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NO. 97098-0

SUPREME COURT OF THE STATE OF WASHINGTON

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent,

v.

GAMESTOP, INC. and SOCOM, LLC,

Petitioner.

ANSWER TO PETITION FOR REVIEW

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I. INTRODUCTION

Washington's sales tax laws allow purchasers of tangible property the opportunity to reduce the amount of sales tax owed on the purchase by delivering to the seller "separately stated trade-in property of like kind." RCW 82.08.010(1)(a)(i). Thus, for example, when a car dealer accepts delivery of a customer's used car as a trade-in on the purchase of a new car, the selling price of the new car is reduced by the value of the trade-in.

The trade-in exclusion in RCW 82.08.010(1)(a)(i) has three plainly stated requirements. First, the trade-in property received by the seller must be of "like kind" to the property being purchased. Second, the trade-in property must be "separately stated" from the property being purchased. Third, the trade-in property must be part of the "consideration" given in exchange for the property being purchased. Is video game hardware (i.e., consoles and controllers) of "like kind" to video game software? The Court of Appeals said no. *Dep't of Revenue v. GameStop, Inc.*, No. 50409-0-II, slip op. at 12 (Wn. App. March 19, 2019). It also ruled that GameStop failed the "separately stated" requirement with respect to the retail sales at issue. Slip op. at 14. Because resolution of those two key issues fully resolved the case, the Court chose not to address the "consideration" requirement. Slip op. at 1 n.1.

GameStop argues that review is necessary because the video game products it sells are "complex" and the various components that make up a gaming system should—for policy reasons—be treated as "separately stated property of like kind." The Court of Appeals correctly analyzed and rejected GameStop's arguments, noting that gaming systems are made up of distinct products: game consoles and video game software. Slip op. at 12. Each serves a different function. Trading a console for software is not like trading a car for a car. It is more akin to trading a car for gasoline or a sewing machine for fabric. The products may be used together, but they are not of a like kind.

Nothing about the Court of Appeals' decision is likely to have any effect on consumer access to used video games, nor will it exacerbate the problem of electronic waste, despite GameStop's policy assertions to the contrary. In reality, GameStop's petition just amounts to a disagreement with the Court of Appeals' holding, which is not a ground for further review under RAP 13.4(b). This Court should deny the petition.

II. COUNTERSTATEMENT OF ISSUES

If the Court were to accept review it would be asked to address the following three issues:

1. Did the Board of Tax Appeals err in concluding that video game consoles and video game software are property of a "like kind"

within the meaning of RCW 82.08.010(1)(a)(i) and WAC 458-20-247 (Rule 247), as the Court of Appeals held in reversing the Board's decision?

2. In those transactions where a customer purchased GameStop merchandise using a trade-in credit that had been loaded onto a stored value card as part of a prior transaction, did the Board of Tax Appeals err in concluding that "separately stated" requirement in RCW 82.08.010(1)(a)(i) had been met, as the Court of Appeals held in reversing the Board's decision?

3. In those transactions where a customer purchased GameStop merchandise using a trade-in credit that had been loaded onto a stored value card as part of a prior transaction, did the Board of Tax Appeals err in concluding that the "single transaction" requirement in WAC 458-20-247 had been met?

III. COUNTERSTATEMENT OF THE CASE

A. Statutory Background

Washington imposes a retail sales tax on sales to consumers of tangible personal property, digital goods, and some services. RCW 82.08.020(1). The term "sale" is broadly defined to include "any transfer of the ownership of, title to, or possession of property for a valuable

consideration." RCW 82.04.040(1).[1] Consideration for the purchased property may include anything of value, including other property. *Olympic Motors, Inc. v. McCroskey*, 15 Wn.2d 665, 671, 132 P.2d 355 (1942).

The retail sales tax is measured by the "selling price" of the goods or services acquired by the consumer. RCW 82.08.020(1). During the periods at issue, RCW 82.08.010(1)(a)(i) defined the term "selling price" as "the total amount of consideration, except separately stated trade-in property of like kind, . . . for which tangible personal property [and certain other goods and services] are sold, leased, or rented, valued in money, whether received in money or otherwise."

B. GameStop's Trade-In Program

Petitioners GameStop Inc. and SOCOM LLC are wholly-owned affiliates of GameStop Corp. AR 035. GameStop Corp. is a well-known retailer of video game products and personal computer entertainment software. The company sells new and used video game hardware, new and used video game software, personal computer entertainment software, and other merchandise such as gaming hint books and action figures. AR 335. GameStop Corp. operates approximately 82 retail stores in Washington through its GameStop and SOCOM subsidiaries. AR 344; AR 318-19.

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[1] The definition of "sale" in RCW 82.04.040(1) is incorporated into the state's sales tax code by RCW 82.08.010(6).

GameStop Corp. has developed a successful trade-in program. As described in the company's 2011 10-K report filed with the Securities and Exchange Commission, GameStop Corp. and its affiliates provide customers with a unique opportunity to trade in their used video game products in exchange for store credits that can be applied towards the purchase of other products. AR 342. The trade-in program also benefits GameStop by providing it with an inventory of used video game products to resell to its "more value-oriented customers." *Id.*

Customers wishing to take advantage of the GameStop trade-in program may trade their used video game hardware or software for a store credit. Tr. at 14. The credit can be used as consideration on the immediate purchase of merchandise, or can be loaded onto a stored value card that the customer keeps and can use to buy merchandise months or years later. *Id.*

When a customer uses the store credit on the immediate purchase of GameStop merchandise, the sales invoice identifies both the purchased property and the trade-in property that the customer delivered to GameStop as consideration for the merchandise being purchased. AR 037. Thus, the "separately stated" and "consideration for" requirements of RCW 82.08.010(1)(a)(i) are met. The only issue in dispute in these

"immediate purchase" transactions is whether the trade-in property was of a "like kind" to the property being purchased.

When, however, the store credit is loaded onto a stored value card for use by the customer months or years later, the sales invoice generated from that transfer of used merchandise by the customer to GameStop in exchange for the credit does not identify the merchandise that may be purchased by the customer in the future. *See* AR 230-31 (representative sales invoice showing used video games delivered to GameStop in exchange for a store credit without identifying the merchandise the customer may purchase in the future though redemption of the credit). And when the customer uses the stored credit on a future purchase, the sales invoice pertaining to that future purchase does not separately state the property that had been delivered to GameStop in the prior transaction. *See* AR 236 (representative sales invoice showing a "redeemed" store credit being used as consideration for the purchase of a video game without identifying the property the customer delivered to GameStop to generate the credit). Thus, these "future purchase" transactions implicate all three of the statute's requirements: (1) whether the trade-in property is of a like kind to the purchased property; (2) whether the trade-in property is separately stated from the purchased property; and (3) whether the

trade-in property was delivered to the seller as consideration for the purchased property.

C. The Board of Tax Appeals Reverses the Department's Audit Assessment

Prior to being audited by the Department of Revenue, GameStop Inc. and SOCOM LLC took the position that everything they sell at their Washington retail stores was "separately stated property of like kind" within the meaning of RCW 82.08.010(1)(a)(i). AR 324-25. They also took the position that the trade-in exclusion applied when a customer purchased merchandise through the redemption of a stored credit generated in a prior transaction.

In 2012 the Department audited GameStop Inc. and SOCOM LLC. The Department determined that the GameStop affiliates had correctly claimed the trade-in exclusion on some of their retail sales, but had improperly claimed the exclusion with respect to other sales, including the following:

- Sales transactions where a customer trades in video game software as part of the consideration paid for the immediate purchase of game consoles or other gaming hardware (i.e., software for hardware).
- Sales transactions where a customer trades in video game console as part of the consideration paid for the immediate purchase of video game software (i.e., hardware for software).

- Sales transactions where a customer purchases GameStop merchandise using a credit that had been loaded onto the customer's stored value card as part of a prior transaction (i.e., credit used as consideration in a later sales transaction).

AR 246.[2]

The audits resulted in the assessment of additional retail sales taxes plus interest. AR 264; AR 272. After exhausting their administrative remedies with the Department, the GameStop affiliates filed a joint appeal with the state Board of Tax Appeals. AR 387.

After a formal hearing under the Administrative Procedure Act, the Board concluded that the trade-in exclusion applied to all of the disputed transactions and ordered the Department to revise the tax assessments accordingly. AR 044. The Department timely sought judicial review.

D. The Superior Court and Court of Appeals Reverse the Board, Reinstating the Audit Assessments

The Thurston County Superior Court reversed the Board of Tax Appeals. CP 38. The court explained that the Board "misapplied the trade-in exclusion when it concluded that video game hardware and video game software are property of 'like kind,' and when it concluded that the

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[2] The Department also disallowed the trade-in exclusion on other transactions reviewed during the GameStop and SOCOM audits, including the trade in of video game software as part of the consideration paid for magazine subscriptions, purchases of gaming hint books, and purchases of action figures. The GameStop affiliates did not contest the audit findings with respect to these other "non-like-kind" transactions.

exclusion applies to a subsequent purchase of merchandise through the redemption of a credit added to a customer's stored value card." CP 44. GameStop and SOCOM appealed. CP 48.

The Court of Appeals, like the superior court, held that the Board of Tax Appeal misapplied the law. More specifically, the Court of Appeals held that the Board misapplied the law when it concluded that video game software and video game hardware are "property of like kind for purposes of RCW 82.08.010(1)(a)(i) and Rule 247(5)" and when it interpreted the statute's "separately stated" language to require only that sales documents separately identify *the consideration* derived from the trade-in property. Slip op. at 12, 14. The Court of Appeals declined to address the Department's alternative argument that the Board misapplied the "single transaction" requirement discussed in WAC 458-20-247(4). Slip op. at 1 n.1.[3] The GameStop affiliates now seek further review in this APA appeal.

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[3] The Court of Appeals originally issued an opinion invalidating Department Rule 247(4) on the basis of its reading of the plain language of RCW 82.08.010(1)(a)(i). However, the Court of Appeals withdrew that opinion after the Department moved for reconsideration. *See* March 19, 2019, Order Granting Motion for Reconsideration in Part and Withdrawing Published Opinion. In its motion, the Department pointed out that the Court failed to consider the statutory definition of "sale" in RCW 82.04.040(1) that, when read in context with the definition of "selling price" in RCW 82.08.010(1)(a)(i), supported the Rule's requirement that separately stated property of a like kind must be transferred as consideration for the purchased property in a single purchase-sale transaction. The Department also pointed out that resolution of the issue had no impact on the tax owed by GameStop and SOCOM. The substitute opinion did not address the validity of the Department's Rule. Slip op. at 1 n.1.

IV. REASONS WHY THE COURT SHOULD DENY REVIEW

As a basis for review, GameStop mentions only RAP 13.4(b)(4), which permits review by this Court if the petition raises an issue of substantial public interest. Pet. at 9. GameStop's petition should be denied. The Court of Appeals' decision raises no issue of substantial public interest. Rather, the opinion correctly applied the plain language of the statute and a longstanding Department rule in holding that GameStop failed to show that any of the disputed sales transactions qualified for the trade-in exclusion. Application of the law to GameStop's unique trade-in program has substantial interest only to GameStop.

A. The Court of Appeals Correctly Applied the Law

GameStop's primary argument amounts to a disagreement with the Court of Appeals' legal analysis involving the meaning of "property of a like kind." *See* Pet. at 14 ("The Court should accept review to correct the Court of Appeals [sic] mistakes").[4] The Court of Appeals did not err. GameStop simply advocates for an overly broad application of the trade-in exclusion that is inconsistent with the statute's language and the Department's longstanding interpretation of the statute.

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[4] The Court of Appeals also held that GameStop failed to meet the statute's "separately stated" requirement, slip op. at 14, an issue that GameStop does not raise in its petition for review.

1. Video game consoles and video game software are not property of like kind

RCW 82.08.010(1)(a)(i) defines the term "selling price" as "the total amount of consideration, except separately stated trade-in property of like kind, . . . for which tangible personal property [and certain other goods and services] are sold, leased, or rented, valued in money, whether received in money or otherwise." Although the definition is long, it is not ambiguous. The Legislature has used clear language and well-understood terms. The statute commands that:

- The trade-in property must be of "like kind" to the property being purchased;
- The trade-in property must be "separately stated" from the purchased property; and
- Qualifying trade-in property is excluded from the "total amount of consideration" received by the seller in exchange for the property being purchased.

The term "property of like kind" is not defined in the Washington tax code. However, as the Court of Appeals noted, Department Rule 247(5) provides a standard for determining whether property qualifies as like kind. Slip op. at 10. Under Rule 247(5), "property of like kind" means "articles of tangible personal property of the same generic classification." WAC 452-20-247(5). To determine whether tangible personal property is within the same generic classification, the Department looks at the "nature

of the property and its function or use." *Id.* In applying that "function or use" standard, the Department has concluded that computer hardware and computer software are not property of like kind. *Id.* Although computer hardware and software may work together, they do not serve the same function or use and, therefore, are not within the same generic class of property.

The Department promulgated Rule 247 a few weeks after the trade-in exclusion was added to RCW 82.08.010(1). *See* Washington State Register 85-02-006 (filed 12/21/84). Since its inception, Rule 247 has employed the "same function or use" standard for determining whether property is of a like kind within the meaning of RCW 82.08.010(1)(a)(i). And while the statute has been amended numerous times, none of those amendments have suggested that the Legislature disagrees with Rule 247 or the manner in which the Department has interpreted and applied the trade-in exclusion.[5] For this reason, the Court of Appeals recognized that Rule 247(5) was entitled to deference and should have been followed by the Board of Tax Appeals in deciding this case. Slip op. at 10-12. *See generally*, *Manor v. Nestle Food Co.,* 131 Wn.2d 439, 445 n.2, 932 P.2d

[5] RCW 82.08.010(1), defining "selling price," has been amended seven times since 1984. Laws of 2003 ch. 168 § 101; Laws of 2004 ch. 153 § 406; Laws of 2005 ch. 514 § 110; Laws of 2007 ch. 6 § 1302; Laws of 2009 ch. 535 § 303; Laws of 2010 ch. 106 § 210; and Laws of 2014 ch. 140 § 11.

628, 945 P.2d 1119 (1997) (legislative acquiescence to an agency's interpretation of a statute is strongest "when the Legislature has amended the statute in other respects without repudiating the administrative construction.").

The Court of Appeals had no difficulty in applying the "same function or use" standard to the specific facts in the record. After first discussing the undisputed testimony pertaining to the discrete functions and uses of modern video game consoles as compared to video game software, slip op. at 11, the Court of Appeals explained why those discrete functions and uses prevented gaming hardware and video game software from being classified as property of a like kind:

> Although video game software and video game hardware are employed together, they do not perform the same function or use. Video game hardware contains a computer system that is made up of mechanical and electronic parts and includes a computer processing unit, graphics processing unit, and memory. On the other hand, video game software provides commands to the hardware and directs its operation so that a video game may function. The use of video game hardware does not require the use of video game software.
>
> In addition, video game software performs the discrete function of allowing a video game to play on a console. A console can be used for a number of other independent functions, like Internet streaming. Moreover, video game software and video game hardware are a subcategory of computer software and computer hardware, and Rule 247(5) explicitly provides that computer hardware and computer software do not have the same function and purpose.

Slip op. at 12 (footnote omitted).

Nothing in the Court of Appeals' analysis and application of the law is inconsistent with any decision of this Court, with any decision of the Court of Appeals, or with any other established law in this state. GameStop does not argue otherwise. It simply disagrees with the Court's holding and hopes for a better outcome should this Court decide to review the Board's administrative decision. But the Board's decision has been rejected in two levels of APA review, first by the superior court and then by the Court of Appeals. A third level of review is unnecessary.

In its effort to obtain a third bite at the apple, GameStop unfairly criticizes the Court of Appeals for discussing and analyzing *the only evidence offered* at the administrative hearing pertaining to the functions and uses of video game software and gaming hardware. Pet. at 13-14. GameStop contends that the Court's analysis improperly focused on "possible functions" of video games and gaming consoles. *Id.* at 13. However, it offers as rebuttal only unsubstantiated statements that are found nowhere in the record. *Id.* at 12, 13.

If the evidence presented at an APA adjudicative hearing matters, as it should, then there is no serious dispute that the Court of Appeals correctly decided this appeal. GameStop presented no evidence suggesting that video game hardware and software perform similar functions or uses.

The evidence in the record was exactly the opposite. *See* slip op. at 4, 11 (describing the testimony of a GameStop witness who conceded that video game software could be used for none of the multiple functions of a game console). Thus, even if GameStop's petition is granted, the underlying evidence in the APA record would not change. *See* RCW 34.05.558 (under the APA, judicial review of disputed issues of fact "must be confined to the agency record"). GameStop is simply hoping that the established evidence will be applied differently and to its benefit. But that is not a recognized reason for seeking review under RAP 13.4(b). The petition should be denied.

2. GameStop's policy arguments are not supported by the record and are better addressed to the Legislature

GameStop also argues that the Court of Appeals decision "will jeopardize consumer friendly trade-in programs" that help keep used electronics out of landfills. Pet. at 15. The company cites no evidence for its claim. Additionally, the claim is inconsistent with its public statements. As explained in its 2011 10-K report, GameStop offers a trade-in program for its own business reasons, including to obtain an inventory of used merchandise. AR 342. Noticeably missing from that 10-K report is any mention of collecting less sales tax from its customers as one of the underlying purposes for the program. *Id.* Nor does it mention

environmental concerns involving the disposal of consumer electronics. *Id.*[6]

GameStop's policy argument should be flatly rejected. First, as discussed above, no evidence in the record supports the policy benefits that GameStop claims would be achieved from its broad interpretation of the trade-in exclusion. Additionally, as this Court has stated many times, tax exemptions and other tax preferences should be construed and applied narrowly, not broadly. *E.g., Dep't of Revenue v. Schaake Packing Co.*, 100 Wn.2d 79, 83, 666 P.2d 367 (1983) (tax exemptions must be construed narrowly, and the burden of establishing a tax exemption falls on the taxpayer). In keeping with this established principle, this Court has consistently rejected the notion that tax exemptions and tax deductions should be broadly construed based on a particular taxpayer's policy

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[6] The 2011 GameStop 10-K explains that its trade-in program provides consumers "with an opportunity to trade in their used video game products in our stores in exchange for store credits which can be applied towards the purchase of other products, primarily new merchandise." AR 342. The 10-K continues:

> Our trade-in program provides our customers with a unique value proposition which is generally unavailable at mass merchants, toy stores and consumer electronics retailers. This program provides us with an inventory of used video game products which we resell to our more value-oriented customers. In addition, our highly-customized inventory management system allows us to actively manage the pricing and product availability of our used video game products across our store base and to reallocate our inventory as necessary. Our trade-in program also allows us to be one of the only suppliers of previous generation platforms and related video games.

Id.

arguments. *See, e.g., Cashmere Valley Bank v. Dep't of Revenue*, 181 Wn.2d 622, 640, 334 P.3d 1100 (2014) (expressly rejecting "policy arguments" that "rest on unsupported assumptions").

Moreover, expanding a sales tax exemption comes at a cost—less revenue to fund important state services. While the Legislature might agree with GameStop that it makes good policy sense to expand the trade-in exclusion to encourage the reuse of video game software and hardware, those arguments should be presented to the Legislature in the first instance. The Legislature can consider and balance the financial benefit to companies like GameStop against the countervailing cost to the State's ability to fund government, and can make appropriate amendments to the trade-in exclusion designed to best achieve the desired goal.

Until the Legislature chooses to amend the statute to GameStop's benefit, the Court of Appeals was correct to apply the statute in a manner that gives effect to its existing language. GameStop's arguments for a different tax policy do not warrant review under RAP 13.4(b).

B. The Court of Appeals' Choice to Avoid Unnecessary Dicta is Not a Matter that Warrants this Court's Attention

GameStop's only other argument pertains to the Court of Appeals' choice to avoid unnecessary dicta in its published opinion. As noted above, the trade-in exclusion has three requirements, including the

requirement that the trade-in property must be delivered to the seller as part of the total consideration given for the property being purchased. Having found that GameStop failed the "like kind" and "separately stated" requirements of the statute with respect to the disputed transactions, the Court, in its final opinion, declined to address the "consideration" requirement or the portion of Rule 247 that interprets and implements that requirement. Slip op. at 1 n.1. Analysis of that third requirement, and analysis of Rule 247(4)'s explanation that trade-in property must be delivered to the seller as part of a single transaction, was simply not necessary to resolve the case.

Nevertheless, GameStop contends that review of this issue, while having no impact on the outcome of the present litigation, is necessary "to provide needed clarity" on the use of stored value cards as means to obtain the tax benefit of the trade-in exclusion. Pet. at 17. GameStop seeks what amounts to an advisory opinion.

This Court should decline to accept review of this issue for two important reasons. First, advisory opinions are disfavored. This Court will "deliver advisory opinions only on those rare occasions where the interest of the public in the resolution of an issue is overwhelming and where the issue has been adequately briefed and argued." *To-Ro Trade Shows v. Collins*, 144 Wn.2d 403, 416, 27 P.3d 1149 (2001) (internal quotations

and citations omitted). Here, there is no overwhelming need to address whether GameStop also failed the statute's "consideration" requirement with respect to the "future purchase" transactions at issue.

Second, RCW 82.08.010(1)(a)(i) already provides clarity on the proper application of the trade-in exclusion to GameStop's business model. The statute unambiguously requires property of a like kind to be part of the "consideration . . . received" by the seller in exchange for the property being purchased. If the consideration received by the seller is money, a credit, or anything else of value other than "separately stated trade-in property of like kind," the exclusion plainly does not apply.

There is no dispute that the redemption of a stored credit to obtain GameStop merchandise involves two distinct purchase-sale transactions. The first occurs when the customer transfers his or her used property to GameStop in exchange for the credit. That transaction is a "sale" under RCW 82.04.040(1) because it involves the transfer of ownership of property by the customer to GameStop for consideration. And that transaction is distinct from the second purchase-sale transaction that may occur months or years later when the customer redeems the stored credit as consideration for the purchase of new or used GameStop merchandise. Under the statute's plain language, neither the "used property for credit" sale nor the later "credit for merchandise" sale qualifies for the trade-in

exclusion because neither transaction involves the trade of property as part of the "consideration . . . received" by the seller for "separately stated property of a like kind." Further clarification of the statute is unnecessary, and review of the statute's plain meaning is not warranted under RAP 13.4(b).

V. CONCLUSION

For the foregoing reasons, the decision of the Court of Appeals does not merit this Court's review. GameStop's petition should be denied.

RESPECTFULLY SUBMITTED this 16th day of May, 2019.

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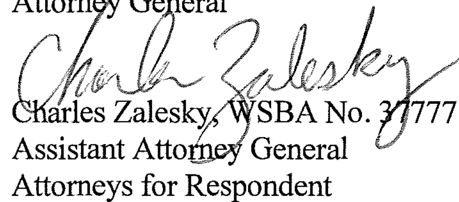
Attorney General



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PROOF OF SERVICE

I certify that on May 16th, 2019, I electronically filed this document with the Clerk of the Court using the Washington State Appellate Courts' e-file portal, which will send notification of such filing to all counsel of record at the following:

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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 16th day of May, 2019, at Tumwater, WA.

Ebonne Robinson, Legal Assistant

ATTORNEY GENERAL'S OFFICE - REVENUE & FINANCE DIVISION

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