No. 54959-0-II

100560-1

DIVISION II, COURT OF APPEALS
OF THE STATE OF WASHINGTON

WALTER DORWIN TEAGUE ASSOCIATES, INC.,

Appellant

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent

PETITION FOR REVIEW

Scott M. Edwards
WSBA No. 26455
Ryan P. McBride
WSBA No. 33280
Daniel A. Kittle
WSBA No. 43340
Attorneys for Petitioner Walter Dorwin Teague Associates, Inc.

LANE POWELL PC
1420 Fifth Avenue, Suite 4200
P.O. Box 91302
Seattle, WA 98111-9402
Telephone: 206.223.7000

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I. INTRODUCTION

This appeal raises the recurring question of whether the Department of Revenue (DOR) has authority to disregard its own interpretive rule when applying a facially ambiguous tax statute—and, further, whether Washington courts can permit DOR to do so when it results in a construction of the statute that disfavors the taxpayer. The answer to both of these questions is no. This Court should accept review to not only right the wrong that occurred in this case, but also to reaffirm fundamental principles of taxation that DOR and our courts too often ignore.

Walter Dorwin Teague Associates, Inc. (Teague) designs aircraft interiors for passenger planes manufactured by Boeing. On some projects, Teague contracts with the airline; on others, Teague contracts through Boeing to work with a particular airline. In both circumstances, however, Teague works directly with the airline to tailor its design to the airline's needs and specifications. Boeing assembles the aircraft's interior as part of

its overall manufacturing process, and then delivers the finished aircraft to the airline for the airline's use.

The apportionment of Teague's B&O tax turns on where Teague's customer "received the benefit" of Teague's services. RCW 82.04.462(3)(b). By rule, DOR interprets that term to mean that, when the taxpayer's services relate to the manufacture of tangible personal property, the customer receives the benefit of the service where the finished property "is expected to be used or delivered." WAC 458-20-19402(303)(b)(ii). Here, the aircraft interiors that Teague designs is the relevant tangible personal property, and there is no dispute that the interiors are "expected to be used or delivered" where the airlines operate—and that is true whether Teague's customer is the airline or Boeing.

Flouting the language of its own rule, DOR apportioned Teague's income to the location where the aircraft interiors are "used or delivered" only when Teague contracted with an airline, but not when it contracted with Boeing—even though Teague's services, Boeing's assembly, and the airline's use of the interiors

are identical in both situations. A divided Court of Appeals accepted DOR's approach. But as the dissent noted, the statute and rule "either provide that Teague should not be subject to B&O taxes for its design services or are hopelessly unclear," in which case, "ambiguity must be resolved in favor of Teague."

The court's published opinion warrants review under RAP 13.4(b)(1) and (b)(2) because, by permitting DOR to defy the plain language of Rule 19402, the opinion conflicts with precedent holding that DOR may not ignore its own interpretive rules in applying ambiguous tax statutes and that such statutes must be strongly construed in favor of taxpayers. More generally, the opinion also warrants review under RAP 13.4(b)(4) because there is a substantial public interest in promoting and rewarding justifiable taxpayer reliance on DOR's interpretive rules given the voluntary compliance nature of our tax system.

II. COURT OF APPEALS OPINION

The Court of Appeals issued its published opinion on December 14, 2021 (Opinion). A copy of the Opinion is attached.

III. ISSUE PRESENTED FOR REVIEW

When Teague contracts with Boeing to design aircraft interiors, RCW 82.04.462 requires income from those contracts to be sourced to the state where Boeing "received the benefit" of Teague's services. DOR promulgated Rule 19402 to interpret that ambiguous term. The Rule provides that, because Teague's services relate to the manufacture of tangible personal property, *i.e.*, aircraft interiors, Boeing receives the benefit of the services "where [that property] is expected to be used or delivered."

Although it was undisputed that the aircraft interiors are "expected to be used or delivered" to airlines operating in other states, DOR sourced Teague's income to Washington where Boeing used Teague's designs during the manufacturing process. Did the Court of Appeals err when it (1) permitted DOR to ignore Rule 19402's plain and ordinary meaning, and (2) refused to construe an ambiguous tax statute in the taxpayer's favor? **Yes.**

IV. STATEMENT OF THE CASE

A. Undisputed Facts

Teague is an industrial design firm that designs aircraft interiors for passenger aircraft manufactured by Boeing, including seat layouts and geometry, airline brand placement, and other aspects of aircraft interiors. CP 235. Depending upon the commercial relationship between Boeing and a particular airline, for some projects Teague contracts directly with the airline; for others, Teague contracts with Boeing. *Id.*; CP 145-46. When Teague contracts with Boeing, Teague performs its design services under a Statement of Work that is specific to each particular airline. CP 235; *see*, *e.g.*, CP 240-52.

Teague works closely with each airline to ensure its design is consistent with the airline's expectations, helping the airline choose design aspects like colors, materials, or other modifications and airline-specified design elements. CP 236. Teague regularly meets with representatives of the airline to obtain design input and approval, including traveling to the

airline's headquarters. *Id*. Critically, whether Teague contracts with an airline or with Boeing, the design work it does for the airline is the same. *Id.*; CP 165 ("It's the same work.").

After an airline approves Teague's design, Boeing assembles the aircraft's interior in accordance with Teague's design. CP 236. Boeing does this as part of its overall assembly process in the same facility; it does not assemble the aircraft interior separately from the rest of the aircraft. CP 317. Boeing views the airplane interior as an integral part of the aircraft as a whole, not a separate component. And, indeed, the Teague-designed aircraft interiors are not completed until Boeing completes the entire aircraft assembly process. CP 317-18.

B. DOR's Interpretive Rule Regarding RCW 82.04.462

Washington's B&O tax applies to income derived from "the act or privilege of engaging in business activities" in Washington. RCW 82.04.220(1). The constitutional concept of apportionment permits Washington to tax only that income properly derived from business activities performed within this

state. RCW 82.04.460(1); *see Gwin, White & Prince Inc. v. Henneford*, 305 U.S. 434 (1939). In 2010, the Washington legislature adopted a "single factor" apportionment method for service income. Laws of 2010, 1st Spec. Sess., ch. 23; RCW 82.04.460. Under RCW 82.04.462, a taxpayer's income must be attributed to the state "[w]here the customer received the benefit of the taxpayer's service." RCW 82.04.462(3)(b)(i).

Because that term is subject to multiple interpretations, DOR promulgated Rule 19402 to explain how taxpayers should apply the statute in various contexts. The Rule provides that, "[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). Critically, the Rule specifies that if the property "will be created in the future," then the customer receives the benefit of the taxpayer's service "where [the property] is expected to be used or delivered." *Id.*, 19402(303)(b)(ii).

C. Administrative and Trial Court Proceedings

In 2015, Teague claimed a refund for overpaid taxes for the period January 1, 2011 through December 31, 2014 arising from RCW 82.04.462's revised apportionment methodology. CP 236; CP 254-56. Teague argued that because its design services relate to tangible personal property to be created in the future, *i.e.*, aircraft interiors, Rule 19402(303)(b) dictated that its income must be sourced to the location where those aircraft interiors were "expected to be used or delivered"—regardless of whether Teague contracted directly with an airline or with Boeing.

DOR refunded Teague taxes paid on income earned from its contracts with the airlines, but not on its contracts with Boeing. CP 258-65; CP 286-300. Teague then challenged DOR's determination in the trial court. CP 1-5. The trial court granted DOR's motion for summary judgment, reasoning that—despite Rule 19402—when Teague contracts with Boeing, Boeing always receives the benefit of Teague's designs where it

assembles the aircraft interiors, not where the interiors were "expected to be used or delivered." VRP at 26; CP 337-38.

D. Court of Appeals' Published Opinion

By a 2-1 decision, the Court of Appeals affirmed. The majority recognized that Rule 19402 provided DOR's guidance on where the taxpayer's customer "receives the benefit of the service" pursuant to RCW 82.04.462's apportionment scheme. Opinion at 7. It further recognized that Teague's design services relate to "tangible personal property" that "will be created or delivered in the future" and, thus, the Rule requires income from those services to be attributed to "where [the property] is expected to be used or delivered." *Id.* at 7-8.

Beyond that, like the DOR before it, the majority largely ignored Rule 19402. Focusing on RCW 82.04.462's requirement that income be attributed to where the "customer received the benefit of the taxpayer's service," the majority held that, because Boeing assembled the aircraft interiors designed by Teague in Washington, Boeing received the benefit of Teague's design

services in Washington. The majority rejected Teague's argument that Rule 19402's unambiguous terms compelled a different result on the ground that it "fails to give effect to the identity of the taxpayer's customer." Opinion at 9.

The dissent disagreed, noting that RCW 82.04.462 was subject to more than one reasonable interpretation. "The majority concludes that Boeing received the benefit of Teague's design services in Washington, where Boeing used the design to manufacture airplane interiors for its commercial airplanes. But another reasonable interpretation is that Boeing received the benefit of Teague's design services when Boeing sold the completed airplanes to out-of-state airlines. Certainly that is where [sic] Boeing received the *financial* benefit of Teague's design services." Opinion at 12 (emphasis in original).

It was because of such ambiguities, argued the dissent, that DOR promulgated Rule 19402. Opinion at 12. Regarding Rule 19402(303)(b)(ii), upon which Teague relies, the dissent properly concluded, "there is no question that the interiors will

be delivered in the future and that the place of delivery is where the airlines are located, not where Boeing is located." *Id.* at 13. "In short, RCW 82.04.462(3)(b)(i) and Rule 19402 either provide that Teague should not be subject to B&O taxes for its design services or are hopelessly unclear." *Id.* If the latter, then the "ambiguity must be resolved in favor of Teague." *Id.*

V. REASONS FOR REVIEW

The Court of Appeals' failure to confront—or even recognize—RCW 82.04.462's patent ambiguity resulted in two fundamental errors, both of which merit this Court's review. First, the majority refused to give deference to Rule 19402's plain meaning as the controlling interpretation of the statute. Second, to the extent Rule 19402 did not clearly resolve the case for Teague, then the majority should have applied the well-established rule of construction that ambiguous statutes must be interpreted in favor of the taxpayer. Either way, as the dissent correctly pointed out, Teague was entitled to a tax refund.

A. RCW 82.04.462 Is An Ambiguous Tax Statute.

The proper apportionment of Teague's income for B&O tax turns exclusively on identifying the state where Teague's "customer received the benefit" of Teague's service. RCW 82.04.462(3)(b)(i). That concept—where the "customer received the benefit" of a service—is inherently ambiguous because it is subject to multiple reasonable interpretations. *See First Student, Inc. v. Dep't of Revenue*, 194 Wn.2d 707, 710, 451 P.3d 1094 (2019) ("A statutory provision is ambiguous when it is fairly susceptible to two or more reasonable interpretations.").

Take, for example, the situation where—as here—the taxpayer's service aids in the customer's manufacture of goods. The taxpayer may perform the service in State A, the taxpayer's customer may use the service when manufacturing the goods in State B, and the finished goods then may be sold to the customer's customer in State C. Does the customer 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?

Indeed, legal commentators have noted that when an apportionment scheme is stated as a broad principle as it is in RCW 82.04.462, to avoid ambiguity, published rules ("proxies") are necessary to inform taxpayers how the principle should be applied to specific transactions. J. Swain, *Reforming the State Corporate Income Tax: A Market State Approach to the Sourcing of Service Receipts*, 83 Tul. L. Rev. 285, 347 (2008) (arguing that although apportionment can "be expressed as a principle, such as 'where the benefit of the service is received' or 'where the service is used and enjoyed' … it would be advisable to adopt a proxy-driven approach because of the ambiguity inherent in identifying where the benefit of a product is received.").

Plainly, DOR understood this too. DOR adopted Rule 19402 because it recognized that, without further explanation and examples, RCW 82.04.462's nebulous "customer received the benefit" standard could lead to inconsistent application and,

thus, provide a trap for unwary taxpayers. *See* WAC 458-20-19402(303) ("This subsection explains the framework for determining where the benefit of a service is received."); *ARUP Labs., Inc. v. Dep't of Revenue*, 12 Wn. App.2d 269, 729, 457 P.3d 492 (2020) (Rule 19402 "was promulgated to help taxpayers assess where the benefit of the service is received.").

B. Neither DOR Nor The Courts Can Ignore Rule 19402.

Because DOR promulgated Rule 19402 to resolve RCW 82.04.462's ambiguities, the Court of Appeals majority should have given the Rule "great weight." *First Student*, 194 Wn.2d at 717; *Ass'n of Wash. Bus. v. Dep't of Revenue*, 155 Wn.2d 430, 447 & n.17, 120 P.3d 46 (2005) (DOR rules entitled to deference if statute ambiguous). At the same time, the majority should have rejected DOR's invitation to substitute the Rule's plain meaning with a novel construction floated for the first time in litigation. *Cowiche Canyon Conservancy v. Bosley,* 118 Wn.2d 801, 815, 828 P.2d 549 (1992) (no deference where agency "bootstrap[s] a legal argument into the place of agency interpretation").

After all, DOR's rules serve "as advance notice of the agency's position should a dispute arise." *Ass'n of Wash. Bus.*, 155 Wn.2d at 447. As such, taxpayers "must be able to rely on the plain meaning of … Department interpretations, without fear that a state agency will later penalize them by adopting a different interpretation." *Silverstreak, Inc. v. Dep't of Labor & Indus.*, 159 Wn.2d 868, 889-90, 154 P.3d 891 (2007); *see also Avnet, Inc. v. Dep't of Revenue*, 187 Wn.2d 44, 82, 384 P.3d 571 (2016) (Gordon McCloud, J., dissenting) ("Not only would it be unfair to ignore [DOR's] own rules, the legislature requires that [DOR] follow its own promulgated rules"). Unfortunately, and as demonstrated below, the Court of Appeals majority failed to follow these settled precedents.

C. Rule 19402(303)(b) Is Unambiguous And Dispositive.

The majority opinion cannot be squared with Rule 19402. The rules of statutory construction apply to regulations and, as such, the "language of an unambiguous regulation is given its plain and ordinary meaning unless legislative intent indicates to

the contrary." *Tesoro Ref. and Mktg. Co. v. Dep't of Revenue*, 164 Wn.2d 310, 322, 190 P.3d 28 (2008). Unlike the statute it interprets, Rule 19402(303)(b) is unambiguous. It is undisputed that Teague provides Boeing with design services, not tangible personal property. It is equally undisputed that these services *relate* to property—*i.e.*, aircraft interiors—that Boeing creates in its airplane assembly process. The Rule provides that, where, as here, the services relate to tangible personal property the taxpayer's customer will "create[] in the future," then the benefit of the service is received "where [the property] is expected to be used or delivered." WAC 458-20-19402(303)(b)(ii).

Rule 19402(303)(b) does not ask where the taxpayer's design services are used by its customer. All that matters is where the finished tangible personal property created from those design services is "expected to be used or delivered." *Id.* Here, whether Teague contracts with Boeing or contracts with a specific airline, it is undisputed that the aircraft interiors it designs and Boeing assembles are "expected to be used or delivered" where the

airlines operate—not where Boeing used the designs to assemble the interiors as part of the plane. Under Rule19402's plain and ordinary meaning, that is the beginning and end of the analysis.

Without confronting the actual language of Rule 19402, the Court of Appeals majority refused to give the Rule's plain meaning effect on the grounds that doing so would "ignore[] the key statutory inquiry, which is 'where the *customer* received the benefit of the taxpayer's service.'" Opinion at 9 (quoting RCW 82.04.462(3)(b)(i)). But the Rule is unequivocal. It does not matter whether the finished property is to be used by or delivered to the taxpayer's customer or the "customer's customer." The location of delivery and/or use is all that matters. To be sure, DOR could have drafted Rule 19402 to draw a distinction based on the customer's location in situations related to the manufacture of tangible personal property, but it did not.

This is clear when Rule 19402 is viewed as a whole. *Dep't of Revenue v. Nord Nw. Corp.*, 164 Wn. App. 215, 224, 264 P.3d 25 (2011) (rule should be read in context of regulatory scheme

as a whole). Unlike section 303(b), sections 303(c) and (d) state that, when a service "does not relate to real or tangible personal property," income is allocated to where the "***customer's*** related business activities occur"; the "***customer*** is located"; or the "***customer*** resides." WAC 458-20-19402(303)(c) & (d). In short, when apportionment turns on the identity or location of the taxpayer's customer, DOR said so specifically—and it did not say so for services related to future personal property.

The Rule's examples confirm DOR's determination that the taxpayer's customer receives the benefit of the taxpayer's services where the customer sells or delivers the property:

> **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). In both, income is sourced where the property is received by the taxpayer's "customer's customer" (XYZ) without regard to the location of the taxpayer's customer (Distributor). The majority's claim that the examples merely "illustrate a scenario where the customer—the distributor—received the benefit of the taxpayer's services in different states" both begs the question and misses the point: the taxpayer's customer "receives the benefit" of the services where the customer's customer takes delivery of the property. So too here.

D. The Rule Reasonably Interprets RCW 82.04.462.

The Court of Appeals' analysis implies that Rule 19402 cannot be given its plain and ordinary meaning because doing so would conflict with RCW 82.04.462. That is, the customer must necessarily "receive the benefit" of the taxpayer's services only where the customer uses the services to create tangible personal property, but not where the customer sells that property. Not so. Washington's "single factor" apportionment method is intended

to allocate service income based on the contributions of market states in generating the income—and, thus, income may be (and often is) sourced to a state other than the state where the services are rendered or received. *See, generally*, Swain, *supra*.

In cases where the taxpayer's services contribute to the creation of tangible personal property, Rule 19402(303)(b) is entirely consistent with RCW 82.04.462's market-contribution approach and "received the benefit" test. When Teague provides designs for Boeing to use as part of its assembly process, it could be said that Boeing receives a benefit in Washington. But, critically, Boeing also receives the benefit of Teague's services in all the markets where Boeing's airline customers purchase, take delivery, and operate the planes with Teague-designed interiors—no less than those airlines that contract with Teague directly and receive the same benefit from the same designs.

For such cases, Rule 19402(303)(b) reflects DOR's determination that Boeing shall be deemed to have "received the benefit" of Teague's services in the destination state for the

property Teague designed, *i.e.*, where the aircraft interiors are "expected to be used or delivered." That determination makes good sense. After all, without the contribution of these market states, there would be no demand for Boeing's planes and no demand for Teague's services. As the dissent correctly observed, "[c]ertainly that is where [sic] Boeing received the *financial* benefit of Teague's design services." Opinion at 12 (emphasis in original). In sum, Rule 19402(303)(b) controls because it reflects DOR's reasonable interpretation of RCW 82.04.462.

E. Any Ambiguity Must Be Resolved In Teague's Favor.

Instead of giving Rule 19402(303)(b) its plain meaning, the Court of Appeals accepted DOR's unsupported argument that the Rule applies only where the tangible personal property at issue is used by or delivered to the taxpayer's customer. Opinion at 9. Such a reading not only conflicts with Rule 19402(303)(b)'s text, it renders the Rule meaningless (and provides taxpayers no guidance) for common multi-state transactions like this one—where the taxpayer's customer uses the taxpayer's services to

manufacture goods in one state that are delivered to and used by the "customer's customer" in another.

Worse yet, the majority was forced to ignore the facts to fit its erroneous interpretation of Rule 19402(303)(b), repeatedly stating that Boeing—not Boeing's customer—was the only party expected to use the "created airplane interiors." Opinion at 8, 11. But the evidence is undisputed that an aircraft interior is not a separate component of an airplane, nor is it assembled or installed separately; the interior is part and parcel of the airplane as a whole, assembled with and at the same time as the rest of the plane. CP 317. Put simply, Boeing *assembles* aircraft interiors; it does not *use* them. Like the rest of the airplane, only the airlines use the interiors after Boeing delivers the completed plane.

DOR's textually-untethered interpretation of Rule 19402 is unreasonable, raised purely in the context of litigation, and should not have been adopted by the Court of Appeals majority. But even if this novel interpretation were reasonable, it would simply show that RCW 82.04.462 and the Rule itself are "fairly

susceptible to two or more reasonable interpretations"—the very definition of ambiguity. *First Student*, 194 Wn.2d at 710; *Seattle Filmworks, Inc. v. Dep't of Revenue*, 106 Wn. App. 448, 453, 24 P.3d 460 (2001) (same for DOR interpretive rules).

As the dissent concluded, and as this Court has repeatedly held, any such ambiguity should be resolved against DOR and in favor of Teague. Opinion at 12-13 (citing *Qualcomm, Inc. v. Dep't of Revenue*, 171 Wn.2d 125, 131, 249 P.3d 167 (2011)); *also Estate of Bracken*, 175 Wn.2d 549, 563, 290 P.3d 99 (2012); *Agrilink Foods, Inc. v. Dep't of Revenue*, 153 Wn.2d 392, 396-97, 103 P.3d 1226 (2005). This rule of construction is not one of convenience; it is compelled by "our constitution's requirement that 'every law imposing a tax shall state distinctly the object of the same to which only it shall be applied.'" *Bracken*, 175 Wn.2d at 563 (quoting Wash. Const. art. VII, § 5). In its haste to adopt DOR's interpretation, the majority ignored this rule as well.

VI. CONCLUSION

RCW 82.04.462 is an ambiguous tax statute. This Court's opinions chart how the Court of Appeals should have resolved the ambiguity: defer to Rule 19402(303)(b) because it reflects DOR's promulgated and reasonable interpretation of the statute; reject DOR's invitation to substitute the Rule's plain meaning for an erroneous one advanced for the first time in litigation; and, in all events, strongly construe any residual ambiguity in Teague's favor. The Court of Appeals majority did none of these things. This Court should accept review and reverse.

I certify that this Petition is in 14 point Times New Roman font and contains 3953 words, in compliance with RAP 18.17(b).

SUBMITTED this 12th day of January, 2022.

LANE POWELL PC

By s/*Ryan P. McBride*
Scott M. Edwards, WSBA No. 26455
Ryan P. McBride, WSBA No. 33280
Daniel A. Kittle, WSBA No. 43340

1420 Fifth Avenue, Suite 4200
P.O. Box 91302
Seattle, WA 98111-9402
Telephone: 206.223.7000

Attorneys for Petitioner Walter Dorwin Teague Associates, Inc.

CERTIFICATE OF SERVICE

I hereby declare under penalty of perjury under the laws of the State of Washington and the United States that on January 12, 2022, I caused a copy of the foregoing document to be served on the following person(s) in the manner indicated below at the following address(es):

Jessica Fogel, WSBA No. 36846 Nam Duc Nguyen, WSBA 47402 Attorney General of Washington Revenue and Finance Division 7141 Cleanwater Lane SW PO Box 40123 Olympia, WA 98504 T: 360.753.5528 E-mail: jessicaf1@atg.wa.gov nam.nguyen@atg.wa.gov katelynj@atg.wa.gov revolyef@atg.wa.gov	☑ by CM/ECF ☐ by Electronic Mail ☐ by Facsimile ☐ by First Class Mail ☐ by Hand Delivery ☐ by Overnight Delivery

DATED this 12th day of January, 2022, at Snohomish, Washington.

s/*Kathryn Savaria*
Kathryn Savaria, Legal Assistant

APPENDIX

Filed
Washington State
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December 14, 2021

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

WALTER DORWIN TEAGUE ASSOCIATES, INC., Appellant, v. STATE OF WASHINGTON DEPARTMENT OF REVENUE, Respondent.	No. 54959-0-II PUBLISHED OPINION

VELJACIC, J. — Walter Dorwin Teague Associates, Inc. (Teague) appeals the trial court's order granting the Department of Revenue's (DOR) motion for summary judgment, which dismissed its tax refund action. Teague argues that the trial court erred in granting summary judgment to the DOR and in denying its cross-motion for summary judgment because the DOR did not properly apportion Teague's design services income under the statute and regulations at issue.

We hold that the trial court did not err in granting the DOR's motion for summary judgment and denying Teague's cross motion. Because no genuine issue of material fact remains as to whether The Boeing Company was Teague's "customer" and that Boeing received the "benefit" of Teague's design services in Washington State, the trial court did not err in concluding that the DOR properly apportioned Teague's income to Washington State as a matter of law. Accordingly, we affirm the trial court's order granting the DOR's motion for summary judgment and in denying Teague's cross-motion for summary judgment.

FACTS

I. FACTUAL BACKGROUND

Teague is an industrial design firm headquartered in Seattle, Washington. Teague offers design and branding services in various industries, including aviation. Relevant here, Teague specializes in designing the interior of passenger airplanes, which includes seating layouts, seating geometry, and brand placement. Teague contracts with Boeing, a major commercial airplane manufacturer, to provide such designs.

Teague provides its design services to Boeing at every stage of an airplane's planning and production cycle. From the very beginning, Teague is involved with Boeing's marketing and engineering departments in conceptualizing new aircraft designs. Once Boeing's board of directors approves an aircraft design, Teague provides a proposed interior design, which includes cabin ambience and layout. When Boeing sells an airplane to a particular airline company, Teague customizes the interior design in accordance with the airline's needs.

During the customization phase, Boeing sends Teague a statement of work to design the interior of a particular airplane. In response, Teague provides Boeing with a proposal which includes cost estimates. Once Boeing and Teague reach an agreement, Boeing issues Teague a work request. Teague then provides the design and sends an invoice to Boeing, which Boeing pays. The income received by Teague from Boeing's work requests during the customization phase is at issue in this case.

Regardless of their contractual relationship, Teague works closely with each airline company to ensure its design is consistent with that airline's standards and expectations. For example, Teague would assist an airline company by helping it decide certain design aspects like color schemes, materials, or airline-specified design elements. In certain circumstances, if an

airline company desires a more specialized design, then the airline company would contract directly with Teague.

Boeing uses Teague's designs to build the aircraft interiors in its manufacturing facilities in Washington State.[1] Boeing owns all designs purchased from Teague. Teague is not involved in Boeing's manufacturing process.

II. PROCEDURAL HISTORY

On August 25, 2015, Teague submitted a tax refund request with the DOR. Teague requested a refund in the amount of $1,020,105 for the tax period of January 1, 2011, through December 31, 2014. Teague contended that the DOR over-apportioned its design services income to Washington.

The DOR agreed with Teague in part. The DOR issued a partial refund of $708,951 for taxes imposed on the income that Teague received from contracting with the airline companies. The DOR denied a refund for taxes imposed on the income that Teague received from contracting with Boeing. The DOR differentiated between the locations where each of Teague's customers received the benefit of Teague's design services.

Teague appealed the DOR's partial refund denial through the DOR's administrative review process. The DOR denied Teague's petition for review. Teague requested reconsideration of the DOR's determination, which was also denied.

[1] Boeing maintains manufacturing facilities that are dedicated to a specific airplane model. For example, if an airline company purchases a Boeing 737, then the aircraft would be always be manufactured in Everett, Washington.

On October 11, 2018, Teague filed this tax refund action in Thurston County Superior Court under RCW 82.32.180.[2] Teague argued that the DOR over-apportioned business and occupation (B&O) taxes in Washington on the income received from its Boeing contracts and requested a refund in the amount of $344,164.

Teague and the DOR filed cross motions for summary judgment. The DOR argued that it properly apportioned the income that Teague received from its Boeing contracts to Washington. Teague argued that its income should have been apportioned to the location were the airline companies used or received the aircraft interiors, which was not in Washington.

The trial court agreed with the DOR. The trial court concluded that Boeing was Teague's "customer" under the statute and regulations at issue. Report of Proceedings (RP) at 26. The trial court further concluded that Boeing received the "benefit" of Teague's design work in Washington—where it manufactured commercial airplanes. RP at 26. Accordingly, the trial court granted the DOR's motion for summary judgment, denied Teague's motion for summary judgment, and dismissed Teague's tax refund action. Teague appeals.

ANALYSIS

Teague argues that the trial court erred in granting the DOR's motion for summary judgment because the income received from its Boeing contracts should not have been apportioned to Washington. We disagree.

[2] RCW 82.32.180 provides that

> [a]ny person . . . having paid any tax as required and feeling aggrieved by the amount of the tax may appeal to the superior court of Thurston county. . . . In the appeal the taxpayer shall set forth the amount of the tax imposed upon the taxpayer which the taxpayer concedes to be the correct tax and the reason why the tax should be reduced or abated.

I. STANDARD OF REVIEW

This matter is on review of a summary judgment decision. "A grant of summary judgment is reviewed de novo, with the court engaging in the same inquiry as the trial court." *Wash. Imaging Servs., LLC v. Dep't of Revenue*, 171 Wn.2d 548, 555, 252 P.3d 885 (2011). "Summary judgment is proper if there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law." *Id*.; CR 56(c). "'A material fact is one upon which the outcome of the litigation depends.'" *Wash. Fed. v. Azure Chelan, LLC*, 195 Wn. App. 644, 652, 382 P.3d 20 (2016) (quoting *Kim v. O'Sullivan*, 133 Wn. App. 557, 559, 137 P.3d 61 (2006)). Where there are no genuine issues of material fact and the issue is how the B&O tax statutes and regulations apply to the facts of the case, we treat the issue as a question of law, which is reviewed de novo. *Wash. Imaging Servs., LLC*, 171 Wn.2d at 555.

Statutory and regulatory interpretation is also a question of law that we review de novo. *Columbia Riverkeeper v. Port of Vancouver, USA*, 188 Wn.2d 80, 90, 392 P.3d 1025 (2017). "We apply normal rules of statutory construction to administrative rules and regulations." *Solvay Chems., Inc. v. Dep't of Revenue*, 4 Wn. App. 2d 918, 927, 424 P.3d 1238 (2018). The primary goal of statutory interpretation is to determine and implement the legislature's intent. *Tesoro Ref. & Mktg. Co. v. Dep't of Revenue*, 173 Wn.2d 551, 556, 269 P.3d 1013 (2012). In conducting a plain language analysis, we will not read provisions in isolation. *Cannabis Action Coalition v. City of Kent*, 180 Wn. App. 455, 477, 322 P.3d 1246 (2014). Rather, "'we construe[] an act as a whole, giving effect to all the language used. Related statutory provisions are interpreted in relation to each other and all provisions [are] harmonized.'" *Id*. at 477 (quoting *C.J.C. v. Corp. of Catholic Bishop of Yakima*, 138 Wn.2d 699, 708, 985 P.2d 262 (1999)).

II. LEGAL PRINCIPLES—APPORTIONMENT

Washington imposes a B&O tax "for the act or privilege of engaging in business activities" here. RCW 82.04.220(1). "The statute requires 'every person' who has a substantial nexus with this state and who conducts activities here 'with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly' to pay a percentage of the gross receipts of the resulting sales." *ARUP Labs., Inc. v. Dep't of Revenue*, 12 Wn. App. 2d 269, 279, 457 P.3d 492 (quoting RCW 82.04.220(1); RCW 82.04.140), *review denied*, 196 Wn.2d 1006 (2020).

Under RCW 82.04.460(1), "any person earning *apportionable income* . . . must, for the purpose of computing tax liability under this chapter, apportion to this state, in accordance with RCW 82.04.462, that portion of the person's *apportionable income* derived from business activities performed within this state." (Emphasis added.) "Apportionable income" means "gross income of the business generated from engaging in apportionable activities," which includes "[a]erospace product development." RCW 82.04.460(4)(a)(vi); RCW 82.04.290(3)(a). "Aerospace product development" means "design . . . activities performed in relation to the development of an aerospace product." RCW 82.04.4461(5)(b). And "[a]erospace product" means "[c]ommercial airplanes and their components." RCW 82.08.975(3)(a)(i). Because Teague's services include designing the interior of commercial airplanes, which is an "apportionable activity," the income earned from such design services is "apportionable income."[3]

[3] The parties do not dispute that Teague's design services are an "apportionable activity."

To determine the amount of B&O tax owed on "apportionable income," the DOR uses an apportionment formula.[4] RCW 82.04.462(1)-(3); *ARUP Labs., Inc*., 12 Wn. App. 2d at 280. One of the important parts of the formula is "the total gross income of the business of the taxpayer attributable to [Washington] during the tax year from engaging in an apportionable activity." RCW 82.04.462(3)(a). The statute explains that a taxpayer's "apportionable activity is attributable to the state . . . *[w]here the customer received the benefit of the taxpayer's service*." RCW 82.04.462(3)(b)(i) (emphasis added). "Customer" means 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). And "benefit" means "'[t]he advantage or privilege something gives; the helpful or useful effect something has.'" *ARUP Labs., Inc*., 12 Wn. App. 2d at 282 (quoting BLACK'S LAW DICTIONARY 193 (11th ed. 2019)).

Guidance on "where the taxpayer's customer receives the benefit of the service" is provided in WAC 458-20-19402(303) (Rule 19402). Rule 19402(303)(b) addresses situations where the taxpayer's service relates to "tangible personal property," which applies here because Teague designs airplane interiors.[5] WAC 458-20-19402(303)(b)(iii)(A). In relevant part, Rule 19402(303)(b) provides that,

[4] The apportionment formula is described as follows: The "[s]ingle factor apportionment formula" multiplies a person's "apportionable income" by its "receipts factor." RCW 82.04.462(1). The "receipts factor" is a fraction where the numerator is the gross income of the business attributed to Washington during the tax year, and the denominator is the total gross income of the business worldwide during the tax year. RCW 82.04.462(3)(a). To determine the numerator of the receipts factor, i.e., the amount of gross income to attribute to Washington, the statute provides that the gross income of the business generated from each apportionable activity is attributable to the state "[w]here the customer received the benefit of the taxpayer's service." RCW 82.04.462(3)(b)(i).

[5] The parties also do not dispute that the Teague's design services constitute "tangible personal property" within the meaning of WAC 458-20-19402(303)(b)(iii)(A).

> (b) **If 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.**
>
> (i) Tangible personal property is generally treated as located where the place of principal use occurs. If the tangible personal property is subject to state licensing (e.g., motor vehicles), the principal place of use is presumed to be where the property is licensed; or
>
> (ii) If the tangible personal property will be created or delivered in the future, the principal place of use is where it is expected to be used or delivered.

III. TEAGUE'S INCOME WAS PROPERLY APPORTIONED TO WASHINGTON STATE

Teague argues that the trial court erred in granting summary judgment because the DOR should have apportioned its income to where the airline companies used the airline interiors; not where Boeing manufactured the airline interiors. The DOR argues that it properly apportioned the income at issue because Washington is where Teague's "customer"—Boeing—received the "benefit" of Teague's services. We agree with the DOR.

Here, Boeing was Teague's "customer." The undisputed evidence demonstrates that Boeing contracted with Teague for its design services. The undisputed evidence also demonstrates that Teague received gross income from Boeing for its interior designs at the customization phase. Because Boeing was the entity with whom Teague contracted and from whom Teague received gross income, we hold that the trial court did not err in concluding that Boeing was Teague's "customer" as a matter of law. RCW 82.04.462(3)(b)(viii).

Boeing received the "benefit" of Teague's design services in Washington. The undisputed evidence demonstrates that Boeing expected to use the created airplane interiors designed by Teague during the manufacturing process. The undisputed evidence also demonstrates that Boeing expected to use the created airline interiors in Washington. Because the created airline interiors were expected to be used by Boeing during the manufacturing process in Washington, the trial

court did not err in concluding that Boeing received the "benefit" of Teague's design services in Washington. WAC 458-20-19402(303)(b)(ii); *ARUP Labs., Inc*., 12 Wn. App. 2d at 282.

Because no genuine issue of material fact remains as to whether Boeing was Teague's "customer," and that Boeing received the "benefit" of Teague's services in Washington, we hold that the trial court did not err in concluding that the DOR properly apportioned Teague's income as a matter of law. RCW 82.04.462(3)(b)(i).

Teague contends that "Rule 19402(303)(b) exclusively allocates the benefit of the taxpayer's service to the location where the designed personal property is used—without regard to the identity of the customer or where the customer uses the service." Br. of Appellant at 10 n.2. And because the airline companies were the parties that used or received the designed interiors, Teague contends that its income should have been apportioned to where the airline companies used or received delivery of the airplane interiors. We disagree.

Here, Teague's argument ignores the key statutory inquiry, which is "where the *customer* received the benefit of the taxpayer's service." RCW 82.04.462(3)(b)(i) (emphasis added). As discussed above, "'[w]e construe an act as a whole, giving effect to all the language used. Related statutory provisions are interpreted in relation to each other and all provisions [are] harmonized.'" *Cannabis Action Coalition*, 180 Wn. App. at 477 (quoting *C.J.C.*, 138 Wn.2d at 708). Because Teague's interpretation of Rule 19402 fails to give effect to the identity of the taxpayer's customer, which is required for the apportionment analysis, we hold that Teague's interpretation is misguided. *Cannabis Action Coalition*, 180 Wn. App. at 477; RCW 82.04.462(3)(b)(i).

Teague contends that the examples 11 and 12 set forth in Rule 19402(304)(b) support its argument that income must be sourced to where the final product is used and that the identity of the taxpayer's customer is irrelevant to the apportionment analysis. Examples 11 and 12 illustrate

a situation where a taxpayer's service income is apportioned to where its customer's factories are located because that is where the customer intended to use the created tangible personal property:

> (b) **Services related to tangible personal property.**
>
> **Example 11.** Big Manufacturing hires an engineer to design a tool that will only be used in a factory located in Brewster, Washington. Big Manufacturing receives the benefit of the engineer's services at a single location in Washington where the tool is intended to be used. Therefore, 100% of engineer's receipts from this service must be attributed to Washington.
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> **Example 12.** The same facts as in Example 11, except Big Manufacturing will use the tool equally in factories located in Brewster and in Kapa'a, Hawai'i. Therefore, Big Manufacturer receives the benefit of the service equally in two states. Because the benefit of the service is received equally in both states, a reasonable method of proportionally attributing receipts would be to attribute 1/2 of the receipts to each state.

WAC 458-20-19402(304)(b) (alterations in original). Because the above examples demonstrate that the apportionment analysis focuses on where the taxpayer's customer intended to use the created tangible personal property, we hold that Teague's argument fails.

Teague further contends that examples 13 and 14 set forth in Rule 19402(304)(b) support its argument that income must be apportioned to where the final product would be used—without regard to the identity of the customer or where the customer uses the service. Examples 13 and 14 provide that:

> **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.
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> **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). Examples 13 and 14 illustrate a scenario where the taxpayer's customer—the distributor—received the benefit of taxpayer's services in different states. *See* WAC 458-20-19402(304)(b). Because examples 13 and 14 focus on where the taxpayer's customer received the benefit of the taxpayer's services, those examples do not support the interpretation that the identity of the taxpayer's customer is irrelevant to the apportionment analysis. Accordingly, Teague's reliance on the examples in Rule 19402(304)(b) fails.

In sum, the undisputed facts demonstrate that Boeing was Teague's "customer" because Boeing was the party that Teague contracted with and received gross income from. RCW 82.04.462(3)(b)(viii). The undisputed facts also demonstrate that Boeing received the "benefit" of Teague's design services in Washington because that is where Boeing expected to use the created airplane interior designs during the manufacturing process *ARUP Labs., Inc*., 12 Wn. App. 2d at 282; WAC 458-20-19402(303)(b)(ii). Because no genuine issue of material fact remains as to whether Boeing was Teague's "customer," and that Washington is where Boeing received the "benefit" of Teague's services, the trial court did not err in concluding that the DOR properly apportioned Teague's design services income as a matter of law. RCW 82.04.462(3)(b)(i); *Wash. Imaging Servs., LLC*, 171 Wn.2d at 555. Accordingly, we affirm the trial court's order granting the DOR's motion for summary judgment.

Veljacic, J.

I concur:

Lee, C.J.

MAXA, J. (dissenting) – The majority opinion's analysis of RCW 82.04.462(3)(b)(i) and WAC 458-20-19402(303)(b)(ii) (Rule 19402) is not unreasonable. But the majority disregards the fact that there is another reasonable interpretation of those provisions, making them ambiguous. And it is well-settled that when a tax statute is ambiguous, the statute must be construed in favor of the taxpayer. *E.g.*, *Qualcomm, Inc. v. Dep't of Revenue*, 171 Wn.2d 125, 131, 249 P.3d 167 (2011). Therefore, I dissent.

RCW 82.04.462(3)(b)(i) states that a business's gross income is attributable to the state "[w]here the customer received the benefit of the taxpayer's service." The majority concludes that Boeing received the benefit of Teague's design services in Washington, where Boeing used the design to manufacture airplane interiors for its commercial airplanes. But another reasonable interpretation is that Boeing received the benefit of Teague's design services when Boeing sold the completed airplanes to out-of-state airlines. Certainly that is when Boeing received the *financial* benefit of Teague's design services. Therefore, Rule 19402 must be consulted for clarification.

Rule 19402(303) "explains the framework for determining where the benefit of a service is received." Section (303)(b) states:

> If 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.
>
> (i) Tangible personal property is generally treated as located where the place of principal use occurs. . . .
>
> (ii) If the tangible personal property will be created or delivered in the future, the principal place of use is where it is expected to be used or delivered.

These provisions apply because Teague's design services related to tangible personal property: airplane interiors.

The majority suggests that subsections (303)(b)(i) and (ii) must be interpreted as referring to the customer's – here Boeing's – principal place of use. But these subsections do not refer to the *customer's* place of use or even contain the word "customer." They refer to where the tangible personal property will be used or delivered.

Regarding subsection (i), the principal place of use of the airplane interiors could be where Boeing installs the interiors in its airplanes. But an equally reasonable interpretation is that the principal place of use is where the airlines purchasing the airplanes containing the interiors are located. Regarding subsection (ii), there is no question that the interiors will be delivered in the future and that the place of delivery is where the airlines are located, not where Boeing is located.

In short, RCW 82.04.462(3)(b)(i) and Rule 19402 either provide that Teague should not be subject to B&O taxes for its design services or are hopelessly unclear. Any ambiguity must be resolved in favor of Teague. *Qualcomm*, 171 Wn.2d at 131. Therefore, Teague was entitled to summary judgment.

Maxa, J.

LANE POWELL PC

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