

No. 37854-0-II

DIVISION II, COURT OF APPEALS
OF THE STATE OF WASHINGTON

ORIGINAL

HOME DEPOT USA, INC.,

Plaintiff-Appellant

v.

WASHINGTON DEPARTMENT OF REVENUE,

Defendant-Respondent

ON APPEAL FROM THURSTON COUNTY SUPERIOR COURT
(Hon. Chris Wickham)

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I. INTRODUCTION AND SUMMARY

This case challenges the State's patently unreasonable position that it is entitled to retain sales tax payments that a retailer made on behalf of customers who then defaulted on their credit accounts and never paid for their transactions. The trial court adopted the State's position wholesale, entering the State's proposed order granting the State summary judgment and denying Home Depot's refund claim. Home Depot now appeals.

The State's position reduces to this: it can keep retailer sales tax payments, even though no sale ultimately occurred and the retailer therefore ultimately owed no tax. To permit the State to retain monies under these circumstances would be plainly unreasonable, manifestly unjust, and contrary to the clear language and import of the RCW's sales tax provisions. Indeed, it shocks the conscience that the State would try to hold onto dollars on a busted transaction where there was no sale at the end of the day and, therefore, ultimately no retailer tax obligation on those transactions. Thus, this Court should now reverse the trial court's ruling and order the State to issue a refund to Home Depot.

The facts here are largely undisputed: Home Depot, like many national retailers, provides private-label credit cards ("PLCCs") to creditworthy customers and uses authorized credit account administrators to administer those accounts. When a PLCC customer purchases a

product from Home Depot on credit, Home Depot pays out of its own pocket the state-levied sales tax on behalf of the customer, who, under the RCW, bears the incidence of the tax. Regrettably, certain PLCC customers default on their accounts and never pay for the products or the sales taxes Home Depot has remitted on their behalf.

The question here is whether the State is entitled to retain sales taxes that Home Depot remitted on transactions that ultimately went bust when the customers — the taxpayers under the RCW — never paid for the products. As a matter of law and fairness, the answer is clear: Of course, the State cannot keep those dollars; it must refund them because no sale actually occurred, so the State is therefore not entitled to retain any tax from the retailer.

Realizing the unjust enrichment that would result if the State retained such dollars, Washington law contemplates a refund. The RCW entitles "sellers" to a refund "for sales taxes previously paid on debts which are deductible as worthless for federal income tax purposes." RCW 82.08.037.¹ Despite that clear statutory prescription, however, the State

¹ All references are to the former RCW chapter 82.08 that was in effect during the claim period.

contended below — and the trial court apparently agreed² — that Home Depot was not entitled to any refund because in PLCC transactions, the financing companies should be considered to bear the cost of bad debts. That argument fails for two principal reasons: First, by its plain language, the RCW merely requires that the bad debts be "deductible as worthless," and does not require that the party seeking the refund actually take the "bad debt" deduction. Here, "bad debt" losses were not only "deductible as worthless;" they were, in fact, deducted as worthless by the financing companies. Thus, on the face of the statute, Home Depot, as the "seller" who "previously paid" the sales tax on bad debts "deductible as worthless," is unquestionably entitled to this refund.

Moreover, the State is simply wrong as a matter of fact about who bore these bad debt losses. Indeed, the uniform and uncontroverted testimony — from Home Depot and independent financing company witnesses alike — confirmed that Home Depot fully reimbursed the financing companies for all expenses of the PLCC program, including the cost of the bad debts arising out of uncollectible PLCC accounts, and therefore Home Depot actually bore this cost. Thus, the factual record

² It is not possible to discern the trial court's reasoning because it entered the State's proposed order granting the State summary judgment and denying Home Depot's refund claim.

here also established Home Depot's entitlement to a refund as the party who actually bore these losses.

The State's self-serving construction of the RCW creates an untenable "Catch-22" that unjustly enriches the State: neither the retailer who remitted the tax and bore the losses (but, according to the State, did not take a federal income tax deduction), nor the financing company that serviced the credit accounts (but did not make any retail sales or remit any tax), would qualify for the refund that the Legislature clearly intended. The one party that surely is not entitled to keep that money, though, is the State, because, effectively, no sale occurred.

In essence, the State is imposing sales tax obligations on retailers when there has been no sale and is making it impossible for retailers with credit programs administered by servicing companies to get a refund. Thus, the State, without any statutory authority whatsoever, has effectively levied a tax on such retailers as a cost of doing business, and the trial court has now sanctioned this money grab. Such a construction of the RCW violates Washington law and the U.S. and Washington Constitutions. Absent this Court's intervention, the State will continue to retain millions of sales tax dollars it has no right to keep because no sale was ever consummated, and retailers such as Home Depot will be denied the refunds that the Legislature clearly intended.

Accordingly, this Court should now reverse the trial court's ruling and order the State to issue a refund to Home Depot.

II. ASSIGNMENT OF ERROR AND ISSUES PRESENTED

This appeal presents a single assignment of error: The trial court erred when it entered its June 6, 2008 order granting the State's motion for summary judgment, allowing the State to keep sales tax that was remitted by a retailer who ultimately had no tax obligation because there was no sale at the end of the day. CP 369-371. The issues pertaining to this assignment of error are:

1. Whether the trial court erred in granting the State summary judgment on Home Depot's claim for a sales tax refund under RCW 82.08.037 where Home Depot met all of the requirements of the statute:

a. Home Depot was a "seller" who made "retail sales" within the meaning of RCW 82.08.010(2);

b. Home Depot collected and remitted the full amount of sales tax for merchandise purchased by Home Depot's customers using Home Depot's PLCC; and

c. The "debt" on which the "sales taxes [were] previously paid" was "deductible" as "worthless" (and was, in fact, deducted when some Home Depot customers failed to pay their credit accounts and, thus, the sales taxes on those transactions).

2. Whether the State can add an unwritten requirement to RCW 82.08.037 that a seller must itself deduct the bad debt for federal income tax purposes when the relevant statutory provision states that "[a] seller is entitled to a credit or refund for sales taxes previously paid on debts which are deductible as worthless for federal income tax purposes."

3. Whether summary judgment can be granted based on a factual allegation that Home Depot did not suffer any loss from its customers' worthless debt when Home Depot adduced extensive and, indeed, uncontroverted evidence that it did, in fact, bear the loss of its customers' worthless debt.

4. Whether legislative intent and public policy are frustrated if the State refuses a refund under RCW 82.08.037, particularly when Home Depot has fully compensated the financing companies that administered its PLCC for the bad debt (including the sales tax that buyers never paid).

5. Whether the State's interpretation that it can discriminate against retailers who contract with financing companies to administer their PLCC programs, on the one hand, in favor of those who offer in-store revolving credit, on the other hand, can stand, given federal and state constitutional prohibitions on discrimination.

III. STATEMENT OF THE CASE

A. **Home Depot Operates Retail Home Improvement Stores Throughout the United States, Including Washington.**

Home Depot operates a chain of retail home improvement stores throughout the United States, including Washington. Between July 1, 1997 and July 31, 2003 (the "refund period"), Home Depot paid the State more than \$427,244,426 in sales tax. CP 4-6 (Notice of Appeal). That amount included sales taxes on transactions financed by Home Depot's PLCCs that were never completed because the customer ultimately defaulted on his or her accounts. CP 56 (Smith Dep. at 30:12-24). Home Depot seeks a refund of \$1,098,641.61 – the total amount of taxes paid on the defaulted PLCC transactions during the refund period. CP 4-6 (Notice of Appeal); CP 264-266 (Refund claim).

B. **Home Depot, Like Most National Retailers, Offers Its Own Credit Card Program Administered On Its Behalf By Financing Companies.**

Home Depot, like most large retailers, provides its customers with the option of purchasing merchandise through a PLCC program. Home Depot offers this program to build customer loyalty, increase sales, and provide special promotions. CP 28 (Thorncroft Dep. at 21:6-23). Home Depot cards may only be used for purchases at Home Depot. CP 38 (Thorncroft Dep. at 50:1-4). Because of burdens imposed by federal lending restrictions and the difficulty of complying with the lending laws

of fifty different states, most national retailers do not extend credit themselves under PLCC programs. Instead, most national retailers, including Home Depot, use third-party financial institutions authorized by federal law to issue credit cards on a nationwide basis to finance and manage their PLCC programs.

In Washington, Home Depot entered into agreements with General Electric Capital Corporation, through its operating entities Monogram Bank of Georgia, GECC, and GE Capital Financial, Inc., under which GE issued PLCCs for Home Depot's customers. CP 30 (*id.* at 24:4-21). The three agreements addressed different customer needs: a Consumer Agreement with Monogram Credit Card Bank of Georgia ("Monogram") serviced Home Depot's retail customers, (CP 199-263); and Commercial and Business Agreements with General Electric Capital Corp. ("GECC"), CP 75-134, and General Electric Capital Financial Inc. ("GE Financial") (collectively, the "financing companies" or "GE"), CP 135-198, serviced Home Depot's commercial customers. These agreements (the "Agreements") governed Home Depot's credit program during the entire refund period.

Under the Agreements, a customer had to fill out a credit card application and submit it to the financing companies to obtain a PLCC. CP 199-262 (Monogram Agreement) (§ 4.02(d)); CP 135-197 (GECC

Agreement) (§ 4.02(d)); CP 75-133 (GEFC Agreement) (§ 4.02(d)). The application was then submitted electronically to GE, which evaluated the creditworthiness of the applicant to determine whether or not to issue that customer a PLCC. CP 26-27 (Thorncroft Dep. at 14:20-15:20). Once approved, the customer could use the PLCC to make purchases on credit exclusively at Home Depot and affiliated stores.

C. Home Depot Bore The Risk Of Loss On Its PLCC Accounts.

Under the terms of its PLCC Agreements, Home Depot fully compensated the financing companies for the costs of the credit program – including administrative and bad debt costs – by providing the financing companies with at least three sources of income from Home Depot and/or its customers. *See* CP 199-262 (Monogram Agreement); CP 75-197 (agreements with other GE affiliates). First, Home Depot provided the financing companies with the benefits that Home Depot itself would have enjoyed if Home Depot had been able to operate its own PLCC program. These benefits included the right to collect interest, late fees, and other ancillary fees from Home Depot's PLCC customers. Second, Home Depot provided the financing companies with the value of Home Depot's customer database, which the financing companies could use to market other products or financial services to Home Depot customers. Third, Home Depot also compensated the financing companies with service fees

on certain PLCC transactions. Significantly, the "fees and [the] income stream that [was] . . . generated by the portfolio covered the financing companies' costs and bad debt losses." CP 35 (Thorncroft Dep. at 30:22-30:24).

The third component of Home Depot's compensation to the financing companies, the service fees, was paid in connection with certain individual sales at Home Depot's retail locations, including in Washington. During the Refund Period, Home Depot charged its customers the retail price for items in its stores plus a 6.5-percent Washington sales tax. RCW 82.08.020(1). PLCC customers, however, did not pay Home Depot any money at the point of sale. Rather, Home Depot was required to remit, out of its own pocket, sales tax to the State on each PLCC transaction, regardless of whether the customer ultimately paid. *See* CP 29, 31 (Thorncroft Dep. at 23:14-21; 25:17-21); CP 56 (Smith Dep. at 30:12-24). The financing companies, meanwhile, paid Home Depot the purchase price of each item bought using a PLCC, including applicable sales tax, less the aforementioned service fee, which Home Depot paid to the financing companies on certain transactions regardless of whether the customer ultimately defaulted. *See* CP 199-263 (Monogram Agreement) (§ 5.01); CP 135-197 (GECC Agreement) (§ 5.01); CP 75-133 (GECF Agreement) (§ 5.01).

These service fees resulted from extensive negotiations between Home Depot and GE. Home Depot and GE used a complex economic analysis to forecast losses from worthless debt and other expenses (as well as the financing companies' income from interest, late charges and other income streams). CP 32-33 (Thorncroft Dep. at 26:23-27:3 (explaining that GE "determine[s] what [their] costs are going to be . . . [including] obviously, losses because not everybody pays [GE]."); CP 40-41 (*Id.* at 26:7-27:17; 72:6-73:2). The fees that Home Depot paid to GE varied depending on the type and cost of the merchandise involved. CP 126 (GECF Agreement); CP 190 (GECC Agreement); CP 253-254 (Monogram Agreement). *See also* CP 34 (Thorncroft Dep. 28:9-21).

In short, because Home Depot "covered [the financing companies'] costs and bad debt losses," Home Depot bore the risk of loss from defaulting customers on a portfolio basis. CP 35 (Thorncroft Dep. at 30:22-30:24). Its losses under the PLCC program, therefore, were no different than if Home Depot owned its own accounts and bore the risk of loss on an account by account basis.

Representatives from the parties to the Agreements concur that Home Depot bore the risk of loss under the PLCC program through payment of the service fee and other forms of compensation identified above. Eugene Thorncroft, Vice-President of Risk Management for GE

Consumer Finance – a pivotal witness with direct knowledge of the Agreements – testified that GE "incorporated the anticipated bad debt into the pricing [they] created as [they] negotiated the agreement." CP 42 (Thorncroft Dep. at 74:2-74:4). Mr. Thorncroft further testified that the "fees and [the] income stream that [was] . . . generated by the portfolio covered [GE's] costs and bad debt losses." CP 35 (Thorncroft Dep. at 30:22-30:24). Moreover, the fact that GE "earned a profit" confirms that Home Depot fully "compensated" GE "for the losses." CP 36 (Thorncroft Dep. at 34:9-10). *See also* CP 35, 41-42 (Thorncroft Dep. at 30:4-24; 73:24-74:8); CP 72 (Ryser Dep. at 41:1-6). Indeed, as intended and contracted, the compensation provided by Home Depot exceeded GE's worthless debt losses and other program expenses for the refund years in question. CP 33-34, 36, 41 (Thorncroft Dep. at 27:18-28:8; 34:8-21; 73:3-10). And Home Depot deducted as business expenses the service fees it paid to the financing company. CP 267-90 (Home Depot Tax Returns)³

³ While the financing companies deduct bad debt losses on their federal income tax returns under I.R.C. 166, they also have to report, at the same time, the income they receive from Home Depot. As previously explained, that income consists of service fees as well as the income that the financing companies derive from the interest, late fees and other consideration that Home Depot provides them, which more than offset those bad debt losses. Home Depot, in turn, bears those bad debt losses, as reflected in the business expense deductions that Home Depot takes on its federal income tax returns for paying these service fees and in the income that Home Depot foregoes when it affords the financing
(continued . . .)

D. Home Depot's Refund Claim And The Trial Court Proceedings.

In December 2003, Home Depot filed a sales tax refund claim with the State for the relevant refund period. CP 264-266. Home Depot sought a refund of previously paid sales tax in the amount of \$1,098,641 under RCW 82.08.037. The claim was based on actual (not estimated) Home Depot customer credit accounts that GE declared as worthless debt for federal income tax purposes (taking into account any subsequent recovery on the debts by GE). CP 58-59, 61, 64 (Smith Dep. at 39:14-40:2; 44:4-7; 54:17-20). Home Depot requested a refund of the sales tax that Home Depot had remitted in connection with these uncollectible credit sales. CP 65 (*id.* at 55:9-19); CP 264-266.

The State denied Home Depot's claim. Home Depot filed a timely notice of appeal to the Superior Court for a *de novo* review of the decision. CP 4-6; *see* RCW 82.32.180. Following discovery, the State moved for summary judgment on the ground that Home Depot did not "incur the bad debt or loss" of these defaulted transactions, even though this requirement is not found anywhere in the statute. CP 7-16. In response, Home Depot argued that its refund must be granted under the plain language of the

(. . . continued)

companies the opportunity to profit from these other forms of consideration in administering its PLCC program.

statute and also adduced evidence that it, and not the financing company, bore the entire loss for the defaults. CP 317-321. The trial court nevertheless granted the State's motion, entering the State's proposed order granting the State summary judgment and denying Home Depot's refund claim, CP 369-371, and Home Depot then filed this appeal. CP 372-373.

IV. ARGUMENT

A. **This Court Is To Conduct A De Novo Review Of The Trial Court's Summary Judgment Order.**

This Court reviews an order of summary judgment de novo, engaging "in the same inquiry as the trial court, [and] treating all facts and reasonable inferences from the facts in a light most favorable to the nonmoving party." *Homestreet v. Dep't of Revenue*, 139 Wn. App. 827, 838, 162 P.3d 458 (2007) (quoting *Enterprise Leasing, Inc. v. City of Tacoma*, 139 Wn.2d 546, 551, 988 P.2d 961 (1999)). Summary judgment is appropriate only if the pleadings, affidavits, depositions, and admissions on file demonstrate the absence of any genuine issues of material fact, and the moving party is entitled to judgment as a matter of law. *Id.*; CR 56(c).

Similarly, where the only issues to be resolved involve statutory interpretation and are legal in nature, this Court "review[s] a trial court's legal conclusions in a tax refund action de novo." *Nelson Alaska Seafoods, Inc. v. Dep't of Revenue*, 143 Wn. App. 455, 461, 177 P.3d 1161 (2008) (quoting *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn.2d 139,

148, 3 P.3d 741 (2000)). For the reasons explained here, a *de novo* review compels reversal and a directive that Home Depot is entitled to a refund as a matter of law under RCW 82.08.037. Alternatively, even if this Court affirms the trial court's conclusions concerning the refund statute's legal requirements, it would still have to reverse the trial court's grant of summary judgment to the State, not only because the principal factual underpinning of its position – namely, its claim that the financing companies bore these bad debt losses – is sharply disputed, but also because it is wholly undermined by this record.

B. Home Depot Satisfied The Statutory Requirements For A Worthless Debt Tax Refund Under RCW 82.08.037.

When interpreting a statute, a court must carry out the Legislature's intent. *Simpson Inv. Co.*, 141 Wn.2d at 148. That intent must be derived from the statute's plain and unambiguous language, regardless of a contrary interpretation by an administrative agency. *Agrilink Foods, Inc. v. Dep't of Revenue*, 153 Wn.2d 392, 396, 103 P.3d 1226 (2005).

For the refund period in question, RCW 82.08.037 provided:

A seller is entitled to a credit or refund for sales taxes previously paid on debts which are deductible as worthless for federal income tax purposes.

RCW 82.08.037.⁴ The Washington Supreme Court has squarely addressed the meaning of this statute and found it free of ambiguity. "Unraveled, RCW 82.08.037, has three requirements: (1) the seller must be a person, (2) making sales at retail, and (3) entitled to a refund for sales taxes previously paid on debts which are deductible as worthless for federal income tax purposes." *Puget Sound Nat. Bank v. Dep't of Revenue*, 123 Wn.2d 284, 287, 868 P.2d 127 (1994). If these three requirements are satisfied, the seller who remitted the sales tax to the State is entitled to a refund. *Id.*

Home Depot certainly meets this standard. Indeed, it is undisputed that Home Depot is a "person" under the statute, *see Puget Sound*, 123 Wn.2d at 287 (quoting RCW 82.04.030), and that Home Depot is a "seller" "making sales at retail" under the statute. *See* RCW 82.08.010(2) (A "seller" is any "person ... making sales at retail or retail sales to a buyer or consumer.").

With respect to the third and final requirement under the statute – whether these debts are "deductible as worthless" – Home Depot, in its

⁴ Laws of 1982, 1st Ex. Sess., ch. 35, § 35. RCW 82.08.037 has been amended several times since its original enactment in 1982. *See* Laws of 2007, ch. 6, § 102; Laws of 2004, ch. 153, § 302; Laws of 2003, ch. 168, § 212. All of these amendments post-date the refund period at issue and, in any event, did not materially alter the language or meaning of the prior version of the statute.

refund claim, sought a return of the sales tax it advanced only in connection with those credit transactions that subsequently became "deductible as worthless for federal income tax purposes." *Puget Sound*, 123 Wn.2d at 287. The financing companies confirmed that they "took a bad debt loss" for the accounts at issue. In other words, the financing companies, in fact, deducted the debts as "worthless" for federal income tax purposes. CP 36 (Thorncroft Dep. at 34:1-4); *see also* CP 292-302 (federal income tax returns). The financing companies supplied detailed information about these write-offs, which Home Depot provided to the State in support of the timing and amount of its refund claim. CP 58-60, 62-63 (Smith Dep. at 39:14-40:2; 41:9-14; 50:7-51:3). Thus, these written-off accounts constituted "worthless" debt that was "deductible" for federal income tax purposes within the meaning of the statute. That should have ended the inquiry.

Because Home Depot satisfied all three requirements under RCW 82.08.037, the trial court should have denied the State's motion for summary judgment and awarded a refund to Home Depot. Instead, it concluded that no refund was due, imposing on Home Depot an additional requirement nowhere to be found in the statute – namely, that Home Depot had to be the party who wrote off that bad debt as a deduction on its own federal income tax return, rather than the tax return of the financing

company who serviced Home Depot's credit program and admittedly took such bad debt deductions. The trial court's conclusion was contrary to the plain language of the RCW and must be reversed.

C. The Trial Court Erred In Concluding That Home Depot Did Not Qualify For A Refund Under RCW 82.08.037.

The State denied Home Depot's refund claim on the ground that RCW 82.08.037 should be read as requiring "that only a retailer that wrote off the bad debt for its federal income taxes can claim a refund." CP 363 (State's reply brief). The State's proffered interpretation – which the trial court apparently accepted – is wrong. The statute contains no such requirement. In fact, its express language, its applicability to Home Depot as the party who actually bore the bad debt losses here, and public policy all compel the opposite result: Home Depot is entitled to this refund.

1. The Plain Language Of RCW 82.08.037 Does Not Require The Seller To Write Off The Worthless Debt At Issue.

The plain text of RCW 82.08.037 refutes the trial court's conclusion that "debts which are deductible" must actually be written off, and that the seller itself must write them off in order for the seller to qualify for a refund. To begin with, under the statute's express language, there is no requirement that a deduction for federal income tax purposes be taken by anyone. The statute only references debts "which are deductible" – in other words, debts that a taxpayer is permitted to deduct under the

Internal Revenue Code, and not debts that have, in fact, been deducted. Here, such debts were not only "deductible," but they were actually deducted. Hence, the statutory requirement was clearly satisfied.

In addition, on its face, the statute does not require that the "seller" itself necessarily write off "debts which are deductible as worthless." The term "seller" defines the individual or entity that is entitled to a refund, while the term "debts which are deductible as worthless for federal income tax purposes" simply defines the circumstance permitting a "refund for sales taxes previously paid." *See id.* The two statutory terms are not actually linked.

Moreover, nothing in the statute suggests that the Legislature intended to limit refunds only to sellers who actually wrote off the worthless debt in question themselves. Indeed, the statutory intent clearly seems broader: to afford a sales tax refund to any seller who paid sales tax on behalf of a buyer who ultimately failed to pay for the sale and the tax on that sale.⁵ For these reasons, the trial court erred in grafting this unwritten "requirement" onto the statute. *G-P Gypsum Corp. v. Dep't of*

⁵ Washington's Legislature is perfectly capable of implementing its intent on matters of sophisticated tax policy. For example, when the Legislature wished to shift the burden of excise taxes from buyers onto sellers, it did so by modifying the relevant statute. *See, e.g., High Tide Seafoods v. State*, 106 Wn.2d 695, 698, 725 P.2d 411 (1986).

Revenue, ___ Wn. App. ___, 183 P.3d 1109, 1112 (2008) (noting that courts "cannot add language to an unambiguous statute even if [they] believe that the Legislature intended something other than what it expressed").

2. Home Depot Bore All Losses Relating to Bad Debt.

In arguing that Home Depot was required to deduct bad debt losses in order to qualify for a refund under RCW 82.08.037, the State also contended that only GE suffered a loss when an account proved to be uncollectible. CP 14-15 (State's Motion for Summary Judgment). The seller's losses are not a relevant consideration under RCW 82.08.037, *see Puget Sound*, 123 Wn.2d 284, 287; yet even if they were, the testimony of GE and Home Depot's witnesses was uniform and uncontroverted: Home Depot, and Home Depot alone, bore the loss for its customers' worthless debts. Thus, it should have been awarded a refund. At a minimum, Home Depot's evidence that it bore all losses created an issue of material fact that should have precluded summary judgment in the State's favor. *See Homestreet*, 139 Wn. App. at 838.

The State claims that, because Home Depot and GE agreed in their contracts that GE owned the accounts and would bear the loss for defaults, only GE bore the loss resulting from bad debt. CP 15 (State's Motion for Summary Judgment). The trial court apparently agreed, even though both parties to those contracts testified that Home Depot exclusively bore such

loss. In negotiating their agreement, the parties understood that some customers purchasing on credit would default. CP 32-33 (Thorncroft Dep. at 26:23-27:3 (explaining that GE "determine[s] what [their] costs are going to be . . . [including] obviously, losses because not everybody pays [GE].")); CP 40-41. Home Depot and GE therefore "incorporated the anticipated bad debt expenses into the pricing [they] created as [they] negotiated the agreement." CP 35; CP 41-42 (Thorncroft Dep. at 74:2-74:4); *see also* CP 71-72 (Ryser Dep. at 41:1-6: Q. "You understood that the fee charged by [GE] included reimbursement to [GE] for customer bad debt?" A. ". . ., yes."). The "fees and [the] income stream that [was] . . . generated by the portfolio covered [GE's] costs and bad debt losses." CP 35 (Thorncroft Dep. at 30:22-30:24); *see also* CP 33-34, 36, 41 (Thorncroft Dep.) (explaining that the fact that GE's total compensation from Home Depot exceeded its actual worthless debt losses for the refund period demonstrates that Home Depot, not GE, "bore the costs" and paid for the bad debt).⁶

⁶ In an effort to neutralize this uniform testimony that Home Depot bore all bad debt losses, the State cites a single line in Home Depot's lengthy agreement with the financing company to the effect that those credit losses "shall be solely borne at the expense" of the financing company. CP 15. It would misconstrue the import of the parties' entire agreement to take that single sentence out of context. The consistent testimony of witnesses on both sides of the transaction confirmed that Home Depot's arrangement with its financing company was structured to, (continued . . .)

Accordingly, even if Home Depot were required to show that it incurred the loss from its customers' worthless debt in order to qualify for a refund, it did so. At the very least, Home Depot raised a genuine issue of material fact that precluded summary judgment in the State's favor.

3. The State's Interpretation Of RCW 82.08.037 Is Contrary To Public Policy.

The trial court's ruling not only ignored the text of RCW 82.08.037 and the evidence of Home Depot's losses, but it also violated the public policy underlying the statute. In Washington, sales taxes are imposed on the buyer, based on the "selling price" of a retail sale. RCW 82.08.010 & .020. Thus, in a credit sale, the seller is required to remit the full amount of sales tax to the State even when the buyer does not pay the tax at the time of sale. *Id.*; *Morrison-Knudsen Co. v. Dep't of Revenue*, 6 Wn. App.

(. . . continued)

and did, in fact, more than fully compensate the financing company for any bad debt losses. The agreement included this requirement that the financing companies bear the loss at the time of the customer's default simply because they were fully compensated by Home Depot in advance for those credit losses. This provision, therefore, merely prevented GE from recovering those costs twice. In any event, a contract cannot be interpreted in a way that violates the understanding of its own signatories. In construing a contract, "the intention of the parties must control . . . and the interpretation which the parties to a contract have placed on it will be given great, if not controlling, weight." *Kennedy v. Weyerhaeuser Timber Co.*, 54 Wn.2d 766, 768, 344 P.2d 1025 (1959); *see also* Restatement (Second) of Contracts § 201(1) (1981) ("Where the parties have attached the same meaning to a promise or agreement or a term thereof, it is interpreted in accordance with that meaning.").

306, 312, 493 P.2d 802 (1972). Ultimate liability for the sales tax, however, remains with the buyer. *Id.*; RCW 82.08.050; *see also GTE Commun. Sys. Corp. v. Dep't of Revenue*, 49 Wn. App. 532, 535, 744 P.2d 638 (1987) (citing RCW 82.08.050).

Consistent with that fundamental tenet of Washington tax law, the Legislature enacted RCW 82.08.037 to prevent the unjust enrichment of the State that would occur if it were to retain taxes paid by the seller on the buyer's behalf when that buyer subsequently defaulted on a credit sale and never the paid sales tax owed. Specifically, RCW 82.08.037 addressed this issue by returning to sellers, dollar-for-dollar, sales taxes never paid by defaulting buyers. In this way, the seller who advanced the sales tax is made whole, and the State does not tax a share of revenue for sales that did not occur.

The policy supporting this result is the same regardless of whether a seller or the seller's contracted financing company writes off the uncollectible account as worthless. Either way, the seller advanced the sales tax and bore the economic consequence of the buyer's failure to pay for the purchase and the tax. In order for the statute's purpose to be fulfilled, the seller must qualify for a refund because the financing company, never having remitted any sales tax to the State, cannot. Otherwise, the RCW would create an untenable "Catch-22": neither the

retailer who remitted the tax and bore the losses (but, according to the State, did not take a federal income tax deduction), nor the financing company that serviced the credit accounts (but did not make any retail sales or remit any tax to the State), would qualify for the refund that the Legislature clearly intended. This would unjustly enrich the State, leaving it with exactly the type of "financial windfall" that the Supreme Court of Washington has specifically disallowed in a case interpreting the same bad debt statute at issue here. *See Puget Sound*, 123 Wn.2d at 290 (holding that bank that purchased installment contracts and was assigned all rights thereunder by automobile dealers was entitled to sales tax refund, and observing that "any other rule is inequitable and entitles the State to a financial windfall").⁷

⁷ How sellers contractually allocate their credit programs for buyers with third-parties should not concern the State. Indeed, the ability of private parties to allocate the costs of taxation in their contracts has allowed other Washington excise tax statutes to survive discrimination claims. *See State v. De Watto Fish Co.*, 100 Wn.2d 568, 576, 674 P.2d 659 (1983) (quoting *Washington v. United States*, 460 U.S. 536, 542 n.4, 103 S.Ct. 1344, 1348 n.4, 75 L.Ed.2d 264 (1983) ("Thus, it makes no difference to the contractor (or to the purchasers) which of them is required to pay the tax to the State, as long as they have the opportunity to allocate the burden among themselves by adjusting the price."). The State's concern is that buyers pay the required sales tax on purchases.

4. The State's Construction of The Statute Violates The U.S. And Washington Constitutions.

The State's denial of a refund violates the Equal Protection and Due Process Clauses of the United States Constitution, and the Washington Constitution's prohibition on discriminatory allocation of privileges and immunities. *See* U.S. Const. amend. XIV; Wash. Const. art. I, § 12 ("No law shall be passed granting to any citizen, class of citizens, or corporation other than municipal, privileges or immunities which upon the same terms shall not equally belong to all citizens, or corporations.").

This Court is obligated to avoid interpretations of its laws raising serious constitutional questions. *See Frisby v. Schultz*, 487 U.S. 474, 483, 108 S.Ct. 2495, 2501, 101 L.Ed.2d 420 (1988) (in interpreting state statutes, noting "well-established principle that statutes will be interpreted to avoid constitutional difficulties"); *Clark v. Martinez*, 543 U.S. 371, 380-81, 125 S.Ct. 716, 724, 160 L.Ed.2d 734 (2005) ("when deciding which of two plausible statutory constructions to adopt, a court must consider the necessary consequences of its choice. If one of them would raise a multitude of constitutional problems, the other should prevail"). Compliance with that venerated canon presents no difficulty here because the plain language of the statute allows for no other interpretation except

that Home Depot is entitled to a refund. The State's construction of that language is so irrational that it violates the Constitution. There is no rational basis upon which to distinguish between vendors who suffer the same economic loss, merely on the basis of how they account for these bad debt losses on their books.

State tax law violates equal protection if there is no rational basis for the State's classification. *See, e.g., Williams v. Vermont*, 472 U.S. 14, 23, 105 S. Ct. 2465, 2471, 86 L. Ed. 2d 11 (1985) (striking down use tax that discriminated between residents and non-residents of Vermont because "[n]o legitimate purpose . . . is furthered by [the] discriminatory exemption"). Likewise, economic regulation violates due process when it is unduly "harsh or oppressive" or "arbitrary and irrational." *United States v. Carlton*, 512 U.S. 26, 30, 114 S.Ct. 2018, 2021, 129 L.Ed.2d 22 (1994).

The U.S. and Washington Constitutions both guarantee similarly situated persons equal treatment under the law. *See* U.S. Const. amend. XIV; Wash. Const. art. I, § 12. In assessing the constitutionality of tax statutes, Washington courts make three inquiries: (1) whether the classification applies alike to all members within the designated class; (2) whether some basis in reality exists for reasonably distinguishing between those within and without the class; and (3) whether the challenged classification bears any rational relation to the purposes of the

challenged statute. *Associated Grocers, Inc. v. State*, 114 Wn.2d 182, 187, 787 P.2d 22 (1990) (citing *Yakima Cy. Deputy Sheriff's Ass'n v. Board of Comm'rs*, 92 Wn.2d 831, 835-36, 601 P.2d 936 (1979), *appeal dismissed*, 446 U.S. 979, 100 S.Ct. 2958, 64 L.Ed.2d 835 (1980)); *see also State v. Coria*, 120 Wn.2d 156, 171-72, 839 P.2d 890 (1992) ("Under the rational basis test, a legislative classification will be upheld 'unless it rests on grounds wholly irrelevant to the achievement of legitimate state objectives.'") (quoting *Omega Nat'l Ins. Co. v. Marquardt*, 115 Wn.2d 416, 431, 799 P.2d 235 (1990)).

The State's construction of the RCW here would impermissibly result in different applications within the same designated class of sellers. It discriminates against sellers such as Home Depot who use third-party financing companies to administer their credit arrangements, denying them the ability to reclaim sales tax remitted to the State even though they incur the same economic loss as sellers who service their own credit accounts. On that basis alone, the State's construction of this sales tax refund statute is unconstitutional. *Associated Grocers, Inc.*, 114 Wn.2d at 188 ("Where, as here, there is but one class, and the members of it are taxed differently, the statute[s] [interpretation] must be declared unconstitutional. It is not necessary to consider the second and third inquiries under the *Yakima County* test.").

Second, the State's inequitable treatment of Home Depot does not stem from the economic "reality" of Home Depot's position. *Associated Grocers*, 114 WN.2d at 187. A retailer who administers and services its own accounts is eligible for a refund under the bad debt refund statute when customers default because it did not exchange any money with a servicing company at the point of sale. As previously explained, Home Depot suffers the exact same loss on an aggregate, portfolio-wide basis.

Finally, there can be no rational basis for providing a sales tax refund to retailers who issue in-store revolving credit, on the one hand, but denying such a refund to the many retailers who contract with national credit card services to administer their credit programs, on the other hand, when both bear all losses associated with bad debt. *Cf. Stewart Dry Goods Co. v. Lewis*, 294 U.S. 550, 55 S.Ct. 525, 79 L.Ed. 1054 (1935) (finding no rational basis for law imposing higher sales taxes on businesses with higher "gross receipts" where gross receipts bore no rational relationship to the net profits of companies subject to the tax). If a regulation burdens one class in particular, "then, in order to satisfy constitutional requirements, the regulation of those within the class, as distinguished from those excluded therefrom, must tend to accomplish the object of the statute." *Sonitrol Northwest, Inc. v. City of Seattle*, 84 Wn.2d 588, 592, 528 P.2d 474 (1975). Not only does the State's construction

here fail to "accomplish the object of the statute," but it wholly defeats the purpose of the statute. *Id.* The Legislature plainly intended to allow retailers to recoup sales tax payments on credit sales where customers ultimately default. The State's construction, in contrast, would serve only to unjustly enrich the State with massive sales tax revenues advanced by retailers on behalf of purchasers who failed to pay and, thus, did not bear their statutory burden of paying sales tax. *See* RCW 82.08.050.

Accordingly, the State's statutory construction violates Equal Protection, Due Process, and the Privileges and Immunities provisions of the Washington Constitution.

V. CONCLUSION

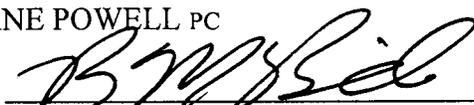
This Court should reverse the trial court's grant of summary judgment and direct the State to award Home Depot a refund or, alternatively, remand for further proceedings.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on September 19, 2008, I caused to be served a copy of the foregoing **BRIEF OF APPELLANT** on the following person(s) in the manner indicated below at the following address(es):

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