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Division II
State of Washington

NO. 50409-0-II

**COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON**

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent,

v.

GAMESTOP, INC. and SOCOM, LLC,

Appellants.

CORRECTED OPENING BRIEF OF RESPONDENT DEPARTMENT OF REVENUE

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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 or used car, the selling price of the car being sold to the customer is reduced by the value of the trade-in. This case addresses the application of the "trade-in exclusion" in the specific context of retail sales of video games and gaming equipment.

By its very terms, the "trade-in exclusion" does not apply to all barter or trade transactions. To qualify, the customer's trade-in property must be "separately stated," must be of "like kind" to the property being purchased, and must be delivered to the seller as consideration for the property being purchased. These requirements are found not only in the statute's plain language, but also in the Department of Revenue's administrative rule implementing the trade-in exclusion, WAC 458-20-247 (Rule 247).

The Board of Tax Appeals broadly construed and applied the trade-in exclusion when it granted the administrative appeal filed by Appellants GameStop Inc. and its related affiliate, SOCOM LLC, who were contesting

audit assessments issued by the Department of Revenue. Although the trial court reversed the Board's decision, concluding that the Board misapplied the law, this Court reviews the Board's decision, not the trial court's decision. Consequently, the burden falls on the Department to again establish that the Board erred.

The Board misapplied the trade-in exclusion in three respects. First, it misapplied the law when it concluded that video game hardware and video game software are property of "like kind" within the meaning of the statute and Rule 247. Second, it misapplied the law when it concluded that the trade-in exclusion applies to a purchase of merchandise through the redemption of a "trade-in credit" derived in a prior transaction. Third, it misapplied the law when it concluded that the statute's "separately stated" requirement had been met when sales documents pertaining to the purchase of merchandise listed only the amount of a trade-in credit, not information about the actual property from which the credit was derived. For each of these reasons, the Board's final decision should be reversed.

II. ASSIGNMENTS OF ERROR

1. The Board of Tax Appeals erred when it concluded that the GameStop affiliates had met their burden of proving that the retail sales transactions at issue "come[] within the trade-in exclusion set forth in RCW 82.08.010(1)(a)(i)." AR 034, Issue statement.

2. The Board of Tax Appeals erred when it found that "[a] customer who chooses to receive in-store credit is choosing to trade his or her used merchandise for new or used in-store merchandise." AR 036, Finding of Fact 12.

3. The Board of Tax Appeals erred to the extent it found that the separate statement requirement set out in RCW 82.08.010(1)(a)(i) is met when the customer is provided a sales invoice that "states the separate amount of the trade-in credit that is being applied as an offset." AR 037, Finding of Fact 15.

4. The Board of Tax Appeals erred when it concluded that the requirement in RCW 82.08.010(1)(a)(i) that trade-in property must be "separately stated" is to ensure the "clear identification of the nontaxable portion of the sales transactions." AR 039, Conclusion of Law 7, including subparts 7.1 and 7.2.

5. The Board of Tax Appeals erred when it concluded that the trade-in property received by the GameStop affiliates from their customers was "separately stated" within the meaning of RCW 82.08.010(1)(a)(i) because the "sales documents separately identify the consideration derived from the trade-in property." AR 040, Conclusions of Law 8.

6. The Board of Tax Appeals erred when it concluded that the GameStop affiliates had complied with Rule 247's "separate-statement

requirement because the 'sales documents'—the Taxpayer's [sic] sales receipts and transaction records—separately identified the purchased items and the nontaxable, trade-in property with appropriate identifying information." AR 040, Conclusions of Law 9.

7. The Board of Tax Appeals erred when it concluded that video game hardware and video game software are property of a like kind within the meaning of the statute and Rule 247. AR 040-042, Conclusions of Law 12 through 17.

8. The Board of Tax Appeals erred when it concluded that, in those transactions where a customer purchased GameStop merchandise using a trade-in credit that had been loaded onto the customer's stored value card as part of a prior transaction, the GameStop affiliates satisfied the "single transaction" requirement set out in Rule 247(4). AR 040, Conclusion of Law 9; AR 042-043, Conclusions of Law 18 through 20.

9. The Board of Tax Appeals erred when it concluded that the GameStop affiliates were "entitled to the trade-in exclusion in RCW 82.08.010(1)(a)(i)." AR 043, Conclusion of Law 21.

10. The Board of Tax Appeals erred when it ordered the Department to modify the tax assessments issued to the two GameStop affiliates. AR 044, Decision.

III. ISSUES PRESENTED

1. *Issue pertaining to Assignments of Error 1, 7, 9 and 10*: Did the Board of Tax Appeals err in concluding that video game hardware and video game software are property of a "like kind" within the meaning of RCW 82.08.010(1)(a)(i) and Rule 247(5)?

2. *Issue pertaining to Assignments of Error 1, 6, 8, 9, and 10*: 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 Rule 247(4) had been met?

3. *Issue pertaining to Assignments of Error 1, 2, 3, 4, 5, 9, and 10*: 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, and the sales invoice listed only the amount of the credit and not information about the used merchandise GameStop previously purchased from the customer to generate the credit, did the Board of Tax Appeals err in concluding that "separately stated" requirement set out in RCW 82.08.010(1)(a)(i) had been met?

IV. STATEMENT OF THE CASE

A. Statutory Background

Washington imposes a retail sales tax on sale of tangible personal property to consumers, measured by the "selling price" of the property sold. RCW 82.08.020. The tax is imposed on the buyer but collected by the retail seller. RCW 82.08.050(1). The seller is liable for any uncollected retail sales tax. RCW 82.08.050(3).

The term "selling price" is defined in RCW 82.08.010(1)(a)(i). In 1984 the citizens of Washington passed Initiative 464, which amended the definition of "selling price" to exclude "trade-in property of like kind." *See* Laws of 1985, ch. 2. Prior to that amendment, the value of trade-in property was included as part of the selling price paid by the buyer. *See Olympic Motors, Inc. v. McCroskey*, 15 Wn.2d 665, 671, 132 P.2d 355 (1942) ("When a seller takes used articles in trade [that] 'trade-in' constitutes a portion of the consideration paid by the purchaser to the seller.")

The Legislature amended RCW 82.08.010(1)(a)(i) in 2004 to limit the trade-in exclusion to "separately stated" property of like kind. Laws of 2004, ch. 153, § 406. As amended, RCW 82.08.010(1)(a)(i) provides that the term "selling price" means "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

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

GameStop Corp. offers a 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 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 GameStop trade-in program also allows the company to acquire "an inventory of used video game products which we resell to our 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 cash or for a store credit. Tr. at 13-14. Customers who choose to receive cash are paid less for their property than customers who choose to receive store credit. Tr. at 14. Store credits can be used as consideration on the immediate purchase of GameStop merchandise, or they can be loaded onto a stored value card to be used by the customer at a later date. *Id.*

When a customer uses the store credit on the immediate purchase of new or used merchandise, the sales invoice identifies the trade-in property that the customer delivered to GameStop as consideration for the property being purchased from GameStop. AR 037; *see also* AR 232 (representative sales invoice listing the used video games delivered to GameStop and the video games purchased from GameStop). Thus, the "separately stated" and "consideration for" requirements of RCW 82.08.010(1)(a)(i) and Rule 247(4) are met when the customer uses the credit earned from the trade-in of his or her used video game hardware or software on the immediate purchase of GameStop merchandise. The only issue in dispute is whether the trade-in property is of a "like kind" to the property being purchased.

When, however, the trade-in credit is loaded onto a stored value card to be used by the customer at a later date, the sales invoice does not

identify the property 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 magazine subscription and a store credit of $26.61, 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 trade-in property that had been delivered to GameStop in the prior transaction. *See* AR 236 (representative sales invoice showing a "redeemed" store credit of $49.54 being used as consideration for the purchase of a video game without identifying the property the customer delivered to GameStop to generate the credit).

C. The Audit and Assessment of Additional Retail Sales Tax

During the 2006 through 2010 tax periods at issue, GameStop Inc. and SOCOM LLC took the position that everything they sell at their Washington retail stores was "property of like kind" within the meaning of RCW 82.08.010(1)(a)(i), and that the trade-in exclusion applied even when merchandise was purchased through the redemption of a stored credit. AR 324-25; AR 330. Consequently, the GameStop affiliates would systematically exclude the amount of any credit the customer used to purchase merchandise from the taxable sales price of that merchandise.

GameStop did not distinguish between (1) the use of the credit on the immediate purchase of merchandise and (2) the use of the credit at a later date through the redemption of a stored value card. In either situation, the GameStop affiliates would exclude the credit from the measure of the retail sales tax.

The Department audited GameStop Inc. for the January 2006 through December 2010 reporting periods, and audited SOCOM LLC for the January 2008 through December 2010 reporting periods. AR 244; AR 254. In conducting the audits, the Department's auditor reviewed several thousand sales transactions. *See generally* AR 350.[1] The auditor concluded that a number of the transactions qualified for the trade-in exclusion because they involved the trade in of video games or gaming hardware as part of the consideration for the immediate purchase of "like kind" products. AR 246; *see, e.g.,* AR 350, ln. 7 ($132.99 trade-in exclusion allowed for trade in of "Games For Games"). However, the auditor disallowed the trade-in exclusion on those transactions that did not qualify under the Department's interpretation of the statute and Rule 247. As relevant here, the auditor concluded that the GameStop affiliates had improperly claimed the trade-in exclusion with respect to the following:

[1] The document starting at AR 350 is the first ten pages of an approximately 450-page audit workpaper pertaining to the GameStop Inc. audit. *See* Tr. at 76-77.

- Sales transactions where a customer trades in video game software as part of the consideration paid for the immediate purchase of gaming consoles or other gaming hardware (i.e., software for hardware).
- Sales transactions where a customer trades in video game hardware 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. Both companies filed administrative appeals with the Department, contesting the audit finding that the trade-in exclusion did not apply to the sales transactions described above. AR 260; AR 267. The Department consolidated the two appeals and upheld the audit assessments in Determination No. 13-0263. AR 280. The Department also rejected a joint petition for reconsideration. AR 305.

[2] The auditor 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 transactions, and they were not part of the Board of Tax Appeals' review.

D. Board of Tax Appeals Proceedings

Shortly after the Department denied the GameStop affiliates' petition for reconsideration, the affiliates filed a joint appeal to the 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 sales transactions and ordered the Department to revise the tax assessments accordingly. AR 044. The Department timely sought judicial review. CP 4.

E. Superior Court Proceedings

The Thurston County Superior Court reversed the Board of Tax Appeals. CP 38. The Court explained that 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 exclusion applies to a subsequent purchase of merchandise through the redemption of a credit added to a customer's stored value card." CP 44; *see also* VRP 45 (trial court's oral ruling that the Board of Tax Appeal "committed an error of law" when it misapplied the requirements of Rule 247). This appeal followed. CP 48.

V. ARGUMENT

A. Standard of Review

The Administrative Procedure Act (APA) governs judicial review of a formal Board of Tax Appeals decision. RCW 82.03.180; *Dep't of Revenue v. Nord Nw. Corp.*, 164 Wn. App. 215, 223, 264 P.3d 259 (2011). In this APA appeal, the burden of demonstrating the invalidity of the Board's order is on the Department of Revenue because it is the party asserting that the Board erred. RCW 34.05.570(1)(a); Division II General Order 2010-1. This Court may reverse the Board's order if, among other reasons, the Board erroneously interpreted or applied the law, the Board made a finding of fact that is not supported by substantial evidence, or the Board's order is arbitrary and capricious. RCW 34.05.570(3).

An appellate court reviews the administrative agency's decision and "applies the APA standards directly to the administrative record." *Verizon Nw., Inc. v. Employment Sec. Dep't*, 164 Wn.2d 909, 915, 194 P.3d 255 (2008). An agency's legal conclusions are reviewed *de novo* under the error of law standard. *Nord Nw.*, 164 Wn. App. at 223. Findings of fact, on the other hand, are reviewed under the "substantial evidence" standard. *Wilson v. Employment Sec. Dep't*, 87 Wn. App. 197, 200-01, 940 P.2d 269 (1997).

B. The Board of Tax Appeals Misapplied the Law When It Broadly Construed and Applied the Trade-In Exclusion

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. As relevant here, the statute commands that:

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

These statutory limitations are also embodied in the Department's rule implementing the trade-in exclusion. In 1984, shortly after the voters passed Initiative 464, the Department adopted WAC 458-20-247.[3] That Rule provides specific guidance with respect to the trade-in exclusion and

[3] The Department of Revenue administers the sales tax laws of this state and is legislatively authorized to adopt administrative rules interpreting the law. RCW 82.01.060(2); RCW 82.32.300.

the recordkeeping requirements needed to document the transaction.[4] Rule 247 explains that in order to exclude the value of trade-in property from the measure of the sales tax, the trade-in property delivered to the seller must be *of a like kind* to the property being purchased, the trade-in property must be consideration given for the property being purchase as part of a *single transaction*, and the sales documents must *separately state* the tangible personal property being purchased from the trade-in property being delivered to the seller. WAC 458-20-247(2), (4). To substantiate that all requirements for the exclusion have been met, sales documents "executed not later than the date the trade-in property is delivered to the seller" must identify the property purchased and the trade-in property being delivered in exchange. WAC 458-20-247(4).

The phrase "trade-in property of like kind" means tangible personal property of the same generic classification as the property being purchased. WAC 458-20-247(5). Whether tangible personal property is of the same generic classification depends on "the nature of the property and its function or use." *Id.* Thus, for example, a recliner chair is within the same generic classification as a sofa because both items function and are used as furniture. However, the exclusion does not apply to "such things as a motorcycle for a boat, a diamond ring for a television set, a battery for

[4] A copy of Rule 247 is attached as Appendix A.

lumber, computer hardware for computer software, or farm machinery . . . for a car" because these items do not have matching functions or uses. *Id.*

The Board of Tax Appeals misapplied the trade-in exclusion in three ways. First, it erred when it concluded that video game hardware and video game software are property of "like kind" because they "naturally fall within the general classification [of] 'gaming components.'" AR 034 (brief answer to issue 1.b). Second, it erred when it concluded that the exclusion applies to a subsequent purchase of merchandise through the redemption of a credit added to a customer's stored value card in a prior transaction. AR 035 (brief answer to issue 1.c). Third, it erred when it concluded that, in those transactions where a customer purchased GameStop merchandise through the redemption of a credit added to the customer's stored value card in a prior transaction, the sales documents maintained by the GameStop affiliates satisfy the "separately stated" requirement of RCW 82.08.010(1)(a)(i). AR 034 (brief answer to issue 1.a).

1. Gaming hardware and video game software are not property of "like kind" within the meaning of RCW 82.08.010(1)(a)(i) and Rule 247.

The term "trade-in property of like kind" is not defined in the Washington tax code. However, Rule 247(5) provides an express standard for determining whether property qualifies as like kind, namely whether

the trade-in property and the purchased property have a similar "function and use." WAC 458-20-247(5). The gaming hardware and video game software sold by the GameStop affiliates do not meet the function and use standard of Rule 247(5), as the Board implicitly held when it modified that standard to allow the trade-in exclusion with respect to property that meets the Board's newly formatted "interdependent components" test. AR 041 (COL 14.2). But the Board has no authority to modify Rule 247(5). Moreover, in many cases the GameStop merchandise at issue would not qualify for the trade-in exemption under the Board's new "interdependent components" test. For both of these reasons, the Board decision should be set aside.

a. Gaming hardware and video game software do not meet the "function or use" standard set out in Rule 247(5).

As defined in Rule 247(5), the phrase "trade-in property of like kind" means tangible personal property of the same generic classification as the property being purchased. WAC 458-20-247(5). Whether tangible personal property is of the same generic classification depends on "the nature of the property and its function or use." *Id.* The "function or use" standard has been part of Rule 247 since its inception and is designed to confine the definition of "trade-in property of like kind" to property that is a comparable substitute for the property being purchased. *See* Wash. St.

Reg. 85-02-006 (filed 12/21/84) (original version of Rule 247). For example, the trade-in of a sofa as consideration for the purchase of a recliner chair meets the "function and use" standard because they are comparable substitutes falling within the general classification of furniture. By contrast, the trade-in exclusion does not apply to dissimilar items of tangible personal property such as "a motorcycle for a boat, a diamond ring for a television set, a battery for lumber, computer hardware for computer software, or farm machinery . . . for a car." Rule 247(5).

Rule 247(5) expressly provides that computer hardware and computer software are not within the same generic classification. Computer hardware and software may work together in tandem, but are not comparable substitutes for one another. Rather, a computer is "an electronic device that accepts information in digital or similar form and manipulates it for a result based on a sequence of instructions." RCW 82.04.215(1). Computer software, by contrast, is "a set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task." RCW 82.04.215(2). These items do not perform the same function or use and, therefore, are not within the same generic class. *See* DOR Det. No. 91-044, 10 WTD 395 (1990) (holding that computer hardware and computer software are not property of like kind for purposes of the trade-in exclusion because they do not serve the

same purpose).[5] *Cf.* RCW 19.194.010(3)(b) (in a statute imposing record keeping requirements on retail establishments that accept computer hardware as trade-in on the purchase of other computer hardware of greater value, the Legislature specified that "computer hardware" does not include software).

GameStop Inc. and SOCOM LLC conceded in the proceedings before the Board of Tax Appeals that "[t]he Department's distinction between hardware and software may be valid in many situations," but argued that the gaming consoles and video game software it sells are of a like kind because they can both be characterized as "video game components." AR 133-34. The Board of Tax Appeals accepted this argument, concluding that "[g]aming hardware (consoles and controllers) and gaming software (video games) are interdependent components of an integrated system . . . and fall within the general classification of 'gaming components.'" AR 041 (COL 14.2).

GameStop and SOCOM's argument and the Board's conclusion of law are unavailing for two reasons. First, nothing in the administrative record suggests that GameStop Corp. or any of its affiliates actually treat gaming hardware and video game software as both falling within the general class of "video game components." To the contrary, in its audited

[5] A copy of Det. 91-044 is in the administrative record at AR 124.

10-K report, GameStop Corp. explains that its merchandise falls within six broad categories: (1) Video Game Hardware, (2) Video Game Software, (3) Used Video Game Products, (4) PC Entertainment and Other Software, (5) Downloadable Content and Subscriptions, and (6) Accessories and Other Products. AR 341-42. "Video game components" are not among the categories of merchandise GameStop sells.

Moreover, characterizing gaming hardware and video game software as "Video game components" is pure semantics and does not change the underlying nature of the property or its function or use. As the Supreme Court has consistently explained, labels do not control when determining if a tax is owed or a tax exemption applies. *See Budget Rent-A-Car of Wash.-Ore., Inc. v. Dep't of Revenue*, 81 Wn.2d 171, 176, 500 P.2d 764 (1972) ("Whatever label may be applied to the automobiles, their sale falls within the taxation provision and not the exemption provision"); *Group Health Co-op. of Puget Sound, Inc. v. Washington State Tax Comm'n*, 72 Wn.2d 422, 433-35, 433 P.2d 201 (1967) (fees labeled as "medical dues" were not "bona fide dues" within the meaning of the tax statute); *Wasem's, Inc. v. State*, 63 Wn.2d 67, 68-70, 385 P.2d 530 (1963) (refusing to permit a contract between seller and buyer, labeled "bill of lading," to determine taxability of sale to buyer).

The only evidence in the record pertaining to the function and uses of the gaming hardware and video game software sold by GameStop and SOCOM confirms that the hardware and software are not comparable substitutes for one another and, therefore, are not property of a like kind. Specifically, at the hearing before the Board of Tax Appeals, a GameStop Senior Vice President agreed that "[t]oday's gaming systems provide multiple capabilities beyond gaming. Most current hardware platforms . . . have the potential to serve as multi-purpose entertainment centers by providing DVD and music playback, movie streaming and interactions with other home entertainment products." Tr. at 44-45 (cross examination of GameStop Senior Vice President Michael Nichols, who acknowledged and agreed with a quotation from the GameStop 2011 10-K report).[6] Video game software performs none of the functions or uses of video game hardware. *See* Tr. at 45-46 (Mr. Nichols confirms that the video game Call of Duty can perform none of the functions or uses of a Sony PlayStation).

The Board erred when it ignored the uncontested evidence pertaining to the dissimilar function and use of gaming hardware and

[6] The quoted statement from the 2011 10-K report is in the administrative record at AR 337. That section of the GameStop 10-K report goes on to explain that "[t]he Nintendo Wii also allows for movie streaming. In addition, the Sony PlayStation 3 and PSP, the Nintendo DSi, DSi XL and Wii and Microsoft Xbox 360 all provide internet connectivity and the Sony PlayStation 3 plays Blu-ray discs." AR 337.

video game software. It also erred when it misapplied Rule 247(5), which expressly provides that computer hardware and computer software are not property of like kind. Had the Board correctly applied the Rule's express language, it would have upheld the Department's determination that the gaming hardware and software sold by GameStop Inc. and SOCOM LLC are not property of a like kind. *See* AR 285-87 (relevant portion of Department determination number 13-0263 issued to the GameStop affiliates, applying Rule 247(5) as written). The Board's decision to ignore the uncontested evidence and key portions of Rule 247(5) should be set aside.

b. Gaming hardware and video game software in many cases will not meet the Board's new "interdependent components" standard.

Rather than fairly apply Rule 247—which expressly provides that computer hardware and computer software are not property of a like kind—the Board of Tax Appeals created a dubious dichotomy between "unrelated items of hardware and software" on the one hand and "interdependent" hardware and software on the other hand. AR 041 (COL 14.1-14.2). Presumably "unrelated" items of hardware and software would not qualify as property of like kind under the Board's reasoning. However, the Board concluded that "the computer hardware and software at issue in the present appeal" did qualify as property of like kind because the

"hardware (consoles and controllers) and gaming software (video games) are interdependent components of an integrated system." AR 041 (COL 14.2). The Board's legal reasoning was flawed.

The primary problem with its analysis is that Rule 247(5) does not contain an "interdependent component" standard for determining whether property is of a like kind. The Board of Tax Appeals simply grafted that standard into the Rule. But the Board has no authority to add language to a Department administrative rule, or to modify the tax policy of this state.

The Board was created in 1967 in order to provide a "convenient and economical form [sic] in which the appeals of individual taxpayers may be determined." Laws of 1967, 1st Ex. Sess., ch. 26, § 1. The Board has the statutory authority to decide a variety of tax appeals and is empowered to "make findings of fact and prepare a written decision in each case decided by it . . . ." *Id.* at § 39 (codified at RCW 82.03.100). However, its role is limited to that of a quasi-judicial adjudicative body. It is not authorized to create or establish the tax policy of the state. *See id.* at §§ 31-48 (setting out Board's powers and duties). Moreover, nothing in the 1967 act that created the Board of Tax Appeals, or any subsequent amendment to that act, suggests that the Board is empowered to ignore, modify, or invalidate administrative rules issued by the Department of

Revenue. Only courts have the authority to invalidate administrative rules. RCW 34.05.570(2).

As noted above, the authority granted to the Board of Tax Appeals is limited to adjudicating tax disputes. RCW 82.03.100. The Board acted outside its express and implied authority when it modified Rule 247(5) to permit "interdependent" computer hardware and software to qualify as property of a like kind.

In addition, even if the Board of Tax Appeals had the authority to modify Rule 247, the undisputed evidence and the Board's own findings of fact establish that gaming hardware and video game software sold by the GameStop affiliates are often not "interdependent" with one another. Most notably, in finding of fact number 5 the Board explained that "Microsoft, Sony, and Nintendo produce their own consoles and controllers, as well as their own video-game software. Each company's hardware products are designed to be used *exclusively with that company's software products*. For example, Microsoft gaming products cannot be used interchangeably with Sony gaming products, and vice versa." AR 35 (FOF 5) (emphasis added). Thus, the trade of a Sony "video game component" as consideration for the purchase of Microsoft component would not qualify as property of like kind under the Board's "interdependent component" test. Nor would the trade of Sony for

Nintendo, Microsoft for Nintendo, or any combination of these discordant gaming products.[7]

Ample evidence in the record supports the Board's finding that the gaming systems offered for sale by GameStop are not "interdependent" with one another. During the hearing before the Board, a GameStop District Manager confirmed that modern video game systems actually are designed to prevent consumers from mixing components from various systems.

> Q. (By Ms. Radosevich) So let's go over some of that. Can I mix and match consoles, controllers and games from different manufacturers?
>
> A. [By Randy McDowell, GameStop District Manager] No, you could not go to your friend's house with your Xbox 360 game and play it on his PS3. You have to stay in the various consoles.
>
> Q. Even if, say, Call of Duty might be offered on both platforms?
>
> A. Yeah, it would still have to be Call of Duty for the Xbox 360 in this example.

---

[7] The trial court recognized the "logical inconsistency" of the Board's reasoning, commenting that under the Board's interdependent components standard "Halo for Xbox could not be traded in for a PS 4 gaming system." VRP at 44.

Q. Okay. Can I mix and match components from various versions that are made by the same manufacturer?

A. You cannot do that either. They've got that worked out pretty well as manufacturers. You've got to upgrade. . . .

Q. Okay. . . . [B]ut I can interchange with somebody else who owns the same version from the same manufacturer?

A. Correct.

Tr. at 66.

Under the Board's reasoning, only those transactions involving the trade of "Microsoft for Microsoft," "Sony for Sony," or "Nintendo for Nintendo" would qualify for the trade-in exclusion. But the GameStop affiliates offered no evidence during the administrative proceedings seeking to identify which sales transactions reviewed as part of the audit and listed in the audit workpapers would actually qualify for the trade-in exclusion under the Board's standard. Consequently, the affiliates have not established that they are entitled to any relief from the sales tax assessments. *Cf.* RCW 82.32.180 (in a refund action in superior court, "the burden shall rest upon the taxpayer to prove that the tax as paid by the

taxpayer is incorrect, either in whole or in part, and to establish the correct amount of the tax").[8]

The Board of Tax Appeal erred when it added an "interdependent component" standard to Rule 247(5) and when it misapplied undisputed evidence presented at the hearing. Video game hardware and software do not qualify as property of a like kind under the "function or use" standard set out in Rule 247(5) and, in many cases, would not even qualify under the "interdependent component" standard the Board improperly added to that Rule. As a result, the Board's final decision should be set aside.

2. Because a credit is not trade-in property, the trade-in exclusion does not apply to purchases made with a stored credit.

The Board of Tax Appeals broadly applied the trade-in exclusion, permitting the GameStop affiliates to claim the exclusion with respect to sales occurring days, weeks, or even years after a customer trades his or her used merchandise in exchange for a credit. In doing so, the Board ignored or misunderstood the statute's requirement that the trade-in property must be delivered to the seller as *consideration* for the property being purchased. The Board also misapplied Rule 247(4), which provides that trade-in property must be delivered to the seller as part of a single

[8] The Board of Tax Appeals typically adheres to the statutory standard that a taxpayer contesting the assessment of excise tax "bears the burden of showing that the Department's assessment is incorrect." *Jersey's All American Sports Bar, Inc. v. Dep't of Revenue*, Docket No. 99-15, 2001 WL 1798528 at 6 (Bd. Tax App. 2001).

purchase-sale transaction to qualify for the exclusion. The redemption of a stored credit as consideration for the purchase of GameStop merchandise does not qualify for the trade-in exclusion under the statute and Rule.

a. The trade-in property must be part of the consideration for property being purchased, not for a credit toward a future purchase.

The trade-in exclusion does not apply to all barter or trade transactions that occur in this state. Rather, the statute imposes limits. In addition to being limited to the trade-in of property of a "like kind" to the property being purchased, the statute also makes clear that the retail seller receiving the trade-in property must do so as *consideration* for the property being sold. *See* RCW 82.08.010(1)(a)(i) (excepting separately stated trade-in property of like kind from "the total amount of consideration . . . received in money or otherwise"). It logically follows from the ordinary meaning of the statute's language that the trade-in property received by the retail seller must be part of the same transaction in which the purchased property is acquired by the customer.

This logical interpretation of the statute is expressly stated in Rule 247(4), which provides:

> **Trade-in as consideration**. Property traded in must be consideration delivered by the buyer to the seller. . . . This does not require simultaneous transfers of the property being traded in and the property being purchased, but it does require that the delivery of the trade-in and the purchase be components of a

> single transaction. Sales documents, executed not later than the date the trade-in property is delivered to the seller, must identify the property purchased and the trade-in property as more fully explained in subsection (8) of this section.

WAC 458-20-247(4).

The Rule explains that the trade-in property delivered to the merchant must be part of a single transaction documented "not later than the date the trade-in property is delivered to the seller." Simply setting aside the proceeds derived from the trade-in of merchandise for use as consideration in a subsequent purchase is not sufficient, as explained in Rule 247(4), example (c). In that example, amounts owed to a customer on the trade-in of a sailboat were held by the merchant in trust to be used for a possible future purchase of a yacht. *Id.* Sometime later the subsequent purchased was consummated and the proceeds held in trust were applied to the selling price of the yacht. The trade-in exclusion does not apply under these hypothetical facts because the delivery of the sailboat and the subsequent purchase of the yacht were not components of a single transaction. *Id.*

The facts here are similar. The only difference is that GameStop and SOCOM load the amounts owed to a customer from the trade-in of used merchandise onto a stored value card rather than holding the funds in trust. But the underlying point of the example remains: the trade-in

exclusion does not apply when the trade-in of used merchandise and the subsequent purchase of different merchandise are not part of the same purchase-sale transaction.

b. The Board of Tax Appeals misread and misapplied Rule 247(4).

The Board of Tax Appeals derived an entirely different meaning from the language of Rule 247(4), concluding that the "single transaction" requirement is met in those circumstances when a customer purchased GameStop merchandise using a trade-in credit that had been loaded onto the customer's stored value card at a prior date. AR 042-043 (COL 18 - 20). According to the Board, the "single transaction" requirement only prohibits the use of a stored credit as consideration for the purchase of separately stated property of like kind when the credit is "contingent on an intermediate transaction." AR 043 (COL 19). But the Rule says no such thing. The Board simply recasts the Rule's express language that the delivery of the trade-in property and the purchase of the like-kind property must be "components of a single transaction" as requiring only the lack of a "contingent . . . intermediate transaction." *Id.* The Board reached its erroneous conclusion by misreading examples provided in Rule 247(4).

The Board asserted in its final decision that the examples in Rule 247(4) provide that the single transaction requirement "is *not met* if the

trade-in transaction is contingent upon a separate transaction, such as a consignment sale." AR 042 (COL 18.4) (emphasis added). From this initial premise, the Board then concluded that the separate transaction requirement is met so long as there is no separate "contingent" transaction. AR 043 (COL 19). The Board's analysis is based on a logical fallacy. It presumes that there is only one possible circumstance in which the Rule's single transaction requirement will be unfulfilled—when there is a "contingent intermediate transaction." A closer review of the Rule's actual language disproves the Board's premise.

It is true that the trade-in exclusion will not apply when a customer delivers property to a merchant in a contingent sale transaction such as a consignment sale, as explained in Rule 274(4) example (a). In that example, "Jane Doe offers to purchase Sailboat A from Dealer, if Dealer accepts her Sailboat B as a trade-in on the purchase." *Id.* Had Dealer accepted Jane Doe's offer, the single transaction requirement in Rule 247(4) would have been met. But Dealer rejected the offer and instead proposed a counter whereby Dealer "offers to sell Sailboat B on a consignment basis with the net proceeds to be applied toward the purchase if Sailboat B is sold within three months." *Id.* Jane Doe accepts the counter-offer. However, under these facts "Jane is not entitled to the trade-in exclusion" because the agreement to sell her Sailboat B on consignment

"does not constitute consideration 'paid or delivered by a buyer to [the] seller.'" *Id.*

The example does not create a limitation to the single transaction requirement. Rather, it explains one circumstance where the requirement is not met—where the property delivered pursuant to the contingent sale agreement is not "consideration" for the property being purchased. It does not follow that if the facts described in example (a) are not present, the single transaction requirement is met. This point is aptly made in example (c), which was previously discussed above at page 28. In that example, amounts owed to a customer from a consignment sale were held by the merchant in trust to be used for a possible future purchase of a yacht. Rule 247(4)(c). Under that fact pattern, the transaction did not qualify for the trade-in exclusion for two reasons. First, "[t]he delivery of Mr. B's sailboat to [merchant] and Mr. B's purchase of the yacht [from merchant] are not components of a single transaction." *Id.* Second, "Mr. B's delivery of his sailboat for consignment sale . . . does not constitute consideration 'paid or delivered by a buyer to a seller,' even if proceeds from the sale are applied to the purchase of the yacht." *Id.*

Example (c) to Rule 247(4) makes clear that a contingent sale is not the only circumstance where the requirements necessary to obtain the tax benefit of the trade-in exclusion are lacking. The requirements are also

lacking where, as here, the receipt of used merchandise by the retailer in exchange for a credit is not a component of the same transaction in which the customer purchases merchandise through the redemption of the credit. The Board of Tax Appeals misunderstood this point, and its conclusion that the single transaction requirement had been met with respect to the redemption of a stored credit as consideration for the "later purchase of 'gaming equipment'" should be rejected. *See* AR 043 (COL 19).

c. Rule 247(4)'s single transaction requirement is entitled to considerable deference.

"While the ultimate authority for determining a statute's meaning remains with the court, considerable deference will be given to the interpretation made by the agency charged with enforcing the statute." *Nord Nw.*, 164 Wn. App. at 229 (quoting *S. Martinelli & Co., Inc. v. Dep't of Revenue*, 80 Wn. App. 930, 937, 912 P.2d 521 (1996)) (internal quotation and citation omitted); *see also Smith v. Employment Sec. Dep't*, 155 Wn. App. 24, 32, 226 P.3d 263 (2010) (courts give "substantial weight to the agency's interpretation of statutes it administers"). The "paramount concern" when considering an agency's interpretation of a statute it is charged with enforcing is to ensure that the interpretation is being applied "in a manner that is consistent with the underlying policy of the statute." *Nord Nw.*, 164 Wn. App. at 229 (quoting *Overlake Hosp.*

Ass'n v. Dep't of Health, 170 Wn.2d 43, 52, 239 P.3d 1095 (2010)). Additionally, as our Supreme Court explained when affirming the validity of a Department of Labor and Industries administrative rule, "[t]he Legislature's failure to amend a statute interpreted by administrative regulation constitutes legislative acquiescence to the agency's interpretation of the statute. This is especially true when the Legislature has amended the statute in other respects without repudiating the administrative construction." *Manor v. Nestle Food Co.,* 131 Wn.2d 439, 445 n.2, 932 P.2d 628, 945 P.2d 1119 (1997) (citation omitted).

Rule 247(4) provides in relevant part that "[p]roperty traded in must be consideration delivered by the buyer to the seller. . . . This does not require simultaneous transfer of the property being traded in and the property being purchased, but it does require that the delivery of the trade-in and the purchase be components of a single transaction." That requirement has been part of Rule 247 since 2001. *See* Wash. St. Reg. 01-08-003 (filed 3/21/2001). Although RCW 82.08.010(1) has been amended several times since 2001, none of those amendments suggest in any way that the Legislature was dissatisfied with the Department's construction of the statute as permitting the exclusion only when the trade-in property is delivered to the merchant as part of a single transaction. For this reason, the Board of Tax Appeals should have respected and fairly applied the

Department's construction of the statute as set forth in Rule 247(4). *See In re Sehome Park Care Ctr.*, 127 Wn.2d 774, 779-81, 903 P.2d 443 (1995) (Supreme Court "decline[d] to disturb" a longstanding interpretive rule pertaining to a businesses and occupation tax exemption); *N. Cent. Wash. Respiratory Care Servs., Inc. v. Dep't of Revenue*, 165 Wn. App. 616, 631, 268 P.3d 972 (2011) (Court adhered to the Department's longstanding construction of a sales tax exemption statute).

The Board of Tax Appeals erred as a matter of law when it failed to fairly construe and apply Rule 247(4), and this Court should set aside the Board's erroneous decision. *See Nord Nw.*, 164 Wn. App. at 234 (Board of Tax Appeals reversed on appeal where the Board failed to fairly apply a Department administrative rule detailing the requirements a contractor must meet to qualify as a "speculative builder").

d. The out-of-state authority relied on by the Board of Tax Appeals does not reflect Washington law.

The Board of Tax Appeals found support for its reading of the Washington statute and Rule from a Louisiana Court of Appeals decision applying Louisiana law. *See* AR 043 (COL 20 and footnote 23, citing *GameStop, Inc. v. St. Mary Parish Sales & Use Tax Dep't*, 166 So.3d 1090 (La. Ct. App. 2015)). The Board's reliance on out-of-state authority

rather than the express terms of RCW 82.08.010(1)(a)(i) and Rule 247(4) led to an incorrect legal conclusion and misapplication of Washington law.

GameStop and SOCOM argued below that the Board should reject the "single transaction" requirement set out in Rule 247(4) and, instead, apply Louisiana and Florida law. AR 135-37. However, the Louisiana and Florida statutes involving the trade in of property as part of a retail sale are materially different from the Washington statute. Neither Louisiana nor Florida limits its sales tax trade-in exclusion to "separately stated . . . property of like kind," as is the case in Washington. *Compare* La. Rev. Stat. Ann. § 47:301(13)(a) (West 2016) *and* Fla. Stat. Ann. § 212.02(16) (West 2015) *with* RCW 82.08.010(1)(a)(i). Louisiana, for example, allows sellers to exclude from the "sales price" of tangible personal property sold at retail the value of "any article traded in." La. Rev. Stat. Ann. § 47:301(13)(a).[9] Thus, in direct contrast to the Washington definition of "selling price," the Louisiana statute is not limited to separately stated trade-in property of like kind. Consequently, the Louisiana statute has been broadly construed by Louisiana courts to apply to GameStop's trade-in program without limitation. *See GameStop, Inc.*, 166 So. 3d at 1096 (holding that under the Louisiana definition of sales price, GameStop's practice of accepting used video game software and hardware from its

[9] A copy in the 2013 version of the Louisiana statute is in the administrative record at AR 081.

customers and placing the value of those items on a stored value card for future use towards the purchase of new GameStop merchandise qualified for the state's trade-in exclusion).

The Florida law is similar to Louisiana's. The Florida definition of "sales price" expressly excludes any "[t]rade-ins or discounts allowed and taken at the time of sale." Fla. Stat. Ann. § 212.02(16).[10] There is no requirement that the trade-in involve "separately stated . . . property of like kind." Additionally, the Florida law expressly allows trade-ins to be taken in the form of a credit that may be used against the "selling price" of a subsequent purchase. Fla. Stat. Ann. § 212.09(1) (West 2015).[11]

These statutes are clearly different from the Washington trade-in exclusion and do not support the Board's reading and application of the Washington law. Washington law does not allow trade-in *credits* to be applied in a subsequent purchase of merchandise. Rule 247(4). The Board's decision, if upheld, would constitute a material shift in the tax policy of this state and is supported only by inapposite out-of-state authority. This Court should reject the Board's flawed legal analysis and, instead, apply the plain language of RCW 82.08.010(1)(a)(i) and Rule 247(4).

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[10] A copy of the Florida statute is in the administrative record at AR 087.
[11] Copy in the record at AR 096.

Under the plain language of the controlling Washington law, GameStop and SOCOM cannot claim the trade-in exclusion with respect to credits loaded onto a customer's stored value card and used in a subsequent transaction. Because the Board of Tax Appeals misapplied Washington law when it concluded otherwise, its decision should be set aside. RCW 34.05.570(3)(d).

e. Finding of Fact Number 12 is contrary to the evidence and should be rejected.

The Court should also reject the Board's Finding of Fact 12, which states that when a customer chooses to receive in-store credit in exchange for used merchandise that customer "is choosing to trade his or her used merchandise *for new or used in-store merchandise*." AR 036 (emphasis added). Although this finding is not significant for purposes of deciding this appeal, it is unquestionably false with respect to the trade-in of used merchandise in exchange for a credit that is loaded onto a customer's stored value card for future use. In that circumstance the customer is trading his or her used property to GameStop *for a credit*, not for in-store merchandise.

A customer can certainly choose to use a stored credit as part of his or her "tender" of valuable consideration in a subsequent purchase of GameStop merchandise. *See* Tr. at 13-14 (GameStop testimony that a

stored value card allows a customer to "utilize [a] trade-in credit as a form of tender in the future when [the customer] makes a purchase"); *see also* AR 236 (example sales receipt showing redemption of stored credit of $49.54 being used as a "tender type" accepted by GameStop as consideration on the sale of new merchandise to the customer). But the Board's finding that trading used gaming products for a stored credit is equivalent to trading property for "in-store merchandise" is not supported by any substantial evidence and should be rejected. *See generally*, *Nord Nw.*, 164 Wn. App. at 231-32 & n.7 (rejecting Board of Tax Appeals' findings of fact not supported by evidence in the record).

3. Where GameStop merchandise is purchased using a stored credit, the trade-in property is not "separately stated" as required by RCW 82.08.010(1)(a)(i).

RCW 82.08.010(1)(a)(i) permits the trade-in exclusion only with respect to "separately stated" trade-in property. The "separately stated" requirement was added to the statute in 2004 and imposes an additional limitation on the availability of the trade-in exclusion.

Neither GameStop Inc. nor SOCOM LLC met the "separately stated" requirement with respect to sales where a customer redeems his or her stored credit as payment for the purchase of merchandise. Rather, the sales invoice the customer receives merely states the amount of the credit. Nothing in the sales invoice identifies or "separately states" the trade-in

property that the customer delivered to GameStop in the prior transaction. *See* AR 236 (representative "redeemed credit for merchandise" invoice showing a redeemed credit of $49.54 without identifying the property the customer delivered to GameStop to generate the credit).

The Board of Tax Appeals misapplied the statutory "separately stated" requirement, which expressly requires the separate identification of the trade-in *property*. Contrary to the express language of the statute, the Board interpreted RCW 82.08.010(1)(a)(i) as requiring only that the "sales documents separately identify *the consideration derived from* the trade-in property." AR 040 (COL 8) (emphasis added). From this misreading of the statute, the Board suggested that the "separately stated" requirement could be met when merchandise is purchased though the redemption of a stored credit because "the sales invoice pertaining to the subsequent purchase of merchandise identifies the new purchases and *state the separate amount of trade-in credit* that is being applied as an offset." AR 037 (FOF 15) (emphasis added). In short, the Board interpreted the statutory phrase "separately stated trade-in property" to mean the "separately stated amount" credited to the buyer.

To support its decision, the Board reasoned that the purpose of the "separately stated" requirement was to "ensure the clear identification of the nontaxable portion of the sales transaction." AR 039 (COL 7). The

Board cited no express legislative history detailing the purpose of the "separately stated" requirement, but it did point out that the language was added as part of the state's implementation of the Streamlined Sales and Use Tax Agreement. *Id.*, n.9.[12] In what appears to be an interconnected insight, the Board also concluded that the "so-called 'Separate Statement Rule' provides 'that a transfer of consideration for a 'bundle' of taxable and nontaxable goods will be treated as nontaxable in part *only if the consideration for the nontaxable aspect of the transaction is separately stated.*'" AR 039 (COL 7.1) (quoting Jerome Hellerstein and Walter Hellerstein, *State Taxation* ¶ 17.03[4] (3d ed. 2009)).[13] Thus, the Board seems to have concluded from its reading of a treatise on state tax law that the "separately stated" requirement in RCW 82.08.010(1)(a)(i) is met if the "*consideration*" is separately stated. Of course, the statute says no such thing, and the Board's reasoning is perplexing.[14]

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[12] The Streamlined Sales and Use Tax Agreement is a comprehensive agreement between twenty-two member states designed to "simplify and modernize sales and use tax administration" and "reduce the burden of tax compliance for all sellers and for all types of commerce." RCW 82.58.030.

[13] A copy of the section of the Hellerstein treatise cited by the Board is provided as Appendix B.

[14] The connection the Board drew between the "separately stated" requirement in RCW 82.08.010(1)(a)(i) and the "Separate Statement Rule" discussed in the Hellerstein treatise was done *sua sponte*. None of the parties to the administrative proceeding raised or briefed the issue. *See* AR 110, AR 070 (Department briefs); AR 130, AR 097 (GameStop briefs). And the Board, in its final decision, did not provide any detailed explanation of the point it was trying to make.

The statutory phrase "separately stated trade-in property" is not ambiguous and requires no foray into its legislative history to discern its meaning. Moreover, the statute cannot fairly be read as requiring only the separate statement of the "consideration" derived from the trade-in property or the "amount" that is being used as an offset in a subsequent purchase-sale transaction. Had the Legislature intended the separately stated requirement to relate to something other than the trade-in property itself, would have used plain language to express that intent. It did not, and the Board of Tax Appeals erred as a matter of law when it substituted its understanding of the "Separate Statement Rule" for the plain language used in the statute.

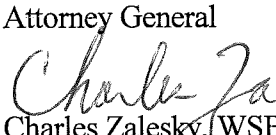
The Board's broad and unprincipled construction of the "separately stated" requirement is not consistent with the plain language of the statute or the statutory authority of the Board of Tax Appeals—which is limited to applying the law in adjudicative cases, not implementing its own preferred tax policy. Because the undisputed evidence establishes that GameStop Inc. and SOCOM LLC failed to separately state the trade-in property with respect to its "redeemed credit for merchandise" sales, those sales do not qualify for the trade in exclusion as a matter of law.

VI. CONCLUSION

The Department of Revenue properly assessed GameStop Inc. and SOCOM LLC for under-collected retail sales tax resulting from the GameStop affiliates' misapplication of the trade-in exclusion. The Board of Tax Appeals' decision to modify the tax assessments was incorrect as a matter of law and is not supported by the evidence. Accordingly, this Court should reverse the decision of the Board of Tax Appeals.

RESPECTFULLY SUBMITTED this 15th day of September, 2017.

ROBERT W. FERGUSON
Attorney General



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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 15th day of September, 2017, at Tumwater, WA.

Candy Zilinskas, Legal Assistant

APPENDIX A

WAC 458-20-247

Trade-ins, selling price, sellers' tax measures.

(1) **Introduction.** This section explains the measure of tax when a trade-in is included in the sale of tangible personal property. It explains how and when the retail sales or use tax exclusions apply and the recordkeeping requirements needed to document the transactions.

The value of "trade-in property of like kind" is excluded from the definitions of "selling price" in RCW **82.08.010** and the definition of "value of the article used" in RCW **82.12.010**.

Unless otherwise stated, "tax," "taxable," and "nontaxable," as used in this section, refer to retail sales or use tax only. The terms "trade-in," "traded in," and "property traded in" have their ordinary and common meaning. The terms refer to property applied, in whole or in part, toward the selling price of property of like kind. Readers are advised that the fact that sales and purchase transactions might be characterized as a "like kind" under Section 1031 of the Internal Revenue Code does not control for the purpose of the trade-in exclusion in RCW **82.08.010** and **82.12.010**.

(a) **Examples.** This section contains examples which identify a number of facts and then state a conclusion. The examples should be used only as a general guide. The tax results of other situations must be determined after a review of all of the facts and circumstances.

(b) **References to related sections.** The department of revenue (department) has adopted other sections that readers may want to refer to.

(i) WAC **458-20-106** Casual or isolated sales—Business reorganizations;

(ii) WAC **458-20-178** Use tax;

(iii) WAC **458-20-208** Exemptions for wholesale sales of new motor vehicles between new car dealers and for accommodation sales;

(iv) WAC **458-20-211** Leases or rentals of tangible personal property, bailments; and

(v) WAC **458-20-272** Tire fee—Core deposits or credits.

(2) **General nature of the trade-in exclusion.** RCW **82.08.010** and **82.12.010** define the terms "selling price" and "value of the article used," in pertinent part, to mean the total amount of consideration, except separately stated trade-in property of like kind, including cash, credit, or tangible personal property, expressed in terms of money paid or delivered by a buyer to a seller. As a result, the buyer of tangible personal property is entitled to reduce the measure of retail sales or use tax if:

- The buyer delivers the trade-in property to the seller;
- The trade-in property is delivered as consideration for the purchase; and
- The property traded in is "property of a like kind."

(a) The trade-in exclusion applies to all trade-in property of like kind delivered by a buyer to a seller as consideration for a purchase. Thus, if a buyer trades in two motor vehicles when purchasing one motor vehicle, the buyer is entitled to a reduction in the measure of retail sales tax based on the value of both trade-in vehicles.

(b) The trade-in exclusion is limited to retail sales and use taxes. There is no comparable exclusion for business and occupation (B&O) tax. (See definition of "gross proceeds of sales" in RCW **82.04.070** and of "value proceeding or accruing" in RCW **82.04.090**.) Sales tax need not have been paid on the item being traded in to be eligible for the trade-in exclusion.

(3) **Buyer to deliver trade-in property to seller.** The buyer must deliver trade-in property to the "seller."

(a) RCW **82.08.010** defines "seller" as "every person ...making sales at retail or retail sales to a buyer, purchaser, or consumer, whether as agent, broker, or principal." There is no requirement that the seller be the owner of the property being sold to the buyer. RCW **82.08.010** anticipates and

includes situations where a "seller" is selling property that he or she does not actually own, such as in consignment sales transactions.

For example, Broker enters into a consignment sale contract with Susan Smith to sell her Boat A. John Doe contacts Broker expressing interest in purchasing Boat A, provided his Boat B is accepted as a trade-in on the purchase. John Doe executes a purchase agreement with Broker which specifically identifies both Boat A being purchased and the trade-in. Broker accepts delivery and ownership of Boat B and places Boat B into Broker's own inventory. In turn Broker arranges delivery of the craft purchased to John. The buyer (John) has delivered the trade-in property (Boat B) to the seller (Broker). There is no requirement that Broker purchase Boat A from Susan (thereby becoming the owner) prior to selling Boat A to John and accepting Boat B as trade-in property because, as a broker, Broker is a seller under RCW **82.08.010**.

(b) The trade-in exclusion does not apply to transactions where a seller transfers tangible personal property in or out of its own inventory in exchange for other property it also owns.

(4) **Trade-in as consideration.** Property traded in must be consideration delivered by the buyer to the seller. The sales documents must identify the tangible personal property being purchased and the trade-in property being delivered to the seller. This does not require simultaneous transfers of the property being traded in and the property being purchased, but it does require that the delivery of the trade-in and the purchase be components of a single transaction. Sales documents, executed not later than the date the trade-in property is delivered to the seller, must identify the property purchased and the trade-in property as more fully explained in subsection (8) of this section.

Examples:

(a) Jane Doe offers to purchase Sailboat A from Dealer, if Dealer accepts her Sailboat B as a trade-in on the purchase. Dealer declines to accept ownership of Jane's Sailboat B, but instead offers to sell Sailboat B on a consignment basis with the net proceeds to be applied toward the purchase if Sailboat B is sold within three months. Jane accepts and Sailboat B is sold within the three-month period, and the net proceeds are applied to Jane's purchase of Sailboat A.

Jane is not entitled to the trade-in exclusion. An agreement to sell property on consignment does not constitute consideration "paid or delivered by a buyer to a seller," even if the subsequent proceeds are applied to the purchase price.

(b) Sally Jones decides to upgrade from her existing motor home to a new, larger motor home. The salesperson at a local RV dealership explains that while the dealership does not currently have on hand a motor home meeting Sally's needs, it can order one for her from the manufacturer. The salesperson also explains that if Sally trades in her motor home at the time she enters into the purchase contract, the dealership will accept the motor home as a down payment toward the purchase of the new motor home. Sally signs the purchase contract, the dealership orders the new motor home, and Sally delivers her motor home to the RV dealership (who accepts ownership of the motor home). Sally's new motor home is delivered to her eight months later.

Sally is entitled to the trade-in exclusion because the motor home was delivered to the RV dealership as consideration paid toward her purchase of the new motor home.

(c) Mr. B and Coastal Brokers enter into a consignment sales agreement. Under the terms of this agreement, Coastal Brokers will sell Mr. B's sailboat on a consignment basis and at the time of sale place the proceeds due Mr. B into a trust account for use toward a possible purchase of a yacht by Mr. B. Mr. B's sailboat is sold and the proceeds due to Mr. B placed in the trust account. Mr. B subsequently purchases a yacht from Coastal Brokers, and the trust account proceeds are applied to the purchase price of the yacht.

Mr. B is not entitled to the trade-in exclusion. The delivery of Mr. B's sailboat to Coastal Brokers and Mr. B's purchase of the yacht are not components of a single transaction. In addition, Mr. B's delivery of his sailboat for consignment sale by Coastal Brokers does not constitute consideration

"paid or delivered by a buyer to a seller," even if proceeds from the sale are applied to the purchase of the yacht.

(d) John Smith agrees to purchase Travel Trailer A from Dealer if Dealer accepts John's Travel Trailer B as a trade-in on the purchase. Dealer accepts ownership of Travel Trailer B at an agreed-upon value, on the condition that John pay Dealer a monthly fee to reimburse Dealer for financing costs associated with Travel Trailer B. This fee is to be paid for a period of four months or until Dealer sells Travel Trailer B, whichever is shorter. John has no further responsibility with respect to Travel Trailer B after this period.

John is entitled to the trade-in exclusion because he delivered Travel Trailer B to Dealer as consideration paid toward Travel Trailer A. The fees John paid to reimburse Dealer for financing costs associated with the trade-in property do not change the nature of the transaction, though for the purposes of the trade-in exclusion they do reduce the originally agreed-upon value of the trade-in property.

(5) **Property of like kind.** The term "property of like kind" means articles of tangible personal property of the same generic classification. It refers to the class and kind of property, not to its grade or quality. The term includes all property within a general classification rather than within a specific category in the classification. Thus, as examples, it means furniture for furniture, motor vehicles for motor vehicles, licensed recreational land vehicles for licensed recreational land vehicles, appliances for appliances, auto parts for auto parts, and audio/video equipment for audio/video equipment. These general classifications are determined by the nature of the property and its function or use. It may be that some kinds of property fit within more than one general classification. For example, a motor home is both a motor vehicle and a licensed recreational land vehicle. Thus, for purposes of the trade-in exclusion, a motor home may be taken as a trade-in on a travel trailer, truck, camper, or a truck with camper attached, and vice versa. Similarly, a travel trailer may be taken as trade-in on a motor home even though a travel trailer is not a motor vehicle; both are licensed recreational land vehicles. Conversely, a utility trailer may not be taken as trade-in on a travel trailer because a utility trailer is neither a motor vehicle nor a licensed recreational land vehicle. Likewise a car may not be taken as trade-in on a camper and vice versa.

It is not required that a car be traded in exclusively on another car in order to get the trade-in reduction of the tax measure. It could, as well, be traded in as part payment for a truck, motorcycle, motor home, or any other qualifying motor vehicle. Similarly, a sofa for a recliner chair, a pistol for a rifle, a sailboat for a motorboat, or a gold chain for a wrist watch are the kinds of generic trade-in transfers which would qualify. The exclusion of the value of property traded in, however, does not include such things as a motorcycle for a boat, a diamond ring for a television set, a battery for lumber, computer hardware for computer software, or farm machinery (including tractors and self-propelled combines) for a car.

(6) **Value of property traded in.** The seller and buyer establish the value of property traded in. The parties may not overstate the value of the trade-in property in order to artificially lower the amount of retail sales or use tax due. Absent proof of a higher value, the property traded in must be determined by the fair market value of similar property of like quality, quantity, and age, sold or traded under comparable conditions.

(7) **Trade-in value exceeds selling price.** If the trade-in value exceeds the selling price of the item sold, the selling price of the item being purchased should be used as the trade-in value. For example, a Washington resident purchases a car with a value of $15,000 and trades in a car with a fair market value of $17,000. The net due to the purchaser is $2,000. When the seller completes the excise tax return, he or she should report a trade-in value of $15,000 and not $17,000 because the trade-in value is capped at selling price of the item being purchased.

(8) **Recordkeeping.** RCW **82.32.070** requires every person liable for any tax to keep and preserve records from which tax liability can be determined. To substantiate a claim for the trade-in

exclusion, the sales agreement and/or invoice must identify both the property being purchased and the trade-in property. Such identification includes the model number, serial number, year of manufacture, and other information as appropriate. The sales agreement and/or invoice must also specify the selling price and the value of the trade-in property.

A copy of the sales agreement or invoice must be retained as a part of the seller's sales records. The following is an example of an invoice providing the necessary information regarding a sales transaction with trade-in:

Sold: 2009 Mountain Home 8.5 ft. Camper	
Model MH-20DT, Serial No. 200010	$19,075
Less "trade-in" - 1983 Meadowlark 8 ft. Camper	
Model No. ML883, Serial No. 0001	$2,000
Subtotal	$17,075
Retail Sales Tax	
Total	

(9) **Encumbered property traded in.** A buyer is entitled to full value for trade-in property, which is otherwise encumbered by a security interest or the subject of a conditional sale, or retail installment sales contract.

(10) **Casual or isolated sales.** The retail sales tax applies to all casual or isolated retail sales made by any person who is required to be registered and reporting tax to the state. The trade-in exclusion applies in the case of a casual or isolated sale, provided the statutory requirements are satisfied. The recordkeeping requirements explained in subsection (8) of this section apply to casual or isolated sales.

Persons who are not engaged in business activity, e.g., private persons, are not required to be registered and are not required to collect sales tax on their casual or isolated sales. See RCW **82.08.0251** and WAC **458-20-106**. The use of property acquired through casual sales is subject to use tax. See RCW **82.12.020** and WAC **458-20-178**.

(11) **Trade-ins as sales.** RCW **82.04.040** defines the term "sale" in pertinent part to mean "any transfer of the ownership of, title to, or possession of property for a valuable consideration." When property is traded in, ownership in that property is transferred. As a result, under the law a buyer delivering trade-in property to a seller is making a sale of the trade-in property.

(a) If the buyer is not in the business of selling the type of property being traded in the buyer incurs no B&O tax liability. See WAC **458-20-106**.

(b) On occasions where the buyer is in the business of selling the type of property being traded in, the buyer incurs a B&O tax liability.

For example, Don's Leasing purchases a new car from Tom the Dealer. This car will be part of Don's inventory of cars that it rents to customers. Don delivers a used car out of its inventory to Tom the Dealer as a part of the consideration paid for the new car. The trade-in of the used car by Don is considered a wholesale sale to Tom. This is not a casual or isolated sale because Don is in the business of selling cars in the form of rentals.

(c) In most cases, a buyer delivers trade-in property to a seller who is in the business of reselling trade-in property (e.g., a buyer trading in an automobile to a new car dealer). The buyer in these cases has no responsibility to collect retail sales tax.

(12) **Retail services.** The exclusion of the value of property traded in from the selling price tax measure applies only to sales involving tangible personal property traded in for tangible personal property sold. It does not apply to any transactions involving services that have been statutorily

included as "sales at retail." See RCW **82.04.050**. For example, a construction contractor may not accept part payment in tangible personal property to thereby reduce the sales tax measure of the construction contract selling price. Similarly, a seller of tangible personal property may not accept retail services as part payment to thereby reduce the selling price tax measure. Such transfers neither qualify as trade-in transfers of tangible property nor "in-kind" transfers.

(13) **Trade-in for rental property.** Under RCW **82.04.050**, rentals or leases of tangible personal property are "retail sales." The "selling price" is also the measure of tax for such rentals and leases. Where tangible personal property is traded in as part payment for the rental or lease of property of like kind (e.g., a used computer against the rental of a new one), the sales tax will apply to all payments after the value of the property traded in has been depleted or consumed and the lessor of the property actually begins making charges for the lease or rental of tangible personal property. Refer to WAC **458-20-211** for more information regarding the tax-reporting responsibilities with respect to lease or rental transactions.

A lessee must first purchase leased property before trading it in toward the purchase/lease of other property to be entitled to the trade-in exclusion. A buyer cannot satisfy the statutory requirement that the trade-in property be delivered to the seller as a part of the consideration for the purchased property if the buyer does not have ownership of and the right to sell the property being traded in. For example, Jane Doe leases Auto A from Leasing Company. Jane decides to lease a newer Auto B from Leasing Company. Jane exercises her option to purchase Auto A, and then delivers Auto A as a trade-in towards the lease of Auto B. Jane is entitled to the trade-in exclusion. By delivering her ownership of Auto A to Leasing Company, Jane has satisfied the statutory requirement that she as the buyer deliver trade-in property to the seller as a part of the consideration paid for Auto B.

(14) **Real property transfers.** Because the trade-in exclusion is limited to tangible personal property, the trade-in exclusion does not apply to sales of real property or transactions where real property is traded in for tangible personal property.

(15) **Use tax.** RCW **82.12.010** defines the measure of the use tax as the "value of the article used." As explained in subsection (2) of this section, the statutory definition excludes "trade-in property of like kind." Therefore, the measure of the use tax for tangible personal property upon which no retail sales tax has been paid (e.g., if it were purchased in another state) is the same as the measure of the retail sales tax. In such cases the value of the property traded in should be excluded from the use tax measure.

The consumer-user, or any seller who has a duty to collect this state's use tax, must retain the sales records reflecting property "traded in," as explained in subsection (8) of this section.

[Statutory Authority: RCW **82.32.300**, **82.01.060**(2), **82.08.020**, and **82.12.010**. WSR 10-02-009, § 458-20-247, filed 12/24/09, effective 1/24/10. Statutory Authority: RCW **82.32.300**. WSR 01-08-003, § 458-20-247, filed 3/21/01, effective 4/21/01; WSR 86-04-024 (Order 86-2), § 458-20-247, filed 1/28/86; WSR 85-02-006 (Order ET 84-6), § 458-20-247, filed 12/21/84.]

APPENDIX B

STATE TAXATION

II

Sales and Use, Personal Income, and Death and Gift Taxes and Intergovernmental Immunities

THIRD EDITION

JEROME R. HELLERSTEIN

(1907–2000)

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PART V

Sales and Use Taxes

Sales and use taxes have become the mainstay of state tax revenues during the past half century and an essential supplement to the tax revenues of many local governments. The area bristles with challenging problems of statutory construction and momentous constitutional issues. Most of Volume II is devoted to sales and use taxes, which are demanding an increasing amount of attention from lawyers and accountants as the scope of the taxes has broadened and as combined state and local tax rates have risen from 2 percent half a century ago to as high as 8 percent currently.

duced cost" of such property than by its original cost. The relevant point of comparison is not the initial purchase by the taxpayer, as the Colorado and Michigan courts in *IBM* found. Such a comparison would have been proper if IBM had been withdrawing the *raw materials* for its own use; however, it was withdrawing the *assembled computers*, not the purchased materials, for its own use. To be sure, as the Michigan court pointed out, IBM enjoyed no competitive advantage over other computer manufacturer-users with respect to its withdrawal and use of such computers. However, it surely enjoyed a substantial competitive advantage over other companies that used computers in their businesses but were not in the business of manufacturing such computers and therefore had to pay sales or use tax on the fair market value of such computers. Insofar as competitive equality is a relevant consideration in determining the use tax measure, it would have made better policy to hold that the proper measure of the use tax on the personal computers was their "inventory value" rather than the cost of materials, so that all companies using computers in their business would be on a level playing field.[28]

¶ 17.02 TRANSPORTATION AND DELIVERY CHARGES

We consider the inclusion or exclusion of transportation and delivery charges in the measure of the sales or use tax in connection with the taxation of services in Chapter 15.[29]

¶ 17.03 GRATUITIES AND SERVICE CHARGES

In theory, there are two reasons why one might exclude gratuities from the sales tax base. First, the sales tax applies only to transfers for a consideration; it does not apply to gifts. Since gratuities are, in principle, paid voluntarily and do not constitute part of the formal consideration for a service, they fall outside the definition of a taxable sale. Second, even if one recognizes that gratuities are a normal and expected part of compensation for certain service providers, such as waiters, taxicab drivers, and hotel personnel, one may contend that the personal services for which the gratuity is paid is not one of the identifiable services that the state has subjected to tax.

The foregoing theory runs into difficulty in several contexts, however. First, sometimes "gratuities" are mandatory. While a mandatory "gratuity" is

[28] See ¶ 16.07.

[29] See ¶ 15.06.

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an oxymoron, an obligatory service charge added to a restaurant or room service bill hardly can be considered voluntary in the ordinary sense of the word. Second, in many circumstances, the services provided are, in fact, taxable, at least when viewed as part of the bundle of services provided by a restaurant or hotel. Third, in some industries, tips are treated as employees' wages for purposes of satisfying the employer's obligation to pay minimum wages. In such circumstances, the contention that the payment is a nontaxable gratuity seems strained at best, since the employer would be contending that it is satisfying its minimum wage obligations through the kindness of strangers.

The case law and administrative regulations reflect the tension and uncertainty over the proper characterization of tips and service charges in varying circumstances.[30] Without suggesting that the rulings or interpretations in this area are consistent or reconcilable, we may nevertheless identify several key criteria that often influence the determination of whether the gratuity or service charge is subject to sales tax. As the ensuing discussion reveals, often more than one of the criteria are cited in support of a particular conclusion.

[1] Benefit to the Employer

If the employer benefits directly from the payment of gratuities or service charges, there is a tendency to consider such payment as part of the taxable measure of the consideration for meals, hotel charges, or other items provided by the service establishment. For example, the California Supreme Court held that tips to waitresses were includable in the measure of the tax to the extent that the employer credited them against the minimum wages due and payable to the waitresses.[31] Thus, the tips constituted consideration for the sale, defined as "[t]he furnishing, preparing, or serving for a consideration of food, meals, or drinks,"[32] including the amount paid for "[a]ny services that are a part of the sale."[33] The California State Board of Equalization did not contend that the balance of the tips (in excess of the portion credited to the employer's minimum wage obligation) was taxable, although such tips plainly benefited the employer in the sense that it could pay its employees less as a result of their expectation of receiving part of their compensation in the form of tips. Apparently, the "indirect" benefit of having one's employees' compensation paid in the form of tips was not sufficient to have the amounts characterized as pay-

[30] See generally "Applicability of sales tax to 'tips or service charges added in lieu of tips,'" 73 ALR3d 1226.

[31] Anders v. State Bd. of Equalization, 82 Cal. App. 2d 88, 185 P2d 883 (3d Dist. 1947).

[32] Cal. Rev. & Tax. Code § 6006(d) (West 1998).

[33] Cal. Rev. & Tax. Code § 6011(b)(1) (West 1998).

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ment for the restaurant's services, except to the extent that the tips actually discharged the employer's legal minimum wage obligation.[34]

[2] Mandatory Versus Voluntary Payments

In many states, the question of whether tips are part of the taxable consideration for the sale of a meal or other taxable item or are nontaxable gratuities depends on whether the payment is mandatory or voluntary. Thus the courts and administrative regulations often treat mandatory service charges, which are automatically included in the restaurant or other bill, as subject to sales tax. The District of Columbia regulations, for example, provide that if a fixed amount of a guest check attributed to gratuities or tips is added to the bill for drinks or meals, affording the purchaser no discretion as to the amount or method of payment, the charge is subject to tax, even though all or part of the charge is distributed by the vendor to its employees.[35] On the other hand, a gratuity or tip is not subject to tax if the customer (1) gives it voluntarily and (2) has discretion as to its amount.[36]

Courts have drawn similar lines. An Illinois appellate court rejected a Playboy Club patron's challenge to a tax on the club's 15 percent mandatory service charge that was added to his bill for food and drinks.[37] The bill stated that the charges included "gratuities," but the court rejected the taxpayer's argument that the mandatory 15 percent charge was "gratuitous." The court likewise rejected the taxpayer's alternative contention that even if the 15 percent charge was not gratuitous, it was payment for nontaxable entertainment provided by the Playboy bunnies rather than payment for taxable food and drink. Where "the only compulsion" on country club members to observe a tipping schedule established by resolution was "a social not a legal one," the Supreme Court of Tennessee held that the tips were voluntary and therefore not part of the taxable "sale price" of items sold by the club.[38] The West Virginia Su-

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[34] The current California regulation on "tips and services charges" provides:

> No employer shall collect, take, or receive any gratuity or a part thereof, paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of such gratuity, or require an employee to credit the amount, or any part thereof, of such gratuity against and as a part of the wages due the employee from the employer . . . . If this prohibition is violated, any amount of such gratuities received by the employer will be considered a part of the gross receipts of the employer and subject to the tax.

Cal. Code Regs. tit. 18, § 1603(g) (RIA through March 2001).

[35] D.C. Mun. Regs. tit. 9, § 467.3 (RIA through March 2001).

[36] D.C. Mun. Regs. tit. 9, § 467.4 (RIA through March 2001).

[37] Cohen v. Playboy Clubs Int'l, Inc., 19 Ill. App. 3d 215, 311 NE2d 336 (1974).

[38] Memphis Country Club v. Tidwell, 503 SW2d 919, 921 (Tenn. 1973).

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preme Court followed the mandatory/voluntary test in holding tips nontaxable, but it added that the business must neither retain any part of the amounts collected nor guarantee its employees an amount other than the amounts collected.[39] Other courts similarly have relied on the mandatory/voluntary distinction in holding mandatory "gratuities" taxable while finding voluntary gratuities exempt.[40]

Not all courts and tax administrators adhere to the mandatory/voluntary distinction between taxable and nontaxable gratuities. In holding that mandatory service charges for food and drink were not taxable, the Minnesota Supreme Court relied on a provision of the statute that permitted a deduction of "charges for services that are part of the sale" if such charges were "separately stated."[41] A Florida court held that the taxability of a mandatory tip added to a club's charge for meals depended on whether the club received a "benefit" from the mandatory charge.[42] Finding that the club received "no benefit" from the charge but merely was an "instrumentality or a conduit for the collection of gratuities or tips," the court set aside the tax.[43] In Wisconsin, the court observed that a mandatory service charge was "a mere codification by the club's bylaws of the social custom of tipping"[44] in holding the charge nontaxable, but it offered no convincing reason why this codification of the custom affected the nature of the charge. However, the court also relied on the fact that the club received no benefit from the charge.[45]

The states' administrative regulations reflect a similar split between those that exclude only voluntary gratuities from tax and those that permit the exclusion of mandatory service charges under some circumstances. For example, California's regulations provide that

> [a]mounts designated as service charges, added to the price of meals, are a part of the selling price of the meals and, accordingly, must be included

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[39] Lakeview Inn and Country Club, Inc. v. Rose, 175 W. Va. 689, 338 SE2d 166 (1985).

[40] Baltimore Country Club, Inc. v. Comptroller of Treasury, 272 Md. 65, 321 A2d 308 (1974); Youngstown Club v. Porterfield, 21 Ohio St. 2d 83, 255 NE2d 262 (1970).

[41] St. Paul Hilton Hotel v. Commissioner of Taxation, 298 Minn. 202, 214 NW2d 351, 352 (1974) (quoting the statute).

[42] Green v. Surf Club, Inc., 136 So. 2d 354 (Fla. Dist. Ct. App. 1961), cert. denied, 139 So. 2d 694 (1962); see supra ¶ 17.03[1].

[43] *Green*, 136 So. 2d 354, 356 (Fla. Dist. Ct. App. 1961), cert. denied, 139 So. 2d 694 (1962).

[44] Big Foot Country Club v. Wisconsin Dep't of Revenue, 70 Wis. 2d 871, 235 NW2d 696, 699 (1975).

[45] See supra ¶ 17.03[1]. See also Ragland v. Meadowbrook Country Club, 300 Ark. 164, 777 SW2d 852 (1989) (amounts added to bills as gratuities by the establishment are not taxable, provided that the entire amount of the gratuity is disbursed directly to the employees).

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> in the retailer's gross receipts subject to tax even though such service charges are made in lieu of tips and are paid over by the retailer to employees.[46]

By contrast, Colorado's regulations provide that even mandatory "gratuities" added to the bill by the service establishment are not taxable as long as the amount is separately stated and the proceeds are distributed by the vendor to the person who actually rendered the service. Thus, in Colorado, nontaxable gratuities include

> cash tips (money left by the patrons for use of those providing the service), charge tips (amounts added to the sales check by the patron for use of those providing the service), banquet tips and tips separately stated and added to the sales check by the vendor at a flat rate, [when] the amount is distributed by the vendor to the persons who actually render the service. "Cover charges" for food, services, and entertainment are taxable unless the charges for services and entertainment are separately stated.[47]

[3] Direct Receipt by the Employees Providing the Services

The administrative regulations of many states require, as a condition of exemption, that the gratuities be received directly by the employees providing the services.[48]

[4] Separate Statement Rule

Virtually all states insist that gratuities that are paid along with a restaurant or other bill must be separately stated on the bill or receipt and segregated for the account of the employee if they are to qualify as nontaxable payments.[49] This rule is simply a specific application of the more general principle that applies

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[46] Cal. Code Regs. tit. 18, § 1603(g) (RIA through March 2001).

[47] Colo. Code Regs. § 26-104.1(e) (RIA through March 2001); see also Conn. Agencies Regs. § 12-426-29(c)(4) (RIA through March 2001) (separately stated service charges, added in lieu of a gratuity, are taxable unless (1) the service charge does not inure to the benefit of the seller (e.g., reduction of payroll expenses), and (2) the service charge is remitted, in its entirety, to the service personnel who provided the meal service).

[48] See, e.g., Ariz. Admin. Regs. R15-5-1708 (RIA through March 2001); Colo. Code Regs. § 26-104.1(e) (RIA through March 2001), quoted supra ¶ 17.03[3]; Conn. Agencies Regs. § 12-426-29(c)(4) (RIA through March 2001).

[49] See, e.g., Ariz. Admin. Regs. R15-5-1708 (RIA through March 2001); Colo. Code Regs. § 26-104.1(e) (RIA through March 2001), quoted supra ¶ 17.03[3]; Conn. Agencies Regs. § 12-426-29(c)(4) (RIA through March 2001).

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throughout the sales tax law and administration—namely, that a transfer of consideration for a "bundle" of taxable and nontaxable goods will be treated as nontaxable in part only if the consideration for the nontaxable aspect of the transaction is separately stated.[50]

¶ 17.04 SUBSIDIES

Employers often subsidize cafeterias, vending machines, and other dining facilities on their business premises for the benefit of their employees. The question arises as to whether such subsidies are includable in the measure of the sales tax. In an Illinois case, the Department of Revenue assessed a tax against a caterer who operated employee cafeterias and vending machines for business customers at their facilities.[51] The employer sometimes paid the caterer a fixed fee to supplement the amounts it charged the employees, and sometimes guaranteed the caterer a specific fee, making additional payments to the caterer only when the employees' payments failed to cover the guarantee. The caterer paid no sales tax on any of the fees it received from the employer.

The Illinois Retailers' Occupation (Sales) Tax is imposed on the retail sale of tangible personal property.[52] "Retail sales" include only sales to "purchasers," who are defined as "anyone who, through a sale at retail, acquires the ownership of or title to tangible personal property for a valuable consideration."[53] The caterer argued that the company's employees were the only purchasers of the food and beverages it sold, and that the fixed fees and guarantees it received from the company were not taxable because they were not paid by "purchasers." The court agreed, treating the arrangement as involving two separate transactions—a sale of food and beverages to the employee, and the fixed fee or guaranty payment by the employer. The court found that only the amounts received from the employees constituted taxable sales.

A strong dissent objected to this interpretation of the statute:

> The court's opinion permits an employer to enter into an agreement with a caterer whereby the caterer would sell employees food and drink at

[50] See supra ¶ 17.01; see also ¶ 15.04[3][b] (describing separate statement rule in context of repair services). This is not to suggest, however, that a separate statement of the consideration for the allegedly nontaxable service always will render it nontaxable. A separate statement generally is a necessary condition of the exemption; it is not a sufficient condition.

[51] Chet's Vending Serv. Inc. v. Department of Revenue, 71 Ill. 2d 38, 374 NE2d 468 (1978).

[52] 35 Ill. Comp. Stat. Ann. 120/2 (West Supp. 2000).

[53] 35 Ill. Comp. Stat. Ann. 120/1 (West Supp. 2000).

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