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NO. 50641-6-II

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

AVENTIS PHARMACEUTICAL, INC., and
SANOFI-AVENTIS US, LLC,

Appellants,

v.

WASHINGTON STATE, DEPARTMENT OF REVENUE,

Respondent.

BRIEF OF RESPONDENT

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I. INTRODUCTION

The question in this case is how to interpret RCW 82.04.272, a statute setting a preferential business and occupation (B&O) tax rate, for a subset of prescription drug wholesalers, not all prescription drug wholesalers. The Legislature set multiple specific requirements for taxpayers to meet to qualify for the rate, including requirements related to who they purchase drugs from, and who they sell the prescription drugs to.

Aventis Pharmaceutical, Inc., and Sanofi-Aventis U.S., LLC (jointly, “Sanofi”) are not entitled to a refund of B&O taxes on the gross proceeds of their sales to three downstream wholesale distributors. Those sales were not sales to hospitals or other providers of health care services, and they were not sales to retail pharmacies with establishments in Washington or to retailers of prescription drugs selling online or through mail orders. Accordingly, for those sales, Sanofi does not meet the very specific definition of “warehousing and reselling drugs for human use pursuant to a prescription” in RCW 82.04.272(2)(b) and does not qualify for the lower tax rate of 0.138 percent under that statute. Instead, Sanofi properly paid the general wholesaling rate of 0.484 percent for the 10-year refund period.

As a matter of law, the trial court properly declined Sanofi’s invitation to broaden the preferential prescription drug warehousing B&O

tax classification. This Court should affirm summary judgment in favor of the Department of Revenue.

II. RESTATEMENT OF ISSUES

1. RCW 82.04.272 allows prescription drug wholesalers to pay a low B&O tax rate when they resell the drugs in Washington to “persons selling at retail or to hospitals, clinics, health care providers, or other providers of health care services” Did the trial court correctly uphold the Department’s interpretation that this preferential B&O tax rate does not apply to a drug wholesaler’s sales to other drug wholesalers, unless the buying wholesaler also is licensed as a pharmacy for retail sales?

2. Are Sanofi’s constitutional arguments untimely and without merit where (a) the due process claim was not raised below and is based on the false premise that the Department’s interpretation of RCW 82.04.272 requires an examination of each downstream transaction made by Sanofi’s wholesaler customers, and (b) the equal protection claim fails to address how the limitations of the tax preference in RCW 82.04.272 are irrational or unrelated to the purposes of the statute?

III. STATEMENT OF THE CASE

To facilitate cross motions for summary judgment in the court below, the parties stipulated to facts and exhibits in this case. *See* Fact

Stipulation, CP 36-43; Stipulated Exhibits, CP 44-78. The following facts are from those stipulations and are undisputed.

Aventis Pharmaceuticals Inc. (“Aventis”), a Delaware corporation, was registered to do business in Washington from 1968 to June 2006. CP 37, ¶4. Sanofi-Aventis U.S. LLC (“Sanofi-Aventis”) is also organized in Delaware and began doing business in Washington in 2005. CP 37, ¶5. Aventis transferred its business activities and employees to Sanofi-Aventis around January 2006, in connection with a restructuring of the business. CP 37, ¶6.

Sanofi purchases, warehouses, and sells prescription drugs for human use and has at all relevant times been registered with the United States Federal Drug Enforcement Agency. CP 39, ¶¶16-21. Both entities have held pharmacy wholesale licenses with the Washington State Pharmacy Quality Assurance Commission at relevant times. CP 39, ¶¶22-23. A majority of Sanofi’s sales in Washington during the relevant tax periods were to three wholesale pharmaceutical distributors: AmerisourceBergen Drug Corporation, McKesson Corporation, and Cardinal Health Corporation (collectively, “the Distributors”). Stip. Exs. 1-3, at CP 51, 57, & 63.

In December 2012, Aventis requested a refund of \$177,318 in taxes, plus applicable interest, for the period of January 2002 through

December 2005. CP 37, ¶8; Stip. Ex. 1 at CP 49. Aventis claimed that it erroneously had paid B&O tax at the rate of 0.484% of its sales of prescription drugs to Washington customers and should have instead paid B&O tax at the lower rate of 0.138% for prescription drug warehousing. Stip. Ex. 1 at CP 49. The Department denied \$171,408 of the refund request on the basis that Aventis properly owed and paid the wholesaling B&O tax rate on that income. Stip. Ex. 1 at CP 48-49. The auditor relied both on RCW 82.04.272 and the Department's published guidance to taxpayers, Excise Tax Advisory 3180.2013 ("ETA 3180"). *Id.* at CP 51; *see* ETA 3180, Stip. Ex. 5, CP 69-70.

Similarly, in December 2012, Sanofi-Aventis administratively claimed a refund of \$831,751 plus applicable interest, for the period of December 2006 through June 2012. The Department denied \$831,599 of the refund request, for the same reasons as it had for denying Aventis's request. CP 37, ¶9; CP 38, ¶15; Stip. Exs. 2, 3 at CP 53-64. In both refund claims, Sanofi asserted it should have reported its gross receipts tax under the warehousing and reselling prescription drug rate of 0.138 percent in RCW 82.04.272 instead of the wholesaling rate of 0.484 percent in RCW 82.04.270. CP 38, ¶11.

According to all of the refund requests, Sanofi purchased prescription drugs from affiliated and contract manufacturers, placed the

products in warehouses, and then sold them to distributors, hospitals, clinics, pharmacies, and other health care providers in Washington. Stip. Exs. 1-3 at CP 49, 55, 61. As it turned out, the vast majority of those sales were to the Distributors, and the Department denied the refund claims as to those sales. Stip. Exs. 1-3.

Sanofi thereafter filed an action in Thurston County Superior Court seeking a refund under RCW 82.32.180 in August 2014. CP 4-31. The parties filed cross motions for summary judgment, and on April 14, 2017, Judge John C. Skinder denied Sanofi's motion and granted summary judgment to the Department. CP 202-03. Sanofi timely filed a notice of appeal to this Court on May 10, 2017. CP 6-31.

IV. ARGUMENT

This Court reviews summary judgment orders de novo and engages in the same inquiry as the trial court. *Folsom v. Burger King*, 135 Wn.2d 658, 663, 958 P.2d 301 (1998). Summary judgment is properly granted where the pleadings, affidavits, depositions, and admissions on file demonstrate “that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law.” CR 56(c). The material facts in this case are undisputed, and the question on appeal is one of statutory construction, which is a question of law. *City of Spokane v. Rothwell*, 166 Wn.2d 872, 876, 215 P.3d 162 (2009). The trial

court properly granted the Department's motion for summary judgment and denied Sanofi's, because Sanofi's sales at issue do not qualify for the rate in RCW 82.04.272.

Washington's B&O tax is imposed on every person "for the act or privilege of engaging in business activities" and applies to the gross income of the business. RCW 82.04.220(1).¹ Unlike the federal income tax, the B&O tax is not a tax on profit, net gain, capital gain, or sales, "but a tax on the total money or money's worth received in the course of doing business." *Budget Rent-A-Car of Wash.-Oregon v. Dep't of Revenue*, 81 Wn.2d 171, 173, 500 P.2d 764 (1972). As a result, unless an exception or deduction applies, a taxpayer owes B&O tax on all income received.

Under the B&O tax statutes, the tax rate varies according to the nature of the business activity the taxpayer is engaged in. The Legislature has identified many specific business activities and set associated rates for them. For instance, auto dealers making sales of new vehicles to customers are subject to the retailing rate in RCW 82.04.250 (currently 0.471% of the gross proceeds of sales). Persons making wholesale sales

¹ The "gross income of the business" is defined as "the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, . . . and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, . . . labor costs, . . . or any other expense whatsoever paid or accrued . . ." RCW 82.04.080(1).

are similarly subject to B&O tax on the gross proceeds of those sales, but at the wholesaling rate of 0.484% in RCW 82.04.270.² Businesses may owe B&O tax under multiple tax classifications for portions of their gross income if they engage in multiple business activities. RCW 82.04.440(1).

Here, Sanofi asserts that rather than being taxable under the B&O tax rate of 0.484 percent for wholesalers under RCW 82.04.270, it should be taxable at the lower rate of 0.138 percent for prescription drug warehousing and reselling under RCW 82.04.272. CP 11-13, ¶¶ 24-29. It seeks a refund of taxes it paid under the wholesaling rate during the years 2002 to 2012, to the extent of the difference in those rates.

The parties agree that the Legislature enacted the preferential prescription drug warehousing B&O tax classification for the purpose of helping in-state wholesalers of prescription drugs to compete with out-of-state companies. *See, e.g.*, Appellants' Br. at 34-35; CP 119, 131. At the time this rate was enacted, out-of-state companies could avoid taxation altogether if certain conditions were met. *See* CP 119, 131, and discussion in Part B.2., below. The prescription drug warehousing statute creates the classification and provides definitions:

² In addition to the specific rates provided by statute, the Legislature also created a catch-all rate referred to as "service and other" that applies to the gross income of "any business activity other than or in addition to an activity taxed explicitly under another section in this chapter" RCW 82.04.290(2).

(1) Upon every person engaging within this state in the business of warehousing and reselling drugs for human use pursuant to a prescription; as to such persons, the amount of tax shall be equal to the gross income of the business multiplied by the rate of 0.138 percent.

(2) For the purposes of this section:

(a) “Prescription” and “drug” have the same meaning as in RCW 82.08.0281; and

(b) “Warehousing and reselling drugs for human use pursuant to a prescription” means the buying of drugs for human use pursuant to a prescription from a manufacturer or another wholesaler, and reselling of the drugs to persons selling at retail or to hospitals, clinics, health care providers, or other providers of health care services, by a wholesaler or retailer who is registered with the federal drug enforcement administration and licensed by the pharmacy quality assurance commission.

RCW 82.04.272.³ Although it was enacted in 1998, the effective date of the new classification was July 1, 2001. Laws of 1998, ch. 343, § 6.

Because Sanofi’s sales to the Distributors do not meet all the requirements of RCW 82.04.272(2)(b)’s definition of “warehousing and reselling drugs for human use pursuant to a prescription,” Sanofi is not entitled to the preferential rate on those sales.

³ Under RCW 82.08.0281, a “prescription” is “an order, formula, or recipe issued in any form of oral, written, electronic, or other means of transmission by a duly licensed practitioner authorized by the laws of this state to prescribe.” RCW 82.08.0281(4)(a). “Drug” is defined in pertinent part as “a compound, substance, or preparation, and any component of a compound, substance, or preparation, other than food and beverage ingredients, dietary supplements, or alcoholic beverages, marijuana, useable marijuana, or marijuana-infused products” RCW 82.08.0281(4)(b). The same statute provides an exemption from retail sales tax on retail sales of prescription drugs. RCW 82.08.0281(1).

A. The Prescription Drug Warehousing B&O Tax Rate Applies to a Qualified Taxpayer's Sales to Health Care Providers or Retail Pharmacies.

There is no dispute that for the tax period at issue, Sanofi made sales in Washington of “drugs” for human use pursuant to a “prescription.” *See* CP 39, ¶¶19-20. Instead, the dispute here centers around the definition of “warehousing and reselling drugs for human use pursuant to a prescription” in RCW 82.04.272(2)(b).

The definition has several components, each of which imposes requirements. First, the taxpayer must be “a wholesaler or retailer who is registered with the federal drug administration and licensed by the pharmacy quality assurance commission.” The parties agree that Sanofi meets these requirements. CP 39, ¶¶17-18, 22-23. Second, a qualifying taxpayer must “[buy] drugs for human use pursuant to a prescription from a manufacturer or another wholesaler” The Department’s auditor did not dispute that Sanofi purchased the drugs in question from a manufacturer or another wholesaler. *See* Stip. Exs. 1-3 at CP 51, 57, & 63.

The third requirement to qualify for this preferential tax rate is that the taxpayer must resell the drugs “to persons selling at retail or to hospitals, clinics, health care providers, or other providers of health care services” Sanofi’s sales to health care providers are not in dispute.

The dispute centers on whether Sanofi's sales to the Distributors are sales to "persons selling at retail."⁴ As a matter of law, they are not.

1. Sanofi's sales to the Distributors do not qualify for the preferential rate.

The fundamental objective in examining a statute is "to ascertain and carry out the legislature's intent." *Dep't of Ecology v. Campbell & Gwinn, LLC*, 146 Wn.2d 1, 9, 43 P.3d 4 (2002). If a statute's meaning is plain, then a court must "give effect to that plain meaning as an expression of legislative intent." *Id.* at 9-10. A statute's meaning "is discerned from all that the Legislature has said in the statute and related statutes which disclose legislative intent about the provision in question." *Id.* at 11.

One related statute indicating the Legislature's intent in using the phrase "persons selling at retail" in RCW 82.04.272 is the statutory definition of "sale at retail." That definition broadly covers sales of tangible personal property, and at the same time, excludes from its scope sales to a person who is purchasing the item for the purposes of reselling it to someone else:

(1)(a) "Sale at retail" or "retail sale" means every sale of tangible personal property . . . to all persons irrespective of the nature of their business . . . other than a sale to a person who:

⁴ A "person" under the tax code includes both individuals and business entities of all types. RCW 82.04.030.

(i) Purchases for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person, . . .

RCW 82.04.050(1)(a)(i). Under the plain meaning of both RCW 82.04.272 and RCW 82.04.050(1)(a), along with grammar and common sense, a person “selling at retail” is a person making “sales at retail.” Likewise, under common understanding, a purchase for the purpose of resale under RCW 82.04.050(1)(a)(i) is a wholesale purchase. The exception for these sales in RCW 82.04.050 complements the definition of “sale at wholesale” in RCW 82.04.060. That definition provides that a “sale at wholesale” or “wholesale sale” means “[a]ny sale, which is not a sale at retail, of . . . [t]angible personal property.” RCW 82.04.060(1)(a).

Applying these definitions, the Legislature did not intend to extend the prescription drug warehousing B&O classification and preferential rate to a prescription drug wholesaler’s sales to other wholesalers or distributors for further resale. Those sales to other wholesalers remain wholesale sales subject to the wholesaling B&O tax rate in RCW 82.04.270. Instead, the Legislature limited the preferential rate to sales to persons who sell those drugs at retail. And under common understanding and the requirements of Washington law, a person making sales of prescription drugs at retail is a retail pharmacy. This is how the

Department interprets the requirements of “persons selling at retail” in its published guidance to taxpayers.

In an Excise Tax Advisory (ETA) issued in September 2013, the Department expressly addressed the requirements to qualify for preferential tax treatment under RCW 82.04.272. ETA 3180.2013, CP 69-70 (Stip. Ex. 5). It set forth both “seller requirements,” which are the requirements for the taxpayer in question to qualify for the rate, and “buyer requirements,” which address the types of buyers that will result in a qualifying sale for the seller. Under the undisputed facts, Sanofi meets the “seller requirements.” CP 39, ¶¶17-23. With regard to the “buyer requirements,” ETA 3180 provides:

Buyer requirements

A seller qualifies for the preferential B&O tax rate if the seller satisfies all the requirements above and resells the prescription drugs directly to a buyer who is:

- A retailer with a pharmacy facility license or non-residential pharmacy license issued by the Department of Health under RCW 18.64.043 or RCW 18.64.370, respectively; or
- A hospital, clinic, health care provider, or other provider of health care services.

Consistent with the statute, ETA 3180 allows Sanofi to report gross income under the prescription drug warehousing B&O tax classification on its sales to retailers operating pharmacies or its sales to hospitals and other health care providers. All other Sanofi sales fall within the

wholesaling B&O tax classification under which Sanofi actually reported and paid taxes for the tax periods in question.

As a matter of law, Sanofi's sales to the Distributors do not qualify for the preferential rate in RCW 82.04.272, and Sanofi properly paid the wholesaling B&O tax on the gross proceeds from those sales under RCW 82.04.270. The parties agree that the three Distributors are licensed by both federal and state authorities as wholesalers of pharmaceuticals. CP 40-42, ¶¶ 25, 27, 29, 31, 34, 36. The parties also agree that the three Distributors do not hold, and never have held, a Washington pharmacy license or a non-resident pharmacy license. CP 41-42, ¶¶ 26, 30, 35. Indeed, Distributor AmerisourceBergen Drug Corporation describes itself as "a leading wholesale distributor of pharmaceutical products" in the United States. CP 39-40, ¶24. Likewise, Cardinal Health Corporation describes itself as "one of the country's leading full-service wholesale distributors of pharmaceutical and related health care products" CP 42, ¶33. Accordingly, the Distributors do not meet the requirement of being a retail pharmacy and are not "persons selling at retail." Sanofi properly paid the regular rate of 0.484 percent on its income from those sales because those sales did not qualify for the rate in RCW 82.04.272.

2. Sanofi’s argument that RCW 82.04.272 applies to all sales by a drug wholesaler in the distribution chain is contrary to the statutory language.

Sanofi continues to argue, as it did below, that the preferential rate in RCW 82.04.272 applies to all “wholesaler to wholesaler transactions” in the distribution chain, so long as the “ultimate customer” is a retailer or health care provider. “It suffices if these are indirect customers of the first wholesaler.” Appellants’ Br. at 5; *see also id.* at 6-7, 12, 17, 20, 25. The Court should reject this argument, notwithstanding Sanofi’s consistent urging of it. The plain meaning of the language in RCW 82.04.272 contradicts that conclusion: The Legislature intended to limit the application of the preferential rate to a *subset* of prescription drug wholesalers, those making sales to prescription drug retailers or to hospitals and other health care providers. In doing so, the Legislature focused the benefit of the classification on the last wholesaler in the distribution chain, regardless of the number of upstream wholesalers.

As the Department correctly notes in ETA 3180, the statute does not simply identify what types of drug sellers will qualify. It contains specific requirements regarding (a) what the taxpayer has to be doing to qualify for the preferential tax rate (buying, warehousing, and reselling), (b) from whom the taxpayer must buy (a manufacturer or another wholesaler), and (c) to whom the taxpayer must sell (health care providers

or retailers). Sanofi's interpretation simply ignores the language the Legislature chose to use, rendering this last set of requirements (the ETA's "buyer requirements") inoperative, contrary to principles of statutory construction. In deciding questions of statutory interpretation, courts do not ignore express terms in the statute. *See Ralph v. Dep't of Nat. Resources*, 182 Wn.2d 242, 248, 343 P.3d 342 (2014). Instead, they interpret statutes as a whole so that "no clause, sentence, or word shall be superfluous, void, or insignificant." *Id.* Giving effect to all the language in RCW 82.04.272 requires giving effect to the buyer requirements.

If the Legislature had intended all wholesaler to wholesaler transactions to qualify for the preferential rate, it would have said so, and the language of RCW 82.04.272(2)(b) would be different. The Legislature could have written the statute to say "reselling of the drugs to persons selling at retail *or wholesale* or to hospitals" or, alternatively, "reselling of the drugs to wholesalers, persons selling at retail, or to hospitals" It did neither. "Courts may not read into a statute matters that are not in it and may not create legislation under the guise of interpreting a statute." *Kilian v. Atkinson*, 147 Wn.2d 16, 21, 50 P.3d 638

(2002). In short, Sanofi's theory is inconsistent with the plain meaning of the statute.⁵

Sanofi claims support for its theory in the opening clause of the statutory definition, "the buying of drugs for human use . . . from a manufacturer or another wholesaler" Sanofi argues that "buying" and "manufacturer" and "another wholesaler" are rendered superfluous if the statute is interpreted to allow the preferential rate only to a wholesaler's sales to pharmacy retailers or health care providers. Appellants' Br. at 5, 32, 37. To the contrary, the Department's interpretation gives full effect to these statutory terms because it applies the "buyer requirements." As discussed above, the statutory definition has multiple components, and the requirements include both who a qualified seller must purchase from and who the seller must sell to. Sanofi satisfies the upstream "seller requirements," but its own sales to the Distributors do not qualify for the "buyer requirements." Reading the words "buying," "manufacturer," and "another wholesaler" in the context of where they appear in the statutory context does not render them superfluous. *See Campbell & Gwinn, LLC,*

⁵ Sanofi accuses the Department of adding words to the statute. Appellants' Br. at 1, 25-26, 29-31. But in arguing its wholesaler-to-wholesaler theory, that is exactly what Sanofi does, adding the category of "wholesalers" to "persons selling at retail" and "hospitals, clinics, health care providers, or other providers of health care services."

146 Wn.2d at 11 (plain meaning is discerned from “all that the Legislature has said” in a statute).

The prescription drug warehousing statute applies only to taxpayers who meet all the requirements of the definition of “warehousing and reselling drugs for human use pursuant to a prescription” for the sales in question. The wording in RCW 82.04.272(2)(b) demonstrates forcefully that the Legislature intended this preferential tax rate to apply to the last wholesaler or distributor in the distribution chain, that is, the wholesaler that sells to retailers and health care providers. Some of the Distributors’ sales to their customers may qualify under RCW 82.04.272 because they may be the last wholesalers in the distribution chain,⁶ but Sanofi’s sales to the Distributors do not.

3. The requirements in ETA 3180 are consistent with the statute and avoid imposing undue administrative burdens on taxpayers and the Department.

Several of Sanofi’s arguments take aim specifically at the Department’s interpretation of the statutory definition in RCW 82.04.272(2)(b) in ETA 3180. In particular, Sanofi objects to the portion of the “buyer requirements” that interpret the phrase “persons selling at

⁶ In the declaration submitted by distributor AmerisourceBergen in the Abbott Laboratories litigation, the sales tax manager does state that the company did pay some of its B&O taxes under the prescription drug warehousing B&O tax classification. Stip. Ex. No. 6, CP 72, ¶ 3. Whether it did so correctly has not been verified. CP 40, ¶24.b.

retail” as “[a] retailer with a pharmacy facility license or non-residential pharmacy license issued by the Department of Health under RCW 18.64.043 or RCW 18.64.370” CP 70. The Distributors are licensed only as wholesalers, and they do not have pharmacy facility licenses or non-residential pharmacy licenses issued by the Washington State Department of Health or the Pharmacy Quality Assurance Commission. CP 40-42, ¶¶25-26, 29-30, 34-35. Accordingly, under the buyer requirements as interpreted in ETA 3180, Sanofi’s sales to the Distributors do not qualify for the preferential rate in RCW 82.04.272.

Sanofi attempts to discredit ETA 3180 by suggesting it was “[c]onveniently” issued in response to Sanofi’s refund request and that it resulted from “polling” Department employees. Appellants’ Br. at 14-16. Sanofi is wrong on the first statement and mischaracterizes the process for issuing ETAs.

Some years ago, another taxpayer that had previously paid B&O taxes under the regular wholesaling classification made the same claim to the Department as Sanofi does here, that its sales to other wholesale drug distributors qualified for the preferential rate in RCW 82.04.272 if any of the distributor’s sales were to hospitals or other health care providers. CP 165, ¶9. After discussions with that taxpayer and internal discussions, the Department followed procedures for interpretative statements. This

included posting the draft on the Department's website and emailing it to a Listserv of persons who stay informed of Department actions concerning excise taxes.⁷ The Department issued ETA 3180 in September 2013. CP 165-67, ¶¶10-13. Sanofi fails to appreciate that collaboration among divisions performing functions such as taxpayer advice, auditing, administrative appeals, legislation, and policy helps to assure that options are aired and the result is consistent with the statute. It also helps to ensure consistent taxpayer treatment going forward. As the audit papers in this case demonstrate, the auditors rely on published Department guidance. CP 50-51, 56-57, 62-63.

Sanofi's complaints about ETA 3180 relate to its alternative argument to the "all wholesaler" theory. Sanofi's point is that the Distributors each make some of their sales to hospitals or other health care providers, and those are considered "retail sales" in Washington. Appellant's Br. at 22-24, CP 10-11, ¶¶20-23. Under Sanofi's theory, if one of its Distributors makes even one sale that is taxed as a retail sale, all of Sanofi's sales to that buyer are taxable under RCW 82.04.272, instead of the regular wholesaling B&O rate, because the Distributor is a person

⁷ ETA 3180 is a formal interpretative statement issued by the Department under RCW 34.05.230 of the Administrative Procedure Act. CP 164, ¶¶5, 13. The Department submits copies of Excise Tax Advisories to the Office of the Code Reviser for publication in the Washington State Register. *Id.*

“selling at retail.” The Court should reject this theory because it expands the benefit of the low B&O tax rate in RCW 82.04.272 beyond its intended scope.

There is no dispute that sales of prescription drugs to hospitals and other health care providers are treated as retail sales in Washington in many instances. In general, sales of medical products, including drugs, to doctors, hospitals, and other health care providers for use in providing medical services to patients are considered to be sold to those entities as consumers, and thus are treated as retail sales. WAC 458-20-18801(302). Unless an exemption applies, these sales are subject to the retailing B&O tax (imposed on the seller) and retail sales tax (paid by the consumer and remitted by the seller). *See id.* When the health care provider uses drugs in providing medical services to patients, the drugs are not considered to have been sold separately from the medical services. “These charges, even if separately itemized, are for providing medical services.” WAC 458-20-168(7)(a).

On the other hand, charges a health care provider makes for drugs it sells to persons or caregivers other than in the context of providing medical services to patients are subject to retailing B&O tax and retail sales tax, unless exempt. *Id.* In these instances, the health care provider is making a wholesale purchase of the drugs from the seller, and making a

retail sale when it resells them. *See id.*; WAC 458-20-18801(302)(c) (“Sales to persons who resell the medical products (e.g., pharmacies) are subject to the wholesaling B&O tax.”) In sum, some sales of prescription drugs to health care providers are considered retail sales, and others are considered wholesale sales.⁸

The record does not establish whether the Distributors actually made any retail sales of prescription drugs to hospitals and health care providers in Washington.⁹ But assuming they did, that does not make them “persons selling at retail” for purposes of the buyer requirements in RCW 82.04.272. Sanofi lumps selling to hospitals and other health care providers into “selling at retail.” The Legislature, however, did not. It

⁸ Though this case concerns the B&O tax, the Court may be wondering about the retail sales tax. Retail sales of prescription drugs are exempt from the retail sales tax. RCW 82.08.0281(1) & (4). In its rule, the Department has extended that exemption to purchases by hospitals and other qualified health care providers. WAC 458-20-18801(402)(d) (requiring buyer to provide seller with an exemption certificate).

⁹ Two of the Stipulated Exhibits in the record are declarations filed in another case in 2014, a refund claim by Abbott Laboratories, Inc. Stip. Ex. Nos. 6 & 7, CP 72-78. In one of these declarations, a representative of distributor AmerisourceBergen states that it filed tax returns in Washington reporting income under three B&O tax categories, prescription drug warehousing, wholesaling, and retailing. CP 72, ¶3. Similarly, in the other declaration, a representative of distributor McKesson Corporation states that “[a]mong other activities,” McKesson makes some sales in Washington that are subject to the retailing B&O tax rate. CP 76, ¶3. Both of these companies sell prescription drugs, according to their 10-K forms, but they also sell other health care related products, cosmetics, toiletries, etc. CP 39-41, ¶¶24.a. & 28.b. Sanofi emphasizes these declarations, Appellants’ Br. at 21-22, but the most they indicate is that these distributors make some sales that may qualify as retail sales. And as indicated in the Fact Stipulation, the Abbott Laboratories litigation was voluntarily dismissed by stipulation of the parties in October 2014 without a court ruling on the merits or any verification by the Department of the information contained in the declarations. CP 40-41, ¶¶24.b. & 28.c. These two declarations contain only the barest amount of information, and what they do provide is insufficient to draw any conclusions about specific Distributor sales.

created two categories, “persons selling at retail” and selling to hospitals and other health care providers: “reselling of the drugs to persons selling at retail *or* to hospitals, clinics, health care providers, or other providers of health care services” RCW 82.04.272(2)(b) (emphasis added). For purposes of this statute and the type of buyers categorized, the Legislature treated hospitals and other health care providers as a distinct category. It is reasonable to assume it intended the same distinction with respect to the nature of those buyers’ own sales. *See Ralph v. Dep’t of Nat. Resources*, 182 Wn.2d at 248 (interpret statute as a whole so that no clause or word is insignificant).

To do otherwise would allow a very broad application of this preferential tax rate, beyond the Legislature’s intended meaning. For example, if Sanofi sold drugs to a distributor that made 99% of its sales to retail chains and pharmacies (wholesale sales) and one percent of its sales to hospitals for use in providing medical services (retail sales), for all practical purposes, Sanofi would essentially be selling drugs to just another wholesaler. Allowing the preferential prescription drug warehousing rate in that instance is contrary to the letter and spirit of RCW 82.04.272. Courts are directed to give statutes “a rational, sensible construction” that produces a “sensible result” consistent with legislative intent. *See State v. Thomas*, 121 Wn.2d 504, 512, 851 P.2d 673 (1993)

(first quotation); *Washington Util. & Transp. Comm'n v. United Cartage, Inc.*, 28 Wn. App. 90, 97, 621 P.2d 217 (1981) (second quotation). The Department did so here, in interpreting “persons selling at retail” to mean retailers with a pharmacy facility license in ETA 3180.

Contrary to Sanofi’s assertions, the Department is not adding words to the statutory requirements, and it is not confused about the role of the Washington Pharmacy Quality Assurance Commission. *See* Appellants’ Br. at 2-3, 6-7, 24-26. The Department in ETA 3180 has set forth a reasonable and practical interpretation of the buyer requirements in RCW 82.04.272(2)(b), when a taxpayer’s buyer is itself a wholesale drug distributor. When presented with the question of how “persons selling at retail” should be interpreted when a drug wholesaler is selling to another drug wholesaler, the Department had a range of options on a continuum:

- 1) Totally exclude sales to other wholesalers;
- 2) Track downstream sales of the other wholesalers and allow the preferential rate depending on who the other wholesalers’ customers are in each sale of product originated from the taxpayer wholesaler;
- 3) Track sales to other wholesalers and allow the preferential rate to the taxpayer wholesaler depending on the overall proportion of that other wholesaler’s retail sales;

- 4) Determine if the other wholesaler also has the ability to make retail pharmacy sales directly to persons with a prescription, based on pharmacy license status; and
- 5) Allow preference for all sales to other wholesalers that make any sales to hospitals and other health care providers.

The Department chose the fourth option. The Department rejected option 5, which is what Sanofi argues here should be the standard. The Department also declined to foreclose sales to wholesalers altogether, option 1. It also rejected an interpretation such as 2 and 3, which would require either transaction by transaction tracking of the other wholesaler's downstream sales (option 2), or information about the proportion of the other wholesaler's sales in Washington that are retail sales (option 3).

In rejecting a transaction-by-transaction approach, the Department sought to avoid burdening taxpayers with collecting information from the other wholesalers and to avoid placing administrative burdens on the Department to review and evaluate such information in audits and appeals. CP 166, ¶¶11-12. The result is an interpretation of RCW 82.04.272(2)(b) that is consistent with distinctions made in the statute and easy for both taxpayers and the Department to apply and administer. And because the Distributors do not have pharmacy facility or non-residential pharmacy licenses in Washington, Sanofi's sales to them do not qualify for the

preferential rate in RCW 82.04.272. The trial court correctly so held. *See Cashmere Valley Bank v. Dep't of Revenue*, 181 Wn.2d 622, 635-37, 334 P.3d 1100 (2014) (deferring to Department's interpretation of deduction for interest received by banks on first mortgages for residential property, as explained in published determination, because it comported with statute); *Dep't of Revenue v. Nord NW Corp.*, 164 Wn. App. 215, 229, 264 P.3d 259 (2011) (applying Department's interpretation because it harmonized the statutory and regulatory scheme).

Sanofi implies that the Department's interpretation is too restrictive, because retail sales might also include sales to the federal government, federal instrumentalities such as the American Red Cross, and sales to Indian tribes. Appellants' Br. at 26-27. Whether retail sales tax applies to these entities is a matter of federal law (state taxes are usually preempted in these instances), and whether B&O tax applies to the seller on these sales can be more complicated.¹⁰ But there is no evidence in the record that the Distributors (or Sanofi, for that matter), sell to

¹⁰ *See Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163, 175, 109 S. Ct. 1698, 104 L. Ed. 2d 209 (1989) (states can impose nondiscriminatory taxes on private parties with whom the United States or an Indian tribe does business, even though the financial burden of the tax may fall on the United States or tribe; approving state oil and gas severance taxes); *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136, 145, 100 S. Ct. 2578, 65 L. Ed. 2d 665 (1980) (whether state tax on non-Indian doing business in Indian country is preempted requires a particularized examination of relevant state, federal, and tribal interests; preempting state motor carrier license and use fuel taxes on logging company working for tribe).

agencies of the federal government, the American Red Cross, or to Indian tribes, or if they do, whether any such sales are in Washington. In addition, we cannot assume that all such sales are retail sales, as Sanofi apparently does. For instance, the Tulalip Tribes of Washington operates its own tribal pharmacy, which is licensed both under federal law and by the State.¹¹ Any sales to that tribal pharmacy would clearly be a sale to a person “selling at retail,” but it would be a wholesale sale, not a retail sale. In sum, the Court should decline Sanofi’s invitation to speculate how RCW 82.04.272 might apply to situations not before the Court.

B. If the Court Determines That RCW 82.04.272 Is Ambiguous, It Should Adopt an Interpretation That Avoids Unlikely Or Strained Consequences.

The definition in RCW 82.04.272(2)(b) of “warehousing and reselling drugs for human use pursuant to a prescription” is not what anyone would consider elegant prose, but neither the parties nor the trial court considered it ambiguous. This Court may disagree. If it does, guidelines for statutory interpretation and the legislative history of RCW 82.04.272 become important. Neither favors the interpretation Sanofi advances.

¹¹ See <http://www.tulalipclinicalpharmacy.com/about-us/who-we-are/> (last visited 11/10/17).

1. The most relevant rules of statutory construction are those that assist the Court in discerning legislative intent.

The prescription drug warehousing and reselling classification is a preferential B&O tax rate. *See* RCW 43.136.021 (defining “tax preference” as including a “preferential state tax rate” for purposes of periodic performance audits). The Court should construe the statute just as it does tax exemption, credit, and deduction statutes: strictly, but fairly, against the taxpayers. *See Lacey Nursing Center, Inc. v. Dep’t of Revenue*, 128 Wn.2d 40, 49-50, 905 P.2d 338 (1995); *Group Health Coop. v. Wash. State Tax Comm’n*, 72 Wn.2d 422, 429, 433 P.2d 201 (1968). Taxpayers receive the same benefit with a preferential tax rate, lower taxes, that they do with tax credits, exemptions, and deductions.¹²

As expected, Sanofi relies on the guideline that ambiguous tax-imposing statutes should be construed in favor of taxpayers. Appellants’ Br. at 29-30 (quoting *Weyerhaeuser Co. v. Dep’t of Revenue*, 106 Wn.2d 557, 565-66, 723 P.2d 1141 (1986)). The Department does not dispute that RCW 82.04.272 is a tax-imposing statute, but the facts of this case are nothing like those in *Weyerhaeuser*, contrary to Sanofi’s arguments.

¹² In 2005, the Washington Supreme Court rejected this approach in another B&O tax case, but the court in that case found the statute at issue to be unambiguous and admittedly made the statement as dicta. *AgriLink Foods, Inc. v. Dep’t of Revenue*, 153 Wn.2d 392, 399, 103 P.3d 1226 (2005).

Unlike in *Weyerhaeuser*, this case does not in any way concern a situation where the Department improperly “imputed” interest or any higher-taxed income than Sanofi actually received.

Regardless of the guidelines for interpreting ambiguous *tax* statutes, if the Court were to consider RCW 82.04.272 ambiguous, it should keep in mind that “all the rules of statutory construction are relevant” in this context. 3A Norman J. Singer, *Statutes and Statutory Construction* § 66:3 at 25 (6th ed. 2003). Rules of statutory construction are not statements of law. “Rather, they are rules in aid of construing legislation and an aid in the process of determining legislative intent.” *Johnson v. Continental West*, 99 Wn.2d 555, 559, 663 P.2d 482 (1983). This Court should rely on the statutory construction rules that provide the best means for ascertaining legislative intent.

One of those principles is that courts will avoid a literal reading of a statute that produces unlikely, absurd, or strained consequences. *Lindeman v. Kelso School Dist. No. 458*, 127 Wn. App. 526, 539, 111 P.3d 1235 (2005). Sanofi’s interpretation, which allows any wholesaler of prescription drugs to qualify for the preferential rate in RCW 82.04.272, at any level in the chain of distribution, produces unlikely consequences. It distorts subsection (2)(b) so that the definition no longer is limited to reselling to health care providers and to “persons selling at retail,” but

includes reselling to “persons selling at retail *or at wholesale*.” Because the Legislature was very specific as to the requirements to qualify for this preferential tax rate, it seems highly unlikely that it intended to include reselling to downstream wholesalers, but omitted any mention of that.

2. The legislative history does not address the statutory definition or the buyer requirements in RCW 82.04.272.

Sanofi seeks support in bill reports from the legislative history, but that information does not shed any light on the issue in this case. If a statute is ambiguous, a court may resort to aids to construction, including legislative history. *Campbell & Gwinn, LLC*, 146 Wn.2d at 12. From summary statements referring to “Washington based wholesalers” and “Washington distributors,” Sanofi argues that the Legislature intended the law to apply “to all wholesalers that previously paid the higher wholesaling B&O tax that applied to general wholesalers” Appellants’ Br. at 35.

If Sanofi were correct, there would have been no need for the Legislature to create the lengthy definition of “warehousing and reselling drugs for human use pursuant to a prescription” in RCW 82.04.272(2)(b). But because the Legislature *was* concerned about qualifying resales, and thus which wholesalers could qualify for the rate, it included the statutory definition, setting both seller and buyer requirements. Including the buyer

requirements (persons selling at retail and hospitals and other health care providers) in the statute facilitated the purpose of helping in-state wholesalers, because wholesalers who were the last wholesalers in the distribution chain and sold to Washington buyers were the most likely to be located in Washington.

The legislative history says nothing about the statutory definition and its limitations. Accordingly, it is not useful for discerning legislative intent about those limitations. Instead, the express language in the statute controls.

What the legislative history *does* make clear is that the Legislature was trying to help Washington-based wholesalers compete with out-of-state drug distributors. CP 119. At the time, out-of-state wholesalers with no physical presence in Washington, i.e., lacking nexus for tax purposes, could avoid paying B&O tax by making all sales by phone or mail or by using what was known as a “direct seller’s representative” to make sales in Washington. *See* former RCW 82.04.423 (2008) (direct seller’s representative exemption); *Lamtec Corp. v. Dep’t of Revenue*, 170 Wn.2d 838, 246 P.3d 788 (2011) (discussing whether physical presence is required to provide nexus for B&O taxes and, if so, what activities in the state satisfy the requirement). Thus, in-state wholesalers were paying

0.484 percent on their gross income from sales in Washington, while such out-of-state wholesalers paid nothing.

The Department initially interpreted the statute as requiring that a qualified business have a warehouse in Washington, in addition to reselling the drugs in Washington. It later changed that position, recognizing that the statute could be viewed as favoring intrastate commerce over interstate commerce, in violation of the Commerce Clause. CP 164-65; *see* U.S. Const. art. I, § 8, cl.3; *American Trucking Ass'n, Inc. v. Scheiner*, 483 U.S. 266, 286, 107 S. Ct. 2829, 97 L. Ed. 2d 226 (1987) (under Commerce Clause, state taxes may not favor in-state business over out-of-state business for no reason other than location of its business). Accordingly, in 2008 the Department issued a Special Notice to clarify for taxpayers that an in-state warehouse was not a requirement for taxpayers to qualify for the prescription drug warehousing and reselling B&O tax classification. Stip. Ex. 4, CP 66; CP 164-65, ¶¶ 6-8. The Special Notice thus put taxable out-of-state drug wholesalers on an even footing with in-state wholesalers. And two years later, legislation effectively eliminated the original advantage to out-of-state wholesalers that the preferential rate in RCW 82.04.272 was designed to address.

First, in April 2010, the Legislature amended the direct seller's exemption to limit it retroactively and repeal it prospectively. Laws of

2010, 1st Spec. Sess., ch. 23, §§ 401-402. Second, in 2010 the Legislature also enacted RCW 82.04.067, which provides means by which some taxpayers are deemed to have substantial nexus with Washington under certain economic standards, without being physically located in the state. Laws of 2010, 1st Spec. Sess., ch. 23, §§101-104. Any drug wholesaler with more than minimal sales in Washington will have nexus with Washington for B&O tax purposes, and it will owe either the regular wholesaling rate of 0.484 percent, or if it makes sales qualifying under RCW 82.04.272, the lower preferential rate. In effect, the Legislature's original purpose of helping in-state drug wholesalers compete on a more level playing field with their out-of-state competitors has turned into a level playing field where all wholesalers who make qualifying sales can report income under the prescription drug warehousing and reselling rate.

The original reasons for enacting RCW 82.04.272 do not exist anymore, and Sanofi is well aware of this. So Sanofi argues that the Legislature "likely" intended cost savings from the preferential rate to be passed to consumers, and that the Department's interpretation undermines this policy. Appellants' Br. at 31-32. But nothing in the legislative history mentions the costs of prescription drugs to consumers. The primary way the Legislature helps keep the cost of prescription drugs lower to consumers is by allowing a retail sales tax exemption on those sales. RCW

82.08.0281. And again, if the Legislature had intended this B&O tax classification to apply broadly to drug wholesalers, it would not have included the limitations that it did in RCW 82.04.272(2)(b). In addition, the fact that the Legislature delayed the effective date of the new rate until July 2001 undermines any conclusion that it intended to provide relief to consumers through RCW 82.04.272. *See* Laws of 1998, ch. 343, § 6.

The express limitations on the scope of the preferential rate in RCW 82.04.272, the fact that it is more broadly applicable today than when it was originally enacted, the fact that the Legislature showed no purpose in enacting it other than to allow in-state wholesalers to compete with out-of-state wholesalers, and the absence of any compelling public policy reason to expand its scope today, all point to a single conclusion: Even if it is ambiguous, RCW 82.04.272 should be interpreted as the Department and the trial court have interpreted it, to require that qualifying sales are to buyers who are pharmacy retailers or hospitals or other health care providers.

C. Neither RCW 82.04.272 Nor the Department's Excise Tax Advisory Violate the Due Process Or Equal Protection Clauses.

“[T]he legislature’s power to enact a statute is unrestrained except where, either expressly or by fair inference, it is prohibited by the state and federal constitutions.” *Wash. State Farm Bureau Fed’n v. Gregoire*,

162 Wn.2d 284, 300-01, 174 P.3d 1142 (2007) (quoting *State ex rel. Citizens Against Tolls (CAT) v. Murphy*, 151 Wn.2d 226, 248, 88 P.3d 375 (2004)). To invalidate a statute, courts must be “fully convinced, after a searching legal analysis, that the statute violates the constitution.” *School Districts’ Alliance for Adequate Funding of Special Educ. v. State*, 170 Wn.2d 599, 606, 244 P.3d 1 (2010) (quoting *Island County v. State*, 135 Wn.2d 141, 147, 955 P.2d 377 (1998)). Legislation affecting economic matters is presumed to be constitutional. *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15, 96 S. Ct. 2882, 49 L. Ed. 2d 752 (1976).

Sanofi argued to the court below for the first time in summary judgment briefing that the Department’s interpretation of RCW 82.04.272 violates the Equal Protection Clause of the Fourteenth Amendment of the United States Constitution. CP 89-91. On appeal, it renews that argument and adds a new assertion under the Due Process Clause. Appellants’ Br. at 38-44. Because neither claim is timely or adequately briefed, this Court should not consider them. *See Public Hosp. Dist. No. 1 of King County v. Univ. of Wash.*, 182 Wn. App. 34, 49, 327 P.3d 1281 (2014) (courts are reluctant to consider “naked castings into the constitutional seas”); *Wallace v. Evans*, 131 Wn.2d 572, 579, 934 P.2d 662 (1997) (rejecting equal protection claim based on “insubstantial constitutional arguments”).

If the Court does consider Sanofi's constitutional arguments, it should reject them as lacking merit.

1. Sanofi's due process claim is untimely, without legal support, and meritless.

Sanofi's Notice of Appeal to the trial court makes no mention of any constitutional claim. CP 6-13. Although Sanofi raised the Equal Protection Clause in its summary judgment briefing, it failed to raise any due process question in the summary judgment process. Now, for the first time, it also argues that the Department's construction of RCW 82.04.272 "raises due process issues." Appellants' Br. at 40. Appellate courts generally refuse to review claimed errors raised for the first time on appeal, but the rule has an exception for a "manifest error affecting a constitutional right." RAP 2.5(a)(3). But this exception is not a free pass for untimely constitutional arguments. "Parties wishing to raise constitutional issues on appeal must adhere to the rules of appellate procedure." *State v. Johnson*, 119 Wn.2d 167, 171, 829 P.2d 1082 (1992). Sanofi has not met this standard because it has failed to provide the Court with the necessary tools to consider a due process challenge.

First, Sanofi has not demonstrated that the claimed error is "manifest" and "truly of constitutional dimension." *Eyman v. McGehee*, 173 Wn. App. 684, 698, 294 P.3d 847 (2013). Appellants must identify a

constitutional error and show how it actually affected the appellant's rights in the trial court. *Id.* at 698-99. If the record from the trial court is not sufficient to determine the merits of the constitutional claim, then the claimed error is not "manifest" and review is not warranted. *Id.*¹³ Sanofi has made no effort to address these standards.

Second, Sanofi's due process theory relies on the premise that the Department's interpretation of RCW 82.04.272 requires a transaction by transaction or tracing of the downstream sales of Sanofi's wholesaler customers. Appellants' Br. at 39-40 ("tracing requirement of subsequent transfers," Department imposes tax "based upon what the three buyers . . . did with its products"). Because Sanofi lacks control over the downstream sales, it relies on a statement in *Dot Foods, Inc. v. Dep't of Revenue*, 166 Wn.2d 912, 215 P.3d 185 (2009) (*Dot Foods I*) for its due process argument.

Even a quick glance at ETA 3180 establishes that Sanofi has based the argument on a false premise. ETA 3180 allows the preferential rate on a qualified taxpayer's sales to "[a] retailer with a pharmacy facility license or non-residential pharmacy license" or to hospitals and other health care

¹³ In addition, under RAP 10.3(a)(6), arguments must be supported by citations to legal authority and references to relevant parts of the record. "Generally, we will not review an issue absent reasoned argument and citation to legal authority." *Eyman v. McGehee*, 173 Wn. App. at 699-700.

providers. CP 70. If one of Sanofi's wholesale buyers also makes sales through one of these retail pharmacy licenses, the sales to that buyer qualify for the lower rate, with no examination of that buyer's actual downstream sales required.

In addition, the statement Sanofi quotes from *Dot Foods I* is inadequate to implicate due process issues in this case, much less to establish a due process violation. The Court in *Dot Foods I* quoted a paragraph from the amicus brief of Melaleuca, Inc., agreeing with the proposition that "A state cannot impose taxes on someone based upon the actions of another person, who is not the seller's agent, and whose actions are beyond the tax payer's control." *Dot Foods I*, 166 Wn.2d at 923 (quoting Amicus Curiae Br. of Melaleuca, Inc., at 11). Melaleuca also stated that this is "undoubtedly required" by the federal and state Due Process Clauses. *Id.* The Court agreed with the paragraph, but neither the Court in its opinion nor Melaleuca in its brief offered any discussion of authorities or additional analysis to support that proposition.

Likewise, Sanofi does nothing more in its brief than pile on to this conclusory proposition, arguing that to impose tax on Sanofi based on what the three Distributors then do with the products is inconsistent with *Dot Foods I*. Appellants' Br. at 39-40. It offers no discussion of due process standards and provides no additional authority to support its new

assertion that the Department's interpretation of RCW 82.04.272 violates those standards.

Sanofi's reading of *Dot Foods I* is faulty because when the Court said it agreed with Melaleuca's analysis, the Court went on to explain why. The reasons related to the statutory wording in former RCW 82.04.423 (the direct seller's exemption), not to any constitutional authority. *Dot Foods I*, 166 Wn.2d at 923.¹⁴

Beyond the foregoing problems in Sanofi's due process challenge, Sanofi offers no authority to support its argument that the Due Process Clause precludes a state from determining a seller's B&O tax rate based on who purchases the seller's goods or how the buyers intend to dispose of the goods. If that were the case, many existing tax statutes would be constitutionally suspect.

The most obvious example would be the activities of making wholesale or retail sales of goods or services generally (not subject to industry-specific provisions). When a seller of clothing, for instance, makes a sale, either the retailing or the wholesaling B&O tax rate will

¹⁴ In the next legislative session after the Supreme Court issued *Dot Foods I*, the Legislature essentially annulled the decision. Laws of 2010, 1st Spec. Sess., ch. 23, § 401. It amended RCW 82.04.423 retroactively to narrow the exemption and repealed the exemption prospectively. *Id.*; RCW 82.04.423 (2010). The Supreme Court later upheld a due process challenge to the retroactivity provision in the 2010 amendment to RCW 82.04.423. *Dot Foods, Inc. v. Dep't of Revenue*, 185 Wn.2d 239, 253, 372 P.3d 747 (2016) (*Dot Foods II*).

apply, depending on whether the customer will be using the clothing as a consumer itself or will resell the clothing in the regular course of its business. *See* RCW 82.04.050(1)(a) (definition of “retail sale” and exception for sales for resale); RCW 82.04.250 (retailing B&O tax rate is .471% of gross proceeds of sales); RCW 82.04.270 (wholesaling B&O tax rate is .484% of gross proceeds of sales).

If the sale is a retail sale, the seller also must collect the retail sales tax from the buyer and remit it to the Department. RCW 82.08.050(1)-(4). If the sale is a wholesale sale, the customer making the purchase for resale generally must obtain a reseller permit from the Department and present the permit to the seller. RCW 82.04.470(1). This eases the seller’s statutory burden of proving that a sale is a wholesale sale rather than a retail sale. The statutes also address procedures for buyers who make both purchases of tangible personal property as consumers (retail) and purchases for resale. RCW 82.08.130. The seller in the foregoing circumstances does not “control” the status of its buyers as consumers, retailers, or wholesalers, as such, but the amount B&O tax it owes will nevertheless depend upon that status.

“A tax provision will not run afoul of Fifth Amendment substantive due process principles unless it is so arbitrary as to amount to a confiscation of property and there are no considerations of policy or

practical convenience to support it.” *Butler v. United States*, 798 F. Supp. 574, 576 (E.D. Mo. 1992) (citing *Steward Machine Co. v. Davis*, 301 U.S. 548, 584, 57 S. Ct. 883, 889-90, 81 L. Ed. 1279 (1936); *Brushaber v. Union Pacific R.R.*, 240 U.S. 1, 24, 36 S. Ct. 236, 244, 60 L. Ed. 493 (1915)). Sanofi presents no argument explaining how RCW 82.04.272 or its interpretation in ETA 3180 is arbitrary, confiscatory, or without support if policy or practical considerations.

2. ETA 3180 does not violate equal protection standards.

Sanofi’s equal protection arguments are similarly untimely and lacking legal merit. Sanofi failed to raise the claim until it filed its summary judgment motion. CP 89. Accordingly, the Department did not undertake any discovery that would have resulted in specific facts about downstream wholesaler sales and how they are made, which might have been relevant to the inquiry. VRP 34-35. But regardless of whether the Court considers Sanofi’s argument, Sanofi has not established any equal protection violations.

Equal protection under the law is required by the Fourteenth Amendment of the United States Constitution and requires that all persons similarly situated be treated alike. *American Legion Post #149 v. Dep’t of Health*, 164 Wn.2d 570, 608, 192 P.3d 306 (2008); *O’Hartigan v. Dep’t of Pers.*, 118 Wn.2d 111, 121, 821 P.2d 44 (1991) (quoting *City of Cleburne*

v. *Cleburne Living Ctr., Inc.*, 473 U.S. 432, 439, 105 S. Ct. 3249, 87 L. Ed. 2d 313 (1985)).

If a challenged law or government action does not address a suspect classification or fundamental right, rational basis review applies to the claim of unequal treatment. *American Legion*, 164 Wn.2d at 608-09. Sanofi concedes that the “minimal scrutiny” or “rational basis” analysis applies to this case. Appellants’ Br. at 42. In addition, social and economic legislation is presumed to be rational, and the presumption may be overcome only “by a clear showing that the law is arbitrary and irrational.” *American Legion*, 164 Wn.2d at 609. As the party challenging the Department’s interpretation of RCW 82.04.272, Sanofi carries the burden “to show that the classification is purely arbitrary.” *Schatz v. Dep’t of Social & Health Services*, 178 Wn.2d 16, 24, 314 P.3d 406 (2013) (citing *Gossett v. Farmers Ins. Co.*, 133 Wn.2d 954, 979, 948 P.2d 1264 (1997)). Sanofi cannot meet that burden here.

It is well established that the Legislature has broad discretion in creating tax classifications. *Forbes v. City of Seattle*, 113 Wn.2d 929, 944-45, 785 P.2d 431 (1990). Its power to create tax classifications is even broader than its power to create regulatory classifications. *Id.* at 944; *General Motors Corp. v. Tracy*, 519 U.S. 278, 311, 117 S. Ct. 811, 136 L. Ed. 2d 761 (1997) (“Indeed, ‘in taxation, even more than in other fields,

legislatures possess the greatest freedom in classification.’”) (quoting *Madden v. Kentucky*, 309 U.S. 83, 88, 60 S. Ct. 406, 84 L. Ed. 590 (1940)).

Sanofi addresses the three-part inquiry set forth in *Associated Grocers*:

(1) whether the classification applies alike to all members within the designated class; (2) whether some basis in reality exists for reasonably distinguishing between those within and without the class; and, (3) whether the challenged classification bears any rational relation to the purposes of the challenged statute.

Associated Grocers, Inc. v. State of Washington, 114 Wn.2d 182, 187, 787 P.2d 22 (1990).

That case concerned the application of a prior version of the wholesaling B&O classification, RCW 82.04.270, to the grocery business. The distinction was between businesses solely making sales at wholesale (Associated Grocers) and businesses that performed wholesaling functions as part of a vertically integrated enterprise, but never made sales at wholesale. 114 Wn.2d at 184-85. The majority in a 6-3 decision held the statute created a single class of wholesalers and distributors, but gave an exemption only to distributors (the entities in the vertically integrated businesses). The court declared the statute unconstitutional on that basis, but decided that it had no need to consider the second and third parts of

the inquiry. *Id.* at 187-88. *Associated Grocers* has never been relied on by a court to strike down a tax on equal protection grounds, presumably because the analysis is incomplete. It does not provide good ammunition for Sanofi's equal protection claim here.

Here, as previously explained, RCW 82.04.272 cannot reasonably be read as creating a single class of all prescription drug wholesalers, selling at any level of the distribution chain, and giving that single class favorable tax treatment. To the contrary, by its plain terms, RCW 82.04.272 gives that favorable tax treatment only to taxpayers on their sales to (a) health care providers and (b) pharmacy retailers, i.e., "persons selling at retail." Because the Distributors fall into neither category, as evidenced by their lack of pharmacy facility licenses or non-residential pharmacy licenses, Sanofi's sales to those Distributors do not qualify for the prescription drug warehousing rate.

Contrary to what Sanofi argues, the Department's interpretation in ETA 3180 of the buyer requirement for "persons selling at retail," requiring those buyers to have a retail pharmacy license, does not create yet another subclass of prescription drug wholesaler distributors. *See* Appellants' Br. at 40-41. The pharmacy license requirement is merely the Department's application of what the Legislature intended when it identified acceptable buyers as "persons selling at retail" in the context of

this statute – retail pharmacies. The preferential rate will apply to a qualified wholesaler’s sales to such persons and to sales to hospitals and other health care providers, just as the statute provides. If RCW 82.04.272 does not violate the first inquiry identified in *Associated Grocers*, neither does ETA 3180.

The court in *Associated Grocers* did not address the second and third inquiries in the equal protection analysis, and neither does Sanofi in its briefing. If the attack is focused solely on ETA 3180, the second inquiry is whether “some basis in reality exists” for distinguishing between a qualified taxpayer’s sales to persons (other than health care providers) with a retail pharmacy license and its sales to persons who do not have such a license. The third inquiry compares the relationship of the challenged classification, Sanofi’s buyers who are wholesalers, either with or without a retail pharmacy license, to the purposes of the statute. Sanofi has not argued that there is no rational basis for distinguishing its buyers on the basis of whether they have a retail pharmacy license. Sanofi also has not argued or established that doing so bears no rational relation to the purpose of the statute. As a matter of law, Sanofi has failed to demonstrate that the distinctions made in either ETA 3180 or in RCW 82.04.272 are irrational, arbitrary, or capricious, and its equal protection argument should fail.

The purpose of this statute is clear from the express language of the statute and from the legislative history. The Legislature created a limited preferential tax rate for certain drug wholesalers, those who made the last wholesale sales in the distribution chain, in order to allow in-state drug wholesalers to compete better with out-of-state wholesalers. CP 119. In drafting the statutory definition of “warehousing and reselling drugs for human use pursuant to a prescription,” the Legislature rationally could have assumed that the last wholesalers in the distribution chain were more likely to be located in Washington than upstream wholesalers and the most likely to be selling to Washington health care providers and retail sellers.

Rational basis review is “extraordinarily deferential,” and only in “the rarest of cases” will a statute fail to survive that review. *More v. Dep't of Ret. Sys.*, 133 Wn. App. 581, 585, 137 P.3d 73 (2006); *DeYoung v. Providence Med. Ctr.*, 136 Wn.2d 136, 144, 960 P.2d 919 (1998). “A conceivable rational speculation is sufficient to uphold the classification.” *More*, 133 Wn. App. at 586; *DeYoung*, 136 Wn.2d at 147-48.

Moreover, the Department’s interpretation of “persons selling at retail” in the context of this statute as including only those resellers with retail pharmacy licenses also has a rational basis. The Department recognized that requiring information from taxpayers about who their customers’ customers are and what the sales volume is of those

downstream sales is unwieldy. The Department chose instead to use a system to identify the status of a taxpayer's customers that relies solely on public records, licensing that proves the business retails prescription drugs. CP 166-67, ¶¶12-13.

Both the United States Supreme Court and Washington courts have considered ease of administration a lawful tax policy to support a classification. *Lehnhausen v. Lake Shore Auto Parts*, 410 U.S. 356, 365, 93 S. Ct. 1001, 35 L. Ed. 2d 351 (1973) (*overruling Quaker City Cab Co. v. Pennsylvania*, 277 U.S. 389, 48 S. Ct. 553, 72 L. Ed. 927(1938)) (avoidance of administrative burden and need to facilitate orderly administration of a tax supply reasonable basis for disparate tax treatment); *United Parcel Service Inc. v. Dep't of Revenue*, 102 Wn.2d 355, 368, 687 P.2d 186 (1984) (same). The Department's "buyer requirement" that a person "selling at retail" have a retailer's pharmacy license is thus reasonable and rationally related to the purpose of the statute.

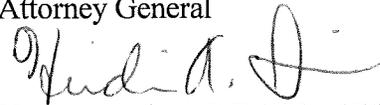
V. CONCLUSION

For the foregoing reasons, the Department respectfully requests that this Court affirm the trial court's order granting summary judgment to the Department and denying Sanofi's summary judgment motion.

RESPECTFULLY SUBMITTED this 17th day of November,

2017.

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Washington that the foregoing is true and correct.

DATED this 17th day of November, 2017, at Tumwater, WA.



Candy Zilinskas, Legal Assistant

APPENDIX

RCW 82.04.272

Tax on warehousing and reselling prescription drugs.

(1) Upon every person engaging within this state in the business of warehousing and reselling drugs for human use pursuant to a prescription; as to such persons, the amount of the tax shall be equal to the gross income of the business multiplied by the rate of 0.138 percent.

(2) For the purposes of this section:

(a) "Prescription" and "drug" have the same meaning as in RCW 82.08.0281; and

(b) "Warehousing and reselling drugs for human use pursuant to a prescription" means the buying of drugs for human use pursuant to a prescription from a manufacturer or another wholesaler, and reselling of the drugs to persons selling at retail or to hospitals, clinics, health care providers, or other providers of health care services, by a wholesaler or retailer who is registered with the federal drug enforcement administration and licensed by the pharmacy quality assurance commission.

[2013 c 19 § 127; 2003 c 168 § 401; 1998 c 343 § 1.]

NOTES:

Effective dates—Part headings not law—2003 c 168: See notes following RCW 82.08.010.

Effective date—1998 c 343: "This act takes effect July 1, 2001." [1998 c 343 § 6.]



Excise Tax Advisory

Excise Tax Advisories are interpretive statements authorized by RCW 34.05.230.

ETA 3180.2013

Issue Date: September 25, 2013

Warehousing/Reselling Prescription Drug B&O Tax Preference

Background

The purpose of this excise tax advisory (ETA) is to clarify the requirements to qualify for preferential tax treatment under RCW 82.04.272.

RCW 82.04.272 provides a preferential B&O tax rate to persons “engaging in the business of warehousing and reselling drugs for human use pursuant to a prescription.” This statute defines “warehousing and reselling drugs for human use pursuant to a prescription” to be:

The buying of drugs for human use pursuant to a prescription from a manufacturer or another wholesaler, and reselling of the drugs to persons selling at retail or to hospitals, clinics, health care providers, or other providers of health care services, by a wholesaler or retailer who is registered with the federal drug enforcement administration and licensed by the Pharmacy Quality Assurance Commission.

Seller and Buyer Requirements

To qualify for the preferential B&O tax rate, the seller must satisfy all of the Seller Requirements AND the qualifying sale must be made to a buyer meeting at least one of the Buyer Requirements:

Seller Requirements

To qualify for the preferential B&O tax rate, the seller must satisfy the following requirements:

- Purchase prescription drugs from a manufacturer or wholesaler¹;
- Warehouse and resell the prescription drugs²;
- Be registered with the Federal Drug Enforcement Administration; and

¹ Direct sales of drugs by the manufacturer do not qualify for the preferential Warehousing/Reselling Prescription Drug B&O tax rate, because the drugs sold were not previously purchased from a manufacturer or wholesaler.

² There is no requirement that the warehousing activity occur within Washington.

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- Be licensed by the Pharmacy Quality Assurance Commission (as either a wholesaler or retailer).
-

Buyer Requirements

A seller qualifies for the preferential B&O tax rate if the seller satisfies all the requirements above and resells the prescription drugs directly to a buyer who is:

- A retailer with a pharmacy facility license or non-residential pharmacy license issued by the Department of Health under RCW 18.64.043 or RCW 18.64.370, respectively; or
 - A hospital, clinic, health care provider, or other provider of health care services.
-

ATTORNEY GENERAL'S OFFICE - REVENUE & FINANCE DIVISION

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