-13.[2] A statute is not ambiguous merely because different interpretations are conceivable. Courts have recognized that "a statute may possibly be unclear in its application to a specific situation, but this does not render it ambiguous." *Bowie v. Dep't of Revenue*, 171 Wn.2d 1, 11 n.7, 248 P.3d 504 (2011).

Teague's interpretation is not reasonable because it focuses on where the taxpayer and the customer's customer received the benefit of taxpayer's services. The statute makes clear that apportionment is based on where "the customer received the benefit of the taxpayer's service." RCW 82.04.462(3)(b)(i). Teague's interpretation conflicts with the statute's customer-centric framework.

Moreover, the Court of Appeals has already concluded that the statutory term "benefit" can be given its plain and ordinary meaning as defined in the dictionary. *ARUP*, 12 Wn.

[2] Teague fails to note that two of these three options place the benefit of the service in this case in Washington.

App. 2d at 282. In *ARUP*, the Court instructed that under the plain meaning of the statute, taxpayer's income is apportioned to the state where the taxpayer's "customers receive the helpful or useful effect of [the taxpayer's] services." *ARUP*, 12 Wn. App. 2d at 282. Here, the Court of Appeals correctly concluded that Boeing received the helpful or useful effect of Teague's design services in Washington, where Boeing used the designs to manufacture airplane interiors as part of its airplane manufacturing process. Boeing did not receive the benefit of Teague's design services in the states where Boeing's airline customers ultimately used the manufactured airplanes.

To the extent there is any ambiguity, however, the Department's rule is consistent with this conclusion. Rule 19402 reiterates that the inquiry is where the "*customer* receives the benefit of the taxpayer's services." WAC 458-20-19402(301)(a) (emphasis added). As discussed above, the rule explains that where the taxpayer's service relates to tangible personal property that will be created or delivered in the future,

the principal place of use is where it is expected to be used or delivered. WAC 458-20-19402(303)(b)(ii). Reading these provisions together, and consistent with the statute, the relevant use of the tangible personal property refers to the use by the *customer*, not the customer's customer. Therefore, under both the statute, the applicable case law, and the rule, Boeing received the benefit of Teague's services where it used the tangible personal property Teague designed. Boeing used the airplane interiors in its manufacturing process in Washington. The Court of Appeals applied the plain meaning of Rule 19402 when it concluded that Boeing received the benefit of Teague's services where Boeing used Teague's designs to manufacture airplane interiors.

The Court of Appeals correctly rejected Teague's arguments with respect to Rule 19402(303)(b) because Teague "ignores the key statutory inquiry" and "fails to give effect to the identity of the taxpayer's customer, which is required for the apportionment analysis." *Teague*, 500 P.3d at 195-96. By

improperly focusing on isolated language in one section of the rule, Teague's argument ignores the overarching directive in both RCW 82.04.462 and Rule 19402 to focus on the customer. "A term in a regulation should not be read in isolation but rather within the context of the regulatory and statutory scheme as a whole." *City of Seattle v. Allison*, 148 Wn.2d 75, 81, 59 P.3d 85 (2002). Teague makes the same mistake by claiming Rule 19402's Examples 13 and 14 confirm that Teague's income should be attributed to where Boeing sells or delivers airplanes. Pet. Review at 15-16.[3] The Court of Appeals addressed this

[3] Example 13. Taxpayer, a commissioned salesperson, sells tangible personal property (100 widgets) for Distributor to XYZ Company for delivery to Spokane. Distributor receives the benefit of Taxpayer's service where the tangible personal property will be delivered. Therefore, Taxpayer will attribute the commission from this sale to Washington.

Example 14. Same facts as in Example 13, but the widgets are to be delivered 50 to Spokane, 25 to Idaho, and 25 to Oregon. In this case, the benefit is received in all three states. Taxpayer shall attribute the receipts (commission) from this sale 50% to Washington, 25% to Idaho, and 25% to Oregon where the tangible personal property is delivered to the buyer. WAC 458-20-19402(304)(b).

argument, explaining that Teague cited them out of context and thus the "examples do not support the interpretation that the identity of the taxpayer's customer is irrelevant." *Teague*, 500 P.3d at 196. These examples actually support the Department's argument because they "focus on where the taxpayer's customer received the benefit of the taxpayer's services." *Id.* Consistent with the examples, the Court of Appeals properly considered Boeing's identity as an airplane manufacturer and the fact that Boeing utilized Teague's design services in the manufacturing of airplane interiors.

Moreover, construing Rule 19402 as Teague suggests would conflict with the statute's focus on where the *customer* received the benefit. Courts must construe administrative rules consistent with the governing statutes. *See Ass'n of Wash. Bus. v. Dep't of Revenue*, 155 Wn.2d 430, 447, 120 P.3d 46 (2005) (agency interpretive rules have no inherent authority but are enforceable "by authority of the statute"); *Activate, Inc. v. Dep't of Revenue*, 150 Wn. App. 807, 816 n.9, 209 P.3d 524 (2009)

(if a rule is inconsistent with the governing statute, "the rule would have to give way to the statute"). The Court of Appeals in this case applied the rule consistent with the applicable statutory directive to apportion to where the customer received the benefits of taxpayer's services, and Teague does not argue otherwise. Therefore, whether or not RCW 82.04.462 is ambiguous, the Court of Appeals applied the law to the facts of this case consistent with both the applicable statute and rule.

C. The Court of Appeals' Decision Does Not Conflict with Any Decisions of the Court of Appeals or This Court

No conflict exists with respect to the existing case law on apportionment in Washington. The Court of Appeals has addressed the concept in two recent cases, both of which applied the statutory framework focusing on "where the customer received the benefit of the taxpayer's service." *ARUP*, 12 Wn. App. 2d at 280 (apportioning income from testing of bodily fluids and tissue samples to Washington, where taxpayer's physician customers used the test results to diagnose

and treat patients); *LendingTree, LLC v. Dep't of Revenue*, 12 Wn. App. 2d 887, 891-93, 460 P.3d 640 (2020) (citing *ARUP* with approval and apportioning income from lending marketplace to locations where LendingTree's lender customers used the leads to generate business). Teague does not argue that the decision below conflicts with either of these cases. Nor could it, as the analyses are consistent.

Instead, resting on the false premise that the courts below ignored the Department rule, Teague claims a conflict exists with cases requiring courts to give effect to the plain meaning of administrative rules. Pet. Review at 15-16. As explained above, the Court of Appeals gave effect to the plain meaning of Rule 19402 by applying the rule to the facts of this case. The Court rejected Teague's argument, not because the Court ignored Rule 19402, but because Teague ignored the statute and rule's direction to focus on the taxpayer's customer, not the taxpayer's customer's customer. RCW 82.04.462 and Rule 19402 both clearly direct taxpayers to apportion to "where

the customer received the benefit of the taxpayer's service." No conflict exists upon which to grant review under RAP 13.4(b)(1) or (2).

Nor does any conflict exist with respect to case law providing that tax imposing statutes should be construed in a taxpayer's favor. Even if the statute or rule were ambiguous, they should not be construed in Teague's favor as Teague contends. The principle of construing ambiguities against the taxing power and in favor of taxpayers applies in the context of tax imposing statutes. *Tesoro Refining & Marketing Co. v. Dep't of Revenue*, 164 Wn.2d 310, 317, 190 P.3d 28 (2008) (plurality opinion) (citing *Agrilink Foods, Inc. v. Dep't of Revenue*, 153 Wn.2d 392, 396-97, 103 P.3d 1226 (2005)). An inverse presumption applies with respect to statutes granting exemptions or deductions, as they are construed fairly and keeping with the ordinary meaning of the language against the taxpayer. *Tesoro*, 164 Wn.2d at 317 (citing *Simpson Inv. Co.*, 141 Wn.2d at 149-50).

Here, RCW 82.04.462 is not a tax imposing statute, but rather a tax calculation statute, and therefore should not be construed in favor of the taxpayer. *See Sacred Heart Med. Ctr. v. Dep't of Revenue*, 88 Wn. App. 632, 636-37, 946 P.2d 409 (1997) (reiterating the rule that courts strictly interpret ambiguities in statutes imposing taxes in favor of the taxpayer . . . but that an opposite analysis applies to tax exemption statutes). Therefore, no rule of construction warrants interpreting the apportionment statute in Teague's favor and no conflict exists on this point.

D. This Case Raises No Issue of Substantial Public Interest

There is no issue of substantial public interest requiring this Court's review under RAP 13.4(b)(4) because the Court of Appeals' decision simply applied the statute, rule, and relevant case law to Teague's fact-specific business activity of designing airplane interiors for an airplane manufacturer in Washington.

Teague' argument in support of an issue of substantial public interest relies on its erroneous claim that the Court of Appeals failed to apply the plain meaning of Rule 19402. As shown above, the Court analyzed and applied the plain meaning of Rule 19402, which must necessarily be interpreted in light of the statute it implements. *See Ass'n of Wash. Bus.*, 155 Wn.2d at 447. Instead, it is Teague that ignored the directives in RCW 82.04.462 and Rule 19402 to apportion its income to where its customer, Boeing, received the benefits of its design services—where Boeing used the airplane interiors that Teague designed in its manufacturing operations.

V. CONCLUSION

The Court of Appeals correctly interpreted and applied the applicable statutes and rule. Teague's petition raises no conflict with other cases or issue of substantial public interest meriting review. This Court should deny Teague's petition.

This document contains 3,665 words, excluding the parts of the document exempted from the word count by RAP 18.17.

RESPECTFULLY SUBMITTED this 11th day of February, 2022.

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PROOF OF SERVICE

I certify that on February 11, 2022, through my legal assistant, I electronically filed this document with the Clerk of the Court using the Washington State Appellate Courts' e-file portal and served a copy of this document via electronic mail under an electronic service agreement on:

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I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 11th day of February, 2022, at Olympia, WA.

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