NO. 46689-9

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Appellant,

v.

MORPHO DETECTION, INC.

Respondent.

REPLY BRIEF OF APPELLANT

ROBERT W. FERGUSON
Attorney General

Joshua Weissman, WSBA No. 42648
Michael Hall, WSBA No. 19871
Assistant Attorneys General
Revenue Division, OID No. 91027
7141 Cleanwater Lane SW
PO Box 40123
Olympia, Washington 98504
(360) 753-5528

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I. INTRODUCTION

Morpho Detection installed complex explosive detection systems at two Washington airports for the United States, under contracts with the Transportation Security Administration. Contractors that improve buildings on real property "of or for" the United States are liable for use tax on the value of materials or items installed under the statutory definition of "consumer" in RCW 82.04.190(6). The statute covers two situations: (1) contractors that improve buildings on real property "of" the United States, and (2) contractors that improve buildings "for" the United States. RCW 82.04.190(6). Because Morpho installed the systems "for" the Transportation Security Administration, the trial court should have ruled that Morpho was a "consumer" subject to use tax on those systems, and its order granting summary judgment to Morpho should be reversed.

Morpho's reading of RCW 82.04.190(6), which the trial court adopted, thwarts the Legislature's intent to ensure that sales or use tax is imposed on materials installed into all of the construction projects in this state. Morpho seeks a loophole to fit its particular fact pattern involving construction paid for by the United States, but not on United States real property. But Morpho does not and cannot explain why the Legislature would have sought to exclude such projects from the tax it imposed on all other projects.

This case involves a fundamental dispute about the basics of statutory interpretation. To the Department, "[t]he fundamental objective in construing a statute is to ascertain and carry out the Legislature's intent." *Dep't of Ecology v. Campbell & Gwinn*, 146 Wn.2d 1, 9-10, 43 P.3d 4 (2002). The plain meaning rule and the tools of statutory construction are a means toward this end.

Morpho disagrees and believes that the Court should only consider legislative intent if a statute is ambiguous. To do otherwise, according to Morpho, is "inappropriate." Resp's Br. at 20 n.19. But by relying on only a dictionary and simple rules of grammar to establish the meanings of statutory words and phrases, and disregarding other reliable indicators of legislative intent, Morpho flips statutory interpretation on its head.

There is no support in the language of the sales and use tax statutes, the purpose behind those statutes, or the legislative history, for Morpho's strained interpretation. Morpho relies on a discredited and rejected version of the plain meaning rule that, even if applied, does not result in the outcome Morpho advocates. Rather, the statutory scheme as a whole demonstrates that a contractor that improves buildings for the United States owes use tax based on the value of the materials installed, regardless of who owns the land. In this case, Morpho is that contractor.

II. ARGUMENT

A. The Legislature's Broad Intent To Tax Federal Contractors Encompasses Morpho's Activities.

To determine the Legislature's intent in enacting RCW 82.04.190(6) and whether Morpho's activities are subject to use tax, the Court should consider the statute's plain meaning. That meaning cannot be discerned merely from individual words or a short phrase in the statute. Instead, the plain meaning should be discerned from all the words of the statute, related statutes, the context in the statutory scheme, and the purpose underlying the statute. Applying this rule, the statutory language demonstrates that the Legislature intended to tax both the improvement of buildings above real property *of* the United States and improvement of buildings *for* the United States. Further, the Legislature's purpose in enacting this statute was to expand the tax base to reach federal projects paid for by the United States—projects like the improvement of Washington airports under the Homeland Security Act.

1. The Washington Supreme Court rejected Morpho's narrow reading of the plain meaning rule.

In *Campbell & Gwinn*, the Washington Supreme Court resolved a diverging line of cases applying the plain meaning rule. The Court explained that in some of its cases, "the court has said that in an unambiguous statute, a word is given its plain and obvious meaning."

Campbell & Gwinn, 146 Wn.2d at 10 (citations and internal quotations omitted). In those cases, only if that language was ambiguous or unclear, should the statute or statutory scheme be reviewed as a whole. *Id.* Otherwise the statute was to be read in isolation. It is this rule upon which Morpho bases its argument. Resp's Br. at 20 n.19. However, the Court in *Campbell & Gwinn* explicitly rejected this line of cases. *Id.* at 11.

Instead, the Court held that "the plain meaning rule requires courts to consider legislative purposes or policies appearing on the face of the statute as part of the statute's context." *Id.* at 11 (citing 2A Norman J. Singer, *Statutes and Statutory Construction* § 48A:16, at 809-10 (6th ed. 2000)). The Court further explained that the plain meaning is "still derived from what the Legislature has said," but that the analysis includes "all that the Legislature has said in the statute and related statutes which disclose legislative intent about the provision in question." *Id.* Washington appellate courts have consistently applied the *Campbell & Gwinn* version of the plain meaning rule since and should apply it here.

For example, in another use tax case, the Supreme Court held that it was error for the Court of Appeals not to consider a statement of legislative purpose in interpreting whether Tacoma's use tax applied to G-P Gypsum's consumption of natural gas within Tacoma city limits. *G-P Gypsum Corp. v. Dep't of Revenue*, 169 Wn.2d 304, 309, 237 P.3d

256 (2010). The Court explained that it had "previously criticized such a crabbed notion of statutory interpretation," and repeated *Campbell & Gwinn*'s instruction that plain meaning should be discerned from all that the Legislature has said in the statute and related statutes that disclose legislative intent. *Id.* Based on this broader understanding of the plain language rule, the *G-P Gypsum* Court held that under the ordinary meaning of "use," *G-P* Gypsum used natural gas in Tacoma when it consumed the gas there. *Id.* at 313-14. As in *G-P Gypsum*, the Court here should consider the entire statutory scheme and the Legislature's intent to tax federal contractors in interpreting RCW 82.04.190(6).

2. The plain meaning of RCW 82.04.190(6) makes Morpho a "consumer" subject to use tax.

Properly applying the plain meaning rule results in the inescapable conclusion that Morpho is a "consumer" and subject to use tax for its work in Washington's airports. The use tax is imposed for the privilege of using within this state as a consumer any article of tangible personal property. RCW 82.12.020(1). "Use" includes "installation." *See* RCW 82.12.010(6)(a). Morpho concedes for purposes of the summary judgment motions on review that it installed the explosive detection systems. *See, e.g.*, Resp's. Br. at 3 n.1.

Morpho also used the explosive detection systems as a "consumer." In pertinent part, RCW 82.04.190(6) defines "consumer" to include both work on federal property and work for the United States:

> Any person engaged in the business of constructing, repairing, decorating, or improving new or existing buildings or other structures under, upon, or above real property of or for the United States . . . including the installing or attaching of any article of tangible personal property therein or thereto, whether or not such personal property becomes a part of the realty by virtue of installation . . .

This statute covers two scenarios: (i) work done under, upon, or above real property "of" the United States and (ii) work done under, upon, or above real property "for" the United States. Because Morpho did work under, upon, or above real property "for" the United States, it fits scenario (ii) and is subject to the use tax.

Under the *Campbell & Gwinn* plain meaning rule, determining whether Morpho is a consumer requires examination of the entire "consumer" definition, as well as the retail sales tax definitions related to government contracting – rather than just the small excerpt from the "consumer" definition that Morpho takes out of context throughout its brief. *See* Resp's Br. at 1, 3, 7, 8, 9, 11, 13, 14, 16, 20, and 21.[1]

[1] For example, see page 21 of Respondent's Brief, arguing that the building or structure must be "under, upon, or above real property of or for the United States" without referring to the rest of the statute.

The statute undoubtedly focuses on those who perform the specified work for the United States. While work on United States real property is included within the definition, the definition is not limited to taxpayers engaged in such work. The constructing, repairing, decorating or improving buildings may be on real property "of" the United States, *or* it may be "for" the United States, on any real property.

The definition of "consumer" in the use tax context can only be understood as a whole and in relation to other statutes within the statutory scheme. *See* RCW 82.04.050(12) (excluding the charge for labor and services for government contracting from the definition of "retail sale"). Throughout its brief, Morpho separates the first portion of RCW 82.04.190(6) that describes "any person engaged in the business of constructing, repairing, decorating, or improving new or existing buildings" from the portion of the statute that Morpho isolates in order to support its position, "under, upon, or above real property of or for the United States." *See, e.g.*, Resp's Br. at 11 ("The undisputed fact is that the real property on which the EDMs are located is not real property of or for the United States."). By doing so, Morpho implies that the intent of the Legislature was to tax based on real property ownership. But RCW 82.04.190(6) does not use the word "own," nor does it make any reference to a lease, easement, or license. *Cf* Resp's Br. at 17 ("[t]hus, if the federal

government leased the land, it would be real property for the United States") (footnote omitted).

Morpho offers no explanation why the Legislature would have intended to limit the tax in such an unprincipled way. Rather, Morpho simply seizes on two words, "real property," as definitive proof of the Legislature's intent. This incomplete reading of the statute is unsupportable. *See Jongeward v. BNSF R. Co.*, 174 Wn.2d 586, 595, 278 P.3d 157 (2012) ("a statute's plain meaning must be discerned from all that the Legislature has said in the statute, not just two words") (citations omitted); *see also Maracich v. Spears*, __ U.S. __, 133 S. Ct. 2191, 2203, 186 L. Ed. 2d 275 (2013) (quoting *United States v. Boisdore's Heirs*, 49 U.S. 113, 122, 8 How. 113, 12 L. Ed. 1009 (1850)) ("In expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy.").

3. The Legislature's intent to tax federal contractors is critical in discerning RCW 82.04.190(6)'s plain meaning.

The Legislature enacts a statute with a purpose in mind, and this purpose provides a significant backdrop to determining a statute's plain meaning. *See G-P Gypsum Corp.*, 169 Wn.2d at 310 ("an enacted statement of legislative purpose is included in a plain reading of a

statute"); *see also* Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. 527, 538-39 (1947) ("Legislation has an aim; it seeks to obviate some mischief, to supply an inadequacy, to effect a change in policy, to formulate a plan of government.").

When it created the definition of "consumer" in RCW 82.04.190(6), the Legislature brought federal contracting back into the tax base. *See Washington v. U.S.*, 460 U.S. 536, 538, 130 S. Ct. 1344, 75 L. Ed. 2d 264 (1983) ("In 1975, the Washington Legislature acted to eliminate the complete tax exemption for construction purchased by the United States."); *see also id.* at 545 ("the tax on federal contractors is part of the same structure, and imposed at the same rate, as the tax on the transactions of private landowners and contractors").

It is not "inappropriate," as Morpho argues, to consider the statutory scheme for taxing construction-related work or the Legislature's expansion of tax liability to federal contracting in 1975 in interpreting RCW 82.04.190(6). To the contrary, the Legislature's intent to include personal property installed in *all* federal construction projects in the sales and use tax base is obviously significant in understanding RCW 82.04.190(6). Morpho's self-serving interpretation negates not only this intent but most of the statute itself. As such, this Court should reject it.

Nothing in RCW 82.04.190(6)'s language indicates that the Legislature intended to limit the application of use tax to projects where federal contractors provide services on real property owned by the United States. Such a reading does not further any identifiable legislative policy.

Morpho appears to argue that the improvement of buildings under, upon, or above real property for the United States means only the improvement of buildings in which the United States has a right or interest in the real property where the activities are taking place. *See* Resp's Br. at 22-23.[2] But there is no indication that the Legislature cryptically desired the phrase "for the United States" to mean a United States real property interest less than ownership. To the contrary, surrounding statutes indicate that when the Legislature intended to specify a particular type of property interest required, it knew how to so say so. *E.g.*, RCW 82.04.050(2)(c) (imposing sales tax on the constructing of a structure upon real property "owned by an owner" who conveys the property to the contractor who then reconveys the property to the original owner); RCW 82.04.050(10) (excluding from the retail sales tax the charge for labor and services rendered in respect to the building of a road "owned by . . . the United States"); RCW 82.04.190(5) (defining as a "consumer" any person who is

[2] At the trial court, Morpho indicated that the use tax would apply if the United States had "a beneficial interest, easement, lease, license to use or other interest in the real property." CP 631. On appeal, Morpho does not specifically state what property right or interest for the United States would satisfy RCW 82.04.190(6).

an "owner, lessee, or has the right of possession to personal property which is being constructed, repaired, improved, cleaned, imprinted, or otherwise altered by a person engaged in business"). In contrast, the words "own," "lease," and "easement" appear nowhere in RCW 82.04.190(6). The Legislature did not intend "or for the United States" to mean work on real property in which the United States has a right or interest.

Morpho imagines various holes in the statutory scheme that simply do not exist when the statute is viewed as a whole with the legislative intent in mind. For example, Morpho asserts that "the Legislature made clear that its intent was to tax a much smaller class of persons" than the Department argues the Legislature intended to tax. Resp's Br. at 21.

Morpho has it backwards. The 1975 Legislature intended to bring federal construction projects, including installations, back into the tax base. *See Washington v. U.S.*, 460 U.S. at 550 (the Legislative change was "purposefully made to catch the burgeoning federal construction in the State."); *see also* RCW 82.04.190(6) (definition of "consumer" subject to use tax includes those who install or attach tangible personal property to real property). Morpho reads the phrase "or for" out of RCW 82.04.190(6) by suggesting a requirement for a specific United States property interest, thereby continuing to exclude contractors paid by the

federal government who happen to work on privately-owned land. There is no plausible reason why the Legislature would have used such limited and obscure criteria to describe which construction projects were subject to sales and use tax and which were not, when its intent was to tax all federal construction projects.

B. Even If The Court Looks Beyond The Plain Meaning, The Department's Interpretation Of RCW 82.04.190(6) Effectuates Legislative Intent.

Properly applying the plain meaning rule, including reviewing the entire statute and related statutes, as well as the statutory scheme for taxing construction projects, resolves this case in the Department's favor. But even if the Court were to turn to other tools to help construe RCW 82.04.190(6), the Department's construction best effectuates the Legislature's intent and should be adopted. *Burns v. City of Seattle*, 161 Wn.2d 129, 140, 164 P.3d 475 (2007) ("Our goal in statutory interpretation is to effectuate the legislature's intent.").

1. Legislative history confirms the Department's construction that "for the United States" includes work paid for by the United States.

The legislative history surrounding RCW 82.04.190(6) is consistent with, and further supports, the Department's interpretation that "for the United States" means work paid for by the United States. *See Filmore LLLP v. Unit Owners Ass'n of Centre Pointe Condominium*, 183

Wn. App. 328, 333 P.3d 498 (2014) ("Legislative history may be of some interest even where the court concludes that the statute's plain language is unambiguous"). This history demonstrates that the Legislature's focus was construction activity funded by the United States that was previously exempt from taxation, not construction tied to a particular property interest. For example, the fiscal note stated that the measure would broaden the tax base "to include construction activity performed for the U.S. Government." CP 134. And the Senate Committee report stated that the new legislation imposed "sales and use tax upon the construction and maintenance of buildings for the United States." CP 130. The fiscal note and the Committee report also show that the Legislature understood what the word "for" meant, and that it did not mean "having a lesser property interest." This history further supports the Department's interpretation.

2. The Department's interpretation of RCW 82.04.190(6) is entitled to deference.

Courts routinely defer to agency interpretations of statutes they administer as long as an interpretation is reasonable and consistent with the statutory scheme and language. *See, e.g., Cashmere Valley Bank v. Dep't of Revenue*, 181 Wn.2d 622, 635, 334 P.3d 1100 (2014) (deferring to Department of Revenue determination concluding that certain investments qualify for a specific tax deduction while others do not);

Dep't of Revenue v. Nord Northwest Corp., 164 Wn. App. 215, 223, 264 P.3d 259 (2011) ("we accord substantial weight to an agency's interpretation of a statute within its expertise").

Such deference is appropriate in this case. The Department's construction of RCW 82.04.190(6) as set forth in its determination of Morpho's tax liability in administrative proceedings is consistent with the statutory scheme and legislative intent. CP 564 (footnote 6). In addition, the D.C. Circuit Court of Appeals held that Morpho should have known it could "reasonably" be determined to be a "consumer" that owed Washington use tax and that the Department's interpretation was "permissible." *Morpho Detection, Inc. v. Transportation Sec. Admin.*, 717 F.3d 975, 982 & n.10 (D.C. Cir. 2013). And the Federal Aviation Administration's Office of Dispute Resolution for Acquisition ruled that the Department "relied on the plain, simple, and singular interpretation that gives meaning to the complete language of the statutory definition of 'consumer.'"[3] CP 598. Even if this Court goes beyond the plain meaning rule to interpret RCW 82.04.190(6), the Department's construction is reasonable and entitled to deference.

[3] Morpho states that the ODRA decision was "nothing more than a recommendation" to the TSA Administrator. Resp's Br. at 18. However, the TSA Administrator adopted the ODRA's findings and denied Morpho's contract dispute in its entirety. *Morpho Detection, Inc.*, 717 F.3d at 978.

3. The Court should not rigidly apply the last antecedent rule in the face of contrary legislative intent.

Morpho never mentions the last antecedent rule, but it appears to argue the principle underlying the rule applies. *See* Resp's Br. at 14. The trial court's oral ruling also suggests that the last antecedent rule influenced the court's reasoning. *See* RP 30. Specifically, Morpho's argument seems to be that the phrase "or for" primarily modifies the last antecedent "real property." Resp's Br. at 14.

If Morpho is arguing the last antecedent rule, this is the sort of rigid application of the rule that courts caution against. *State v. McGee*, 122 Wn.2d 783, 788-89, 864 P.2d 912 (1993) (the last antecedent rule is an aid to discovering intent and is not inflexible or uniformly binding); *see also Buscaglia v. Bowie*, 139 F.2d 294, 296 (1st Cir. 1943) (the last antecedent principle "is of no great force" and should not be applied if a "very slight indication of legislative purpose or a parity of reason, or the natural and common sense reading of the statute, may overturn it and give it a more comprehensive application.").

The last antecedent rule states that qualifying or modifying words and phrases generally refer to the last antecedent in the absence of a comma before the qualifying phrase at issue. *State v. Bunker*, 169 Wn.2d 571, 578, 238 P.3d 487 (2010). However, the rule does not apply if other

factors counsel against its application. *Id.* Context, related statutes, and avoiding absurd results are all reasons to avoid applying the rule: "We do not apply the rule if other factors, such as context and language in related statutes, indicate contrary legislative intent or if applying the rule would result in an absurd or nonsensical interpretation." *Id.*

The last antecedent rule also does not apply if such an application impairs a sentence's meaning. The last antecedent refers to "the last word, phrase or clause that can be made an antecedent *without impairing the meaning of the sentence*." *In re Smith*, 139 Wn.2d 199, 205, 986 P.2d 131 (1999) (quoting *In re Kurtzman's Estate*, 65 Wn.2d 260, 264, 396 P.2d 786 (1964)) (emphasis added).

Applying the last antecedent rule here as Morpho advocates would violate these principles. It would impair the statute's meaning: while the qualifying word "of" can pertain to real property, the qualifying word "for" naturally refers not to the real property, but to the entity for whom the work is being performed. Reading the word "for" in connection with only the last antecedent "real property" impairs the meaning of the sentence—in fact, it destroys it.

Applying the last antecedent rule in this manner also impairs the functioning of the statutory scheme. The statute imposes use tax on contractors in those situations where tax on the federal government cannot

be imposed. To read the "consumer" definition as including only those projects on federal property means that one category of construction projects, work on private land that the federal government funds, escapes tax altogether. The Legislature did not intend this result.

Applying the last antecedent rule also leads to an absurd result. The use tax is imposed on government contractors to collect tax in situations where the Supremacy Clause prohibits Washington from taxing the United States. But Morpho's construction rewrites the statute in a way that prevents the law from doing just that. If work performed "for" the federal government is not subject to use tax, but work performed on real property owned by the federal government is, then the statute is tailored to the wrong issue. This is because the problem, in constitutional terms, occurs when the federal government is the purchaser, not when it owns the underlying property. The State must tax the contractor on work done "for" the federal government or no one will be taxed.

Under Morpho's construction, the very transactions at which the statute is aimed—contracts with the federal government—will not be subject to tax if they happen to concern work performed on non-federal land. In other words, Morpho proposes a construction basing taxation on *where* the work is, while the statute was written to impose a tax based on

who pays for the work. This application of the last antecedent rule turns the statute around and does not fulfill the purpose behind the statute.

4. The Court should not construe RCW 82.04.190(6) against the Department.

Both sides assert that the plain meaning rule resolves this dispute, although the Supreme Court has rejected Morpho's outdated version of the plain meaning rule. Apparently in the alternative, Morpho suggests several times, mostly in footnotes, that if the Court finds the tax statute ambiguous, it should be construed against the Department. Resp's Br. at 11, 12 n.9, 19 n.17, 20 n.19. This is a canon of construction, but it is not the only one.

The Court's overall goal is to ascertain and carry out the Legislature's intent. *See Getty Images, Inc. v. City of Seattle*, 163 Wn. App. 590, 600, 260 P.3d 926 (2011) ("When interpreting statutory language, our goal is to carry out the intent of the legislative body."). There is more than enough here in the statutory language, scheme, purpose, and legislative history to reverse the trial court's ruling. This Court need not resort to a tie-breaker such as the canon of construction construing ambiguous tax statutes against the Department. Our Supreme Court has cautioned that this canon should not be over-used:

> Initially, the estate argues that any doubt in the meaning of a taxing statute must be resolved in favor of the taxpayer.

> *See Vita Food Prods., Inc. v. State*, 91 Wn.2d 132, 134, 587 P.2d 535 (1978). This rule has been generally overemphasized and exaggerated in scope, however.
>
> "The better rule . . . is that statutes imposing taxes and providing means for the collection of the same should be construed strictly in so far as they may operate to deprive the citizen of his property by summary proceedings or to impose penalties or forfeitures upon him; but otherwise tax laws ought to be given a reasonable construction, without bias or prejudice against either the taxpayer or the state, in order to carry out the intention of the legislature and further the important public interests which such statutes subserve."

In re Estate of Hitchman, 100 Wn.2d 464, 466, 670 P.2d 655 (1983) (quoting 3 C. Sands, *Statutory Construction* § 66.02 (4th ed. 1974)). The Court should not resort to this canon of construction in the face of contrary legislative intent.

C. Even If Morpho's Construction Of RCW 82.04.190(6) Is Correct, The United States Has At Least A License To Access Explosive Detection Systems In The Airports.

Unable to give meaning to the phrase "or for" in RCW 82.04.190(6), Morpho tentatively proposed in the court below that the phrase meant that the United States would have to have "a beneficial interest, easement, lease, license to use or other interest in the real property." CP 631. Morpho appears to argue the same in its brief on appeal. *See* Resp's Br. at 22-23. Even if Morpho is correct, the United States possesses at least a license over the relevant areas in the airports. A

license is merely the right to use another's land. *Lacey Nursing Center, Inc. v. Dep't of Revenue*, 103 Wn. App. 169, 183-84, 11 P.3d 839 (2000); *see also Teel v. Stading*, 155 Wn. App. 390, 395, 228 P.3d 1293 (2010) (citations omitted) ("A licensee is a person who is privileged to enter or remain on land only by virtue of the possessor's consent.").

There can be no doubt that the federal statutes requiring the TSA to oversee security operations at the airports, in combination with the evidence in the record, demonstrate the United States has a right to enter and use the relevant real property at the airports. *See, e.g.*, 49 U.S.C. § 44901 (requiring TSA to supervise passenger screening at airports); CP 511-12 (Morpho deponent states that TSA or its contractors operate the explosive detection systems). As a matter of law, this constitutes at least a license. *See, e.g., Showalter v. City of Cheney*, 118 Wn. App. 543, 547-51, 76 P.3d 782 (2003) (tavern owner's right to place canopy over sidewalk was a license, even though right was revocable). The fact that it arises through the operation of federal law does not change the conclusion. Thus, even if Morpho's unusual interpretation of RCW 82.04.190(6) were correct, the Department still properly imposed use tax on Morpho.

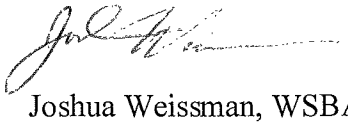
III. CONCLUSION

Legislative intent is not an after-thought to be considered only if the rules of grammar result in statutory mystery. Legislative intent is the

whole point. Applying the statutory interpretation standards in *Campbell & Gwinn* demonstrates that the Department's interpretation of RCW 82.04.190(6) is correct, and Morpho was properly subject to use tax as a "consumer" on the value of the systems it installed in Washington airports "for" the TSA. The legislative history further supports this conclusion. This Court should reverse the order granting Morpho summary judgment and direct the trial court to enter partial summary judgment in favor of the Department.

RESPECTFULLY SUBMITTED this 23rd day of March, 2015.

ROBERT W. FERGUSON
Attorney General



Joshua Weissman, WSBA No. 42648
Michael Hall, WSBA No. 19871
Assistant Attorneys General
Revenue Division, OID No. 91027

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Frank Dinces
Geoffrey Knudsen
Dinces Law Firm
5314 28th St NW
Gig Harbor, WA 98335
fgdinces@comcast.net
gknudsen@smithhennessey.com

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

DATED this 23rd day of March, 2015, at Tumwater, WA.

Susan Barton
Legal Assistant

WASHINGTON STATE ATTORNEY GENERAL

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