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STATE OF WASHINGTON
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NO. 95625-1

SUPREME COURT OF THE STATE OF WASHINGTON

STATE OF WASHINGTON,

Respondent,

v.

PAUL TIMOTHY CHASE,

Petitioner.

ANSWER TO PETITION FOR REVIEW

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I. INTRODUCTION

Petitioner Paul Chase seeks review of a Court of Appeals decision, which affirmed that Chase, who was a shareholder and officer of a corporation, did not have personal privacy interests in the corporation's records. In holding that the corporation's records did not implicate Chase's personal privacy interests, the Court of Appeals applied well-established case law that clearly separates corporate affairs from the personal affairs of a shareholder or officer. Moreover, the records at issue have historically not been considered a "private affair" because corporate tax audits have been statutorily authorized since at least 1935. This Court should deny the petition because Chase fails to establish any of the criteria for review.

II. COUNTERSTATEMENT OF THE ISSUE

If review were granted, the following issue would be presented:

1. **Does a stockholder or officer of a closely held corporation have a personal privacy interest in the corporation's bank account information, where those records are sought for an audit by taxing authorities, and the records have historically been open to such audits?**

III. STATEMENT OF CASE

The Department of Revenue audited a corporation, Red Leaf Construction, Inc., after a customer claimed that the company had not paid sales taxes. CP 89-91. As a part of the audit to determine what Red Leaf might owe the State, the Department issued an administrative summons to

Banner Bank, requesting Red Leaf's various corporate bank, check, leasing, and invoice records. CP 90. Banner Bank complied with this administrative summons. CP 90. The Department issued the bank summons after unsuccessfully serving Chase, Red Leaf's owner. CP 17-18, 30-32.

Upon reviewing these records, the Department determined that over many years Red Leaf had collected sales tax from customers but had not provided the tax it collected to the Department. CP 91. Believing these actions may be criminal, the Department referred the matter to the Attorney General. CP 87. Red Leaf was not charged with a crime, but evidence from its corporate records led the Attorney General's Criminal Justice Division to charge Chase with First Degree Theft. CP 85-86. Chase was the treasurer of the closely held corporation, in addition to serving as a corporate officer who was president, secretary, and board chairman. CP 89. The corporation is not a party in this case.

The trial court denied Chase's motion to suppress the audit of the corporate bank records, finding them not to be Chase's personal or private information. CP 19. On discretionary review, the Court of Appeals affirmed and held that Chase did not have a privacy interest in the corporation's financial records, and only the corporation, not Chase, had standing to challenge the corporate audit. *State v. Chase*, 1 Wn. App. 2d 799, 803-08, 407 P.3d 1178 (2017). Chase now petitions this Court for review.

IV. OVERVIEW OF ARGUMENT

This Court has consistently held that the personal affairs of corporate officers and stockholders are separate and distinct from the corporation's affairs. The decision of the Court of Appeals does not conflict with decisions of this Court, involve a significant constitutional question, or present an issue of substantial public interest that this Court should decide. For these reasons, this Court should deny the petition for review.

V. WHY REVIEW SHOULD BE DENIED

A. The Opinion by The Court Of Appeals is Consistent with the Decisions of This Court that Corporate Affairs are Separate and Distinct from the Private Affairs of Individual Shareholders and Officers

This Court has long held that a “corporation exists as an organization distinct from the personality of its shareholders.” *Grayson v. Nordic Const. Co., Inc.*, 92 Wn.2d 548, 552, 599 P.2d 1271 (1979). *Grayson* did not involve the search of a business, but did outline the importance of maintaining a distinction between the corporation and those people who comprise a corporate entity. *Id.* “The shareholders of a corporation, who are also the corporation’s officers and directors [are to] conscientiously keep the affairs of the corporation separate from their personal affairs” *Id.* at 552-53 (citing *Frigidaire Sales Corp. v. Union Properties, Inc.*, 88 Wn.2d 400, 405, 562 P.2d 244 (1977)).

The principle upon which we proceed is that a corporation exists as an organization distinct from the personality of its shareholders. This separate organization, with its distinctive privileges and liabilities, is a legal fact, and not a fiction to be disregarded when convenient. The concentration of its ownership in the hands of one or two principal shareholders does not, ipso jure, dispel those corporate characteristics of the organization.

State v. Northwest Magnesite Co., 28 Wn.2d 1, 41, 182 P.2d 643, 663-64 (1947). The Court of Appeals correctly held that Red Leaf's corporate affairs are separate and distinct from Chase's private affairs, and "a corporation's separate legal identity is not lost merely because all of its stock is held by members of a single family or by one person." *Chase*, 1 Wn. App. 2d at 805 (quoting *Grayson*, 92 Wn.2d at 553).

Because it is expected that a corporation's affairs are separate from the private affairs of shareholders and officers, there was no likelihood that the private affairs of Chase or anyone else would have been disturbed in the Department's corporate audit. *Chase*, 1 Wn. App. 2d at 805. The audit was limited to a search of corporate business records. *Id.* These records belonged to Red Leaf, not Chase. *Id.* at 802. As the court correctly held, there was no violation of Article, I, Section 7 of the Washington Constitution, because Chase did not show that *Chase's* private affairs were disturbed. *Id.* at 803-04 ("Article I, section 7 has two components: 'private affairs' and 'authority of

law.’ If the defendant does not show that his private affairs were disturbed, there is no violation.”).

Chase maintains that this Court should review this case because it runs afoul of *State v. Miles*, 160 Wn.2d 236, 244, 156 P.3d 864 (2007), and *State v. Reeder*, 184 Wn.2d 805, 814-15, 365 P.3d 1243 (2015). But those cases are not applicable here. The State agrees that financial records held by a bank can fall within constitutional protections of private affairs. *Miles*, 160 Wn.2d at 244. But in *Miles* and *Reeder*, the Court held that a person has a privacy interest in their *own* bank records held by a bank, in their personal bank account. 160 Wn.2d at 251-52; 184 Wn.2d at 814-15. Neither *Miles* nor *Reeder* assert that a person has a privacy interest in the bank records of a separate legal entity, or of a business bank account. *Id.* Unlike in *Miles* or *Reeder*, the State did not issue a summons for Chase’s personal bank records. *Chase*, 1 Wn. App. 2d at 805. The audit was for the corporate records belonging to Red Leaf. *Id.* The Court of Appeals properly recognized that the “corporation’s bank records are not an individual’s personal bank records.” *Id.*

In addition, these corporate banking records are not “private affairs” because they have not historically been considered private. In *Miles*, this Court held that in determining whether a person’s private affairs are being violated, there should be a review of the “nature and extent of the

information which may be obtained as a result of the government conduct' and at the historical treatment of the interest asserted." *State v. Hinton*, 179 Wn.2d 862, 869, 319 P.3d 9 (2014) (quoting *Miles*, 160 Wn.2d at 244; *State v. McKinney*, 148 Wn.2d 20, 29, 60 P.3d 46 (2002); and *State v. Jordan*, 160 Wn.2d 121, 156 P.3d 893 (2007)). The Court of Appeals correctly determined that records related to Red Leaf's collection of taxes have "historically been available to the Department for audit" and were obtained in accordance with statutory authority dating back to 1935 that allow for administrative summonses to determine corporate tax liability. *Id.* at 870. Further, the U.S. Supreme Court has held there is no expectation of privacy nor Fourth Amendment protection from a legitimate inquiry by taxing authorities. *See Dep't of Revenue v. March*, 25 Wn. App. 314, 320, 610 P.2d 916 (1979) (citing *Couch v. United States*, 409 U.S. 322, 335, 93 S.Ct. 611, 619, 34 L.Ed.2d 548, 558 (1973)).

Chase's reliance on *Miles* is misplaced, since Chase's personal affairs were not searched in this corporate audit and the search of Red Leaf's affairs that took place was statutorily authorized and historically acceptable. The Court of Appeals decision that "*Miles* does not control this case" is correct. *Chase*, 1 Wn. App. 2d at 804. *Reeder* is inapposite for the same reason. The opinion by the Court of Appeals is consistent with the decisions

of this Court that a corporation's affairs are separate and distinct from the private affairs of individual shareholders and officers.

B. The Corporate Tax Audit of Red Leaf Was Statutorily Authorized, Historically Accepted, and Done Properly

Corporations are well aware that their business records are subject to a tax audit. The Revenue Act of 1935 created a variety of state sales, business, and excise taxes for generating state revenue. As a part of this tax structure, administrative auditing authority was codified at that time and has existed ever since. RCW 82.32.110. This statutory authority allows the Department to “examine any books, papers, records, or other data, or stock of merchandise bearing upon the amount of any tax payable or upon the correctness of any return, or for the purpose of making a return when none has been made, or in order to ascertain whether a return should be made . . .” *Id.*

The Department examined Red Leaf's business records to determine the amount of tax payable and whether a tax return should be made, in accordance with the statute, by using a minimally invasive bank summons. *See id.* The audit showed that Red Leaf had collected sales tax from customers but had not forwarded these funds to the State. The audit established that the State was due this tax revenue. This audit was done pursuant to a long-standing statutory legal framework that set limits on how

the State can examine business tax records but still allow for the effective regulation of business. Without this authority, the people of Washington could not ensure that the sales tax they paid to state-incorporated businesses was reaching the State treasury. The Court of Appeals correctly held that the Department acted in accordance with this historical statutory authority when it sought banking records to assess Red Leaf's sales tax liability after a customer complaint.

Chase relies on *Burwell v. Hobby Lobby Stores, Inc.*, ___ U.S. ___, 134 S.Ct. 2751, 2768, 189 L.Ed.2d 675 (2014), but that case has no application here. First, Chase incorrectly suggests that *Miles* and *Reeder* relied on the notion expressed in *Hobby Lobby* that certain personal rights should be enjoyed by a business as well because humans own, run, and are employed by the business. Pet. at 7. In fact, as discussed above, *Miles* and *Reeder* involved personal banking records of a human person, so the Court made no mention of this notion. Second, *Hobby Lobby* did not involve the Fourth Amendment, or any constitutional provision at all. Instead, it involved application of a federal statute, the Religious Freedom Restoration Act. *See Hobby Lobby*, 134 S.Ct. at 2759. Thus, it does not control here.

It is true that the Fourth Amendment protects the rights of people from being unreasonably searched, even when associated with a

corporation. *G.M. Leasing, Inc. v. United States*, 429 U.S. 338, 353, 97 S.Ct. 619, 50 L.Ed.2d 530 (1977) (holding that corporations retain some Fourth Amendment rights). However, this principle does not transform a corporation's business records into an individual's private affairs. A corporation's records are not someone else's private affairs. Moreover, a corporate bank account would not reveal the kind of information that a personal account would, and it historically has not been considered private. *See* RCW 82.32.110. Business by its special nature and voluntary existence may open itself to intrusions that would not be permissible in a purely private context. *G.M. Leasing, Inc.*, 429 U.S. at 353-55. The fact that a warrant may be needed to physically enter a business premises, *Id.* at 353-55, does not change the historical treatment of business records as entitled to less protection than a person's private bank account. The audit of Red Leaf was statutorily authorized, of a corporate entity not an individual, and constitutionally sound. The Court of Appeals opinion that held this audit to be lawful was proper.

VI. CONCLUSION

The Court of Appeals applied well-settled law that a corporation is separate from its shareholders and officers in determining that the corporation's banking records were not the personal affairs of the

shareholder and officer. None of the criteria for this Court's review are satisfied; this Court should deny review.

RESPECTFULLY SUBMITTED this 4th day of May, 2018.

ROBERT W. FERGUSON
Attorney General

A handwritten signature in cursive script, appearing to read "Michael Pellicciotti", written over a horizontal line.

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DECLARATION OF
SERVICE

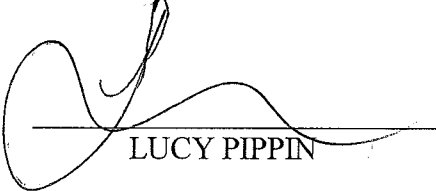
I, Lucy Pippin, declare as follows:

On May 4, 2018, I sent via electronic mail, true and correct copies of Answer to Petition for Review and Declaration of Service, addressed as follows:

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

DATED this 4th day of May, 2018, at Seattle, Washington.


LUCY PIPPIN

WASHINGTON STATE ATTORNEY GENERAL'S OFFICE - CRIMINAL JUSTICE DIVISION

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