

FILED  
Court of Appeals  
Division II  
State of Washington  
12/24/2018 1:32 PM

NO. 51468-1-II

---

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

---

ADVANCED H2O, LLC & TYSON FRESH MEATS, INC.,

Appellants,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

---

**REPLY BRIEF OF RESPONDENT  
DEPARTMENT OF REVENUE**

---

ROBERT W. FERGUSON  
Attorney General

Rosann Fitzpatrick, WSBA No. 37092  
Assistant Attorney General  
Revenue Division, OID No. 91027  
P.O. Box 40123  
Olympia, WA 98504-0123  
(360) 753-5528

## TABLE OF CONTENTS

I.	INTRODUCTION.....	1
II.	ARGUMENT .....	3
	A. Advanced H2O and Tyson Misstate the Applicable Standard of Review.....	3
	B. The Pallet Rental Transactions Do Not Meet Any of the Three Conditions for Treatment as Wholesale Sales.....	5
	1. Renting the pallets for use in delivering products to customers is a purpose “other than for sublease” .....	5
	2. Advanced H2O and Tyson did not sublease the pallets to their customers .....	9
	3. Advanced H2O and Tyson’s own use of the pallets precludes them from qualifying for the lease-for- sublease exemption.....	14
	C. The Board Misinterpreted and Misapplied WAC 458-20- 115 in Concluding Advanced H2O and Tyson’s Pallet Rentals Qualify as Wholesale Purchases .....	16
III.	CONCLUSION .....	22

## TABLE OF AUTHORITIES

### Cases

<i>Activate, Inc. v. Dep't of Revenue</i> , 150 Wn. App. 807, 209 P.3d 524 (2009).....	5
<i>Black v. State</i> , 67 Wn.2d 97, 406 P.2d 761 (1965).....	15, 16
<i>Brambles Indus., Inc. v. Indiana Dep't of Revenue</i> , 892 N.E.2d 1287 (Ind. App. 2008) .....	18
<i>Cashmere Valley Bank v. Dep't of Revenue</i> , 181 Wn.2d 622, 334 P.3d 1100 (2014).....	21
<i>City of Phoenix v. Bentley-Dille Gradall Rentals, Inc.</i> , 136 Ariz. 289, 665 P.2d 1011 (1983) .....	11
<i>Dep't of Revenue v. Bi-Mor, Inc.</i> , 171 Wn. App. 197, 286 P.3d 417 (2012).....	4
<i>Gandy v. State</i> , 57 Wn.2d 690, 359 P.2d 302 (1961) .....	10, 11, 13
<i>Lakewood Lanes, Inc. v. State</i> , 61 Wn.2d 751, 380 P.2d 466 (1963).....	7
<i>Mayflower Park Hotel, Inc. v. Dep't of Revenue</i> , 123 Wn. App. 628, 98 P.3d 534 (2004).....	7, 15, 17
<i>Sprint Spectrum, LP v. Dep't of Revenue</i> , 174 Wn. App. 645, 302 P.3d 1280 (2013).....	4, 13, 14
<i>Time Oil Co. v. State</i> , 79 Wn.2d 143, 483 P.2d 628 (1971).....	14
<i>Wasem's, Inc. v. State</i> , 63 Wn.2d 67, 385 P.2d 530 (1963).....	14

<i>William Dickson Co. v. Puget Sound Air Pollution Control Agency</i> , 81 Wn. App. 403, 914 P.2d 750 (1996).....	4
---	---

**Statutes**

RCW 82.04.040(3)(a) .....	2, 9, 10, 13
RCW 82.04.050(1)(a)(i).....	6, 7
RCW 82.04.050(4)(a) .....	7
RCW 82.04.050(4)(b) .....	6
RCW 82.08.010(11).....	7
RCW 82.32.410 .....	21

**Regulations**

WAC 458-20-115.....	3, 16
WAC 458-20-115(3)(a) .....	16, 19
WAC 458-20-115(5)(c) .....	20
WAC 458-20-115(6)(c) .....	3, 16, 17, 18
WAC 458-20-211.....	2, 13
WAC 458-20-211(5)(a)(ii).....	15
WAC 458-20-211(5)(a)(iii) .....	5

**Treatises**

Steven J. Hopp, <i>Sales Tax, in WASHINGTON STATE AND LOCAL TAX</i> DESKBOOK 4-12 (C. James Judson, ed., 1996) .....	6
---	---

## I. INTRODUCTION

The undisputed evidence in the record establishes as a matter of law that Advanced H2O and Tyson leased pallets for their own use in delivering goods, actually used the pallets to fulfill that purpose, and did not sublease the pallets to their customers. Thus, Advanced H2O and Tyson are not entitled to a refund of the sales or use taxes they paid on their pallet rentals. In reaching contrary conclusions, the Board of Tax Appeals (Board) disregarded well-established case law on the sale-for-resale exemption and applied the exemption in an overly simplistic way. The Board also misapplied the lease-for-sublease exemption to Advanced H2O and Tyson's pallet rentals by ignoring the undisputed fact that their own lease periods ended when they transferred possession of the pallets to their customers.

The touchstone in assessing sales and use taxes is identifying the "consumer," i.e., the person that enjoys the use of tangible personal property for a purpose other than resale. In a rental transaction, an amount is paid for the right to possess or use property for a period of time. The "consumer" of the property is the person that actually uses it during the rental period. Here, Advanced H2O and Tyson enjoyed the rental value of the pallets they used to deliver their products and, thus, they are the "consumers" of the rented pallets.

Advanced H2O and Tyson try to justify the Board's erroneous application of the lease-for-sublease exemption as compelled by the statutory definition of "lease," which they incorrectly assert requires disregarding its ordinary meaning. In fact, the statute codifies the common law elements of a lease: the exchange of consideration for the right to possess or use property for a period of time. Because their own right to possess and use the pallets ended with the transfer of possession to their customers, Advanced H2O and Tyson did not, and could not, "sublease" the pallets to their customers. As a matter of law, the amount their customers paid for the products they purchased from Advanced H2O and Tyson was not "consideration" for the right to possess or use the pallets for a "fixed or indeterminate period of time" within the meaning of RCW 82.04.040(3)(a) (defining "lease").

Even if it were technically true that Advanced H2O and Tyson's transfer of the pallets to their customers fits within the very broad statutory definition of a "sale," their own pallet rentals still would not qualify as wholesale sales because Advanced H2O and Tyson made "intervening use" of the pallets to deliver their products. No legal authority supports Advanced H2O and Tyson's argument that the intervening use analysis does not apply to the lease-for-sublease exemption. Consistent with Washington case law, the tax regulation on leases, WAC 458-20-211,

makes it clear that a lessee's own use of leased property disqualifies it from the lease-for-sublease exemption.

Finally, Advanced H2O and Tyson's argument that the pallet rentals qualify as purchases of "nonreturnable" pallets to be sold with their products is not a reasonable interpretation of the tax regulation on packaging materials, WAC 458-20-115. Equipment rented for use in delivering products to customers is, by definition, "returnable" by the product seller's customer for purposes of WAC 458-20-115(6)(c), and, thus, it is not acquired for the purpose of resale or sublease.

The Board erroneously interpreted and applied the sale-for-resale and lease-for-sublease exemptions. The superior court correctly reversed the Board's decisions and this Court should affirm.

## **II. ARGUMENT**

### **A. Advanced H2O and Tyson Misstate the Applicable Standard of Review**

Advanced H2O and Tyson restate the issues on review as if the Board had held an evidentiary hearing to resolve disputed issues of fact rather than deciding this matter on summary judgment. They assert the Court should review the record for substantial evidence supporting the Board's rulings even though the Board did not exercise its fact-finding authority in this case.

The cases Advanced H2O and Tyson cite as support for their argument are wholly inapt. *Sprint Spectrum, LP v. Dep't of Revenue*, 174 Wn. App. 645, 302 P.3d 1280 (2013), stands for the proposition that an agency's mislabeling of findings of fact as conclusions of law does not control the standard of review on appeal. *Sprint Spectrum*, 174 Wn. App. at 653. *William Dickson Co. v. Puget Sound Air Pollution Control Agency*, 81 Wn. App. 403, 914 P.2d 750 (1996), explains that an appellate court defers to an agency's resolution of disputed factual issues. *Dickson*, 81 Wn. App. at 411. These cases are inapposite because they involve agency adjudications of disputed factual issues. Here, the only "findings" the Board made were that there are no disputed issues of material fact and that Advanced H2O and Tyson are entitled to prevail as a matter of law.

No legal authority supports Advanced H2O and Tyson's novel proposition that an agency's summary judgment order should be reviewed on appeal as if it were a finding of fact mislabeled as a conclusion of law. Where, as here, the Board decides a tax appeal on summary judgment, the appellate court reviews the Board's legal conclusions de novo while viewing the facts in the light most favorable to the nonmoving party. *Dep't of Revenue v. Bi-Mor, Inc.*, 171 Wn. App. 197, 202, 286 P.3d 417 (2012). The real issue on appeal is whether the Board misinterpreted and misapplied the elements of the lease-for-sublease and sale-for-resale

exemptions to the undisputed facts in the record. This is a pure question of law subject to de novo review.

**B. The Pallet Rental Transactions Do Not Meet Any of the Three Conditions for Treatment as Wholesale Sales**

The Board failed to apply the three-part test Washington courts have established for evaluating whether a sale qualifies as a wholesale transaction. For their pallet rentals to qualify as wholesale transactions, Advanced H2O and Tyson were required to establish three things: (1) that they acquired the pallets for resale or sublease; (2) that they resold or subleased the pallets; and, (3) that they did so without making “intervening use” of the pallets. *Activate, Inc. v. Dep’t of Revenue*, 150 Wn. App. 807, 817, 209 P.3d 524 (2009); WAC 458-20-211(5)(a)(iii) (intervening use of leased property disqualifies lessee from claiming sublease exemption). The undisputed facts preclude Advanced H2O and Tyson from meeting any of these requirements.

**1. Renting the pallets for use in delivering products to customers is a purpose “other than for sublease”**

Advanced H2O and Tyson’s purpose for renting the pallets from CHEP was to use them to ship their products to customers. AR-H2O 91; AR-Tyson 88. They rented the pallets only for so long as they needed them to fulfill that purpose. AR-H2O 117, ¶ 2(a); AR-Tyson 99, ¶ 5.2. Advanced H2O and Tyson’s customers assumed liability to CHEP for

their own possession or use of the pallets. AR-H2O 130; AR-Tyson 99, ¶ 5.2. These undisputed facts establish as a matter of law that Advanced H2O and Tyson acquired the pallets for a purpose other than for resale.

The Board failed to consider whether acquiring pallets for use in delivering products to customers qualifies as a purpose other than for resale. The Board disregarded the numerous Washington case law authorities that have established the framework for applying the sale-for-resale exemption, relying instead on an overly simplified statement of the law from a 1996 deskbook on Washington taxes: “The retail sales tax does not apply if the purchaser will resell the item.” AR-H2O 13 (quoting Steven J. Hopp, *Sales Tax, in WASHINGTON STATE AND LOCAL TAX DESKBOOK 4-12* (C. James Judson, ed., 1996)); AR-Tyson 13 (same).

Advanced H2O and Tyson, likewise, gloss over their obvious business need for the pallets. They concede that they rented the pallets for use in shipping products to customers, but they appear to argue that their customers’ eventual use of the transferred pallets somehow negates their own use. Advanced H2O and Tyson provide no appellate authority supporting the proposition that acquiring property for use in delivering products to customers does not count as a “purpose other than for resale” or sublease within the meaning of RCW 82.04.050(1)(a)(i) and RCW 82.04.050(4)(b).

Washington case law makes it clear that a seller's use of property is a distinct taxable incident from its customer's use of the same property. *See, e.g., Lakewood Lanes, Inc. v. State*, 61 Wn.2d 751, 753-54, 380 P.2d 466 (1963) (lessor's use of pinsetting machines to produce revenue is a separate taxable incident from a bowling alley owner's use of the machines to attract customers); *Mayflower Park Hotel, Inc. v. Dep't of Revenue*, 123 Wn. App. 628, 632, 98 P.3d 534 (2004) (hotel owner's own use of amenities placed in hotel rooms for guest use is a separate taxable incident from the guest's actual use of the items). The eventual use Advanced H2O and Tyson's customers made of the pallets does not negate their own use of the pallets to deliver their products.

Advanced H2O and Tyson are in the business of manufacturing or processing goods and selling them to retailers. Delivering their products to customers is a necessary part of their business operations. Renting pallets for use in delivering products to customers is a purpose "other than for resale" or "sublease" within the meaning of RCW 82.08.010(11) (defining "retail sale"), RCW 82.04.050(1)(a)(i), and RCW 82.04.050(4)(a).

Advanced H2O and Tyson argue that since they had the right to retain the pallets for an "indefinite period of time" without additional charge, they gave up a valuable property right by transferring the pallets to their customers. Appellant's Response Brief (Resp. Br.) at 18. Upon the

transfer of possession, CHEP removed the pallets from Advanced H2O or Tyson's inventory and added them to its customers' inventory. AR-H2O 117, ¶ 2(a); AR-Tyson 99, ¶ 5.2. Thus, transferring the pallets once they no longer needed them benefited Advanced H2O and Tyson themselves by discharging them from liability for the pallets and reducing their future pallet rental costs.

It is irrelevant whether Advanced H2O and Tyson paid a "one-time" fee or daily rent to CHEP. *See* Resp. Br. at 18. In either case, the amount of rent covered the period of time Advanced H2O and Tyson had possession and use of the pallets, and no longer. CHEP periodically adjusted the issue fee based on a customer's actual usage history. *See* AR-Tyson 102 ("Pallet pricing charges shall be based upon Cycle time and Volume."), AR-Tyson 107 (email from CHEP's director of sales to Tyson, stating pallets with cycle time of 0-15 days are subject to \$2.75 issue fee and \$1.07 transfer fee; 16-32 days \$3.18 issue fee and \$1.07 transfer fee). Thus, if Advanced H2O and Tyson had, in fact, kept the pallets longer than necessary for their own use, their rental fees would have increased.

The rental fees Advanced H2O and Tyson paid to CHEP were in exchange for the right to possess and use the pallets themselves. They acquired the right to transfer the pallets to their customers for their own benefit. It allowed them to fulfill their purpose of using the pallets to

deliver their products. Once a customer took delivery, the pallet was no longer “on hire” by Advanced H2O or Tyson. AR-Tyson 112, ¶ 5.2 (defining “Quantity of Equipment on Hire”). The undisputed facts establish as a matter of law that the Advanced H2O and Tyson acquired the pallets for their own use, and not for the purpose of resale or sublease.

**2. Advanced H2O and Tyson did not sublease the pallets to their customers**

The Board erred as a matter of law in concluding Advanced H2O and Tyson subleased the pallets to their customers. The fundamental error in the Board’s analysis was ignoring the essential element of a lease transaction: the exchange of consideration for the right to possess or use property for *a period of time*. Because Advanced H2O and Tyson’s own rental period ended with the transfer of possession, they could not have “subleased” the pallets to their customers. The amount their customers paid for the products Advanced H2O and Tyson sold was not “consideration” for the customers’ right to possess or use the pallets “for a fixed or indeterminate time.” RCW 82.04.040(3)(a).

Advanced H2O and Tyson double-down on the Board’s error, repeatedly misstating the elements of a lease transaction. Resp. Br. at 13 (asserting the statute “imposes two requirements and no others”); Resp. Br. at 16 (“all that is required to satisfy the statutory definition of a

‘lease’ is to transfer possession of property in exchange for compensation”); Resp. Br. at 23 (“the controlling statutory language only requires a transfer of possession for consideration”).

RCW 82.04.040(3)(a) defines “lease or rental” as “any transfer of possession or control of tangible personal property *for a fixed or indeterminate term* for consideration.” (Emphasis added). This language codifies the common law meaning of a lease. *See Gandy v. State*, 57 Wn.2d 690, 694, 359 P.2d 302 (1961) (describing the “usual definition” of a lease as “a contract whereby one party gives to another the right to the use and possession of property for a specified period of time and, ordinarily, for fixed payments”). The taxable incident of a lease is the exchange of consideration for the right to possess or use property for a period of time.

RCW 82.04.040(3)(a).

The rental fees Advanced H2O and Tyson paid to CHEP were for the period of time they actually possessed the pallets. Their ability to pass on their pallet rental costs in the prices they charged for their products does not mean Advanced H2O or Tyson subleased the pallets to their customers. Advanced H2O and Tyson had no property interest in the transferred pallets and, thus, could not have demanded “consideration” in exchange for their customer’s possession or use of the pallets for *any* period of time.

The existence of a sublease requires that the lessee has the right to possess or use the leased property during the period of time covered by the sublease. “The principal characteristic of a rental or lease is the giving up of possession to the lessee so that he, as opposed to the lessor, exercises control over and uses the leased or rented property.” *City of Phoenix v. Bentley-Dille Gradall Rentals, Inc.*, 136 Ariz. 289, 665 P.2d 1011 (1983). In the CHEP pallet rental program, CHEP owns the pallets and “administers the circulation of all Equipment as part of a pool.” AR-H2O 118 at 6(a). The pool participants do not resell or sublease the pallets to one another. Each successive transferee assumes direct liability to CHEP for the pallets within its possession. There is no overlap in the rental periods covered by the pallet rental fees paid by CHEP’s customers.

Contrary to Advanced H2O and Tyson’s argument, the Department does not contend that a sublease must involve “a series of transactions.” Resp. Br. at 16. The point is that each rental payment must correspond to a period of time. “Each rental payment relates to a period of possession. It is this possession for which the lessee contracts and for which the periodic consideration is given.” *Gandy*, 57 Wn.2d at 694. The rental fees Advanced H2O and Tyson paid to CHEP were in exchange for the period of time *they* possessed the pallets. Upon relinquishing possession, their own rental period was over, so they could not have subleased the pallets.

Regardless of whether the rental period was indeterminate at the time Advanced H2O or Tyson first took possession of a pallet, the rental period ended when the pallet was transferred to a customer. *See* AR-H2O 117, ¶ 2(a) (“Equipment will be added to and/or deducted from the Quantity of Equipment on Hire” when a pallet is transferred to another CHEP customer); AR-Tyson 99, ¶ 5.5 (“As of the date of transfer of Equipment, the Quantity of Equipment on Rental will increase at the authorized location and will decrease the Quantity of Equipment on Rental at the Customer by the quantity transferred.”). Thus, whatever amounts Advanced H2O and Tyson charged their customers for the beverage and beef products they sold was *not* consideration for their customers’ own possession or use of the pallets for any period of time.

Advanced H2O and Tyson point out that CHEP did not charge a transfer fee for pallets shipped “under load” from one CHEP customer to another. Resp. Br. at 21. This does not change the fact that Advanced H2O and Tyson no longer had the pallet “on hire” after transferring possession to its customer. CHEP alone was free to assert a property interest in the pallets: it could retrieve the pallet at any time, charge rent, or demand compensation for a lost or damaged pallet.

Advanced H2O and Tyson argue the statute defining “lease or rental” requires the Department and the courts to disregard “typical or

common law notions of what constitutes a lease.” Resp. Br. at 17. The provision they rely on is inapposite. RCW 82.04.040(3)(a) states:

The definition in this subsection (3) must be used for sales and use tax purposes regardless if a transaction is characterized as a lease or rental under generally accepted accounting principles, the United States internal revenue code, Washington state’s commercial code, or other provisions of federal, state, or local law.

This provision relates to the specific types of transactions that are included or excluded from the definition of “lease.”<sup>1</sup> The special meanings given to the term are not at issue here. Advanced H2O and Tyson’s pallet rentals fall within the general definition of a lease, which codifies its “usual definition.” *Gandy*, 57 Wn.2d at 594. This Court has recognized that *Gandy* remains good law in applying the sales and use tax statutes. *See Sprint Spectrum*, 174 Wn. App. at 655 (citing *Gandy* for the proposition that a monthly wireless service contract is taxable as a “series of sales”).

Advanced H2O and Tyson’s argument also contradicts the well-established principle that the State’s excise taxes are to be applied in a

---

<sup>1</sup> The specific types of lease transactions described in the statute codify the Department’s administrative rulings on how the sales and use taxes apply to such transactions. Their purpose is to deter tax avoidance by businesses that may try to recharacterize installment sales or “financing leases” (which are fully taxable at the time of sale) as “true leases” (taxable only as the rental payments come due), and to resolve certain other controversies involving leases. *See* WAC 458-20-211 (leasing and renting tangible personal property).

common sense and practical rather than hypertechnical manner. *See, e.g. Time Oil Co. v. State*, 79 Wn.2d 143, 146, 483 P.2d 628 (1971) (rejecting taxpayer’s reliance on “the technicalities of the transference of title and possession” to avoid wholesaling B&O taxes as an exaltation of form over substance); *Wasem’s, Inc. v. State*, 63 Wn.2d 67, 70, 385 P.2d 530 (1963) (rejecting seller’s ploy to avoid its duty to collect sales taxes by having in-store customers sign documents agreeing to “deliver” the goods to themselves at a point outside the State). The lease-for-sublease exemption is no exception.

Advanced H2O and Tyson’s transfer of possession of the pallets to their customers was not a “sublease” because the amounts their customers owed for the products they purchased was not “consideration” for the customers’ own possession or use of the pallets for *any* period of time.

**3. Advanced H2O and Tyson’s own use of the pallets precludes them from qualifying for the lease-for-sublease exemption**

Even if a taxpayer establishes that it acquired property for resale or sublease and that it actually resold or subleased the property in the regular course of business, the sales or use tax still applies if the taxpayer made “intervening use” of the property. *Sprint Spectrum*, 174 Wn. App. at 664. Thus, even if Advanced H2O and Tyson were correct in asserting that the amount they charged their customers was “consideration” for the

transferred pallets within the statutory meaning of a “sale,” their own use of the pallets during the rental periods at issue disqualifies them from the lease-for-sublease exemption. *Cf. Mayflower Park Hotel*, 123 Wn. App. at 632-33 (hotel owner’s “use” of amenities placed in hotel room to attract guests disqualifies it from the sale-for-resale exemption).

Advanced H2O and Tyson argue that the intervening use analysis does not apply to the lease-for-sublease exemption, but they do not explain why that would be so. The tax regulation on lease transactions specifically states that the renting or leasing of equipment qualifies as a wholesale sale only when the leased equipment is re-rented or subleased “without intervening use” by the lessee: “when equipment is rented for re-rent by the lessee, *without intervening use*, then the original rental is subject to the wholesaling classification of tax and the subsequent rental is subject to the retailing classification.” WAC 458-20-211(5)(a)(ii) (emphasis added). The tax regulation is consistent with Washington case law on leases.

For example, in *Black v. State*, 67 Wn.2d 97, 406 P.2d 761 (1965), the Supreme Court affirmed a sales tax assessment on the lease of a ship that was acquired for use as a floating hotel. The Court acknowledged that a lease transaction could qualify as a sale-for-resale, but only if the lessee actually subleased the property without using it for its own purposes. *Id.* at 102-03 (“There is no exemption from sales tax in the law for one

who purchases (rents) tangible personal property for the purpose of using the same in rendering services.”). In concluding that the leasing of individual rooms to hotel guests did not qualify as a “sublease” of the ship, the Court reasoned that the lessee was “the ultimate consumer” of the leased ship because it used it as the platform for its own business activities. *Id.*

As in *Black*, Advanced H2O and Tyson’s own use of the pallets to deliver their products to customers disqualifies their pallet rentals from treatment as wholesale transactions. Advanced H2O and Tyson’s use of the pallets was not merely “intervening,” but practically exclusive since they actually possessed the pallets for the entire period of time covered by the rental fees they paid to CHEP.

**C. The Board Misinterpreted and Misapplied WAC 458-20-115 in Concluding Advanced H2O and Tyson’s Pallet Rentals Qualify as Wholesale Purchases**

The Board also erroneously interpreted the “plain language” of WAC 458-20-115, resulting in an overly broad application of the sale-for-resale exemption. AR-Tyson 17. Specifically, the Board misinterpreted the rule as treating pallets rented for use in delivering products as purchases-for-resale under WAC 458-20-115(3)(a), and (6)(c). There is no statutory exemption for equipment rented for use in delivering products to customers. Thus, if Rule 115 really meant what the Board concluded it

means, the rule would be contrary to the governing tax statutes and the statutes would control. *Cf. Mayflower Park Hotel*, 123 Wn. App. at 633 (rejecting taxpayer's reliance on rule language that purportedly authorized a broader tax exemption than statutorily authorized).

Advanced H2O and Tyson argue the pallets they use to deliver goods should be treated the same as "nonreturnable" pallets that are "sold with the product" under the example provided in Rule 115(6)(c). Resp. Br. at 29. To the contrary, the pallets are more similar to the two other types of pallet transactions described; (1) pallets "used strictly" by the manufacturer itself, and (2) "returnable" pallets used in delivering products to customers. Rule 115(6)(c). The pallets are similar to those used strictly by the manufacturer itself because Advanced H2O and Tyson had possession and use of the pallets for the entire period of time for which they paid rent. The pallets are similar to pallets that must be returned by the seller's customer because CHEP retains exclusive ownership of the pallets and may retrieve them from the transferee at any time, charge rent, or demand compensation for lost or damaged pallets.

Advanced H2O and Tyson contend the Department "reads something into the WAC that isn't there" in concluding the type of "returnable" pallets described in the example includes pallets returnable to a person other than the seller. Resp. Br. at 30. But the language of the rule

does not specify to whom the pallets must be returned: “A second type of pallet is returnable and the customer is charged a deposit which is refunded at the time the pallet is returned.” WAC 458-20-115(6)(c). The passive construction of the sentence does not support the argument that it only describes pallets returnable directly to the seller.

In applying a similarly worded sales tax exemption, the Indiana Court of Appeals held that a manufacturer’s pallet rentals did not qualify as wholesale purchases of “nonreturnable” packages to be sold with the goods they contain. *Brambles Indus., Inc. v. Indiana Dep’t of Revenue*, 892 N.E.2d 1287 (Ind. App. 2008). Like Advanced H2O and Tyson here, the manufacturer argued its rental of pallets for use in delivering products qualified as exempt purchases of “nonreturnable” packages because its customers were required to return the pallet to CHEP rather than to the manufacturer. *Id.* at 1290. The court rejected the argument, stating:

Neither the statute, the regulation, nor the dictionary definition of the word ‘return’ require that the container go back to the person from whom it was immediately acquired in order to be considered ‘returned,’ as the manufacturers contend. It is enough that the pallets are ‘pass[ed] back to an earlier possessor,’ which in this case is CHEP.

*Id.* at 1291. Consequently, the Court concluded the manufacturers’ lease payments to CHEP did not qualify for the sales tax exemption applicable to nonreturnable containers.

This Court should follow the sound reasoning of the Indiana court and reject Advanced H2O and Tyson's hypertechnical reading of the Department's rule. Leased property is by definition "returnable." Advanced H2O and Tyson's customers were not, in fact, free to keep the pallets in perpetuity as part of the products sold.

Finally, Advanced H2O and Tyson argue their pallet rentals should be treated the same as pallets purchased "for purposes of shipping them to customers as part of the sale of a company's products," which would qualify as a sale-for-resale under WAC 458-20-115(3)(a). Resp. Br. at 15. Advanced H2O and Tyson argue these two types of transactions are identical. They are incorrect. The taxable incidents of a sale and a lease differ and so do the tax consequences. The differing tax treatment results from factual differences between these two types of transactions.

Sales and use taxes apply to the person that uses or consumes tangible personal property. Properly identifying the "consumer" requires consideration of the nature of the property interest acquired and how it is used. In a rental transaction, an amount is paid for the right to possess or use property for a period of time. The "consumer" of the property is the person that actually uses it during the rental period. Here, Advanced H2O and Tyson enjoyed the full rental value of the pallets they used to deliver their products and, thus, they are the "consumers" of the rented pallets.

In contrast, when a manufacturer purchases a pallet for the purpose of reselling it to a customer along with its products, most of the useful value of the pallet is to be conveyed to the manufacturer's customer. The manufacturer's use of the pallet to deliver its products is incidental to its purpose of reselling it. Thus, the imposition of the sales or use tax is deferred until the pallet reaches the ultimate consumer. If the manufacturer's customer retains the pallet for its own use, the use tax then applies. *See* WAC 458-20-115(5)(c) (use tax applies to the use of pallets by a manufacturer or seller where the pallets will be retained for use rather than resold). If the manufacturer's customer resells the pallet to its own customer, the tax is again deferred.

Unlike manufacturers that purchase pallets for resale, Advanced H2O and Tyson did not pass on any property interest in the pallets to their customers. Rather, they enjoyed the entire rental value of the pallets by using them to deliver their products. Thus, they were the ultimate consumers of the pallets.

Advanced H2O and Tyson's pallet rentals are more like pallets acquired for use in a pallet exchange arrangement between manufacturers and retailers than they are to pallets purchased for resale. As explained in the Department's opening brief, manufacturers choosing to purchase pallets for use in delivering products typically enter into barter

arrangements with their customers agreeing to exchange loaded pallets for an equal number of empty ones. Opening Br. at 40 n.8. This benefits both manufacturers and retailers by extending the useful life of the pallets. The Department's published tax determinations explain that manufacturers and retailers must pay sales or use tax on the pallets they purchase for use in such exchange arrangements.<sup>2</sup> AR-Tyson 71-76 (Det. No. 01-143, 24 WTD 324 (2005)). The manufacturer or retailer is the consumer because it is the person that actually enjoys the benefits of pallet ownership for a purpose other than resale, i.e., using it to deliver goods and to exchange for other pallets it can reuse.

Manufacturers that rent pallets from CHEP consume the pallets to the same extent as manufacturers that purchase pallets for exchange with their customers. The primary difference is that a manufacturer purchasing a pallet pays sales or use tax upfront on the full value of a pallet. In contrast, a manufacturer renting a pallet pays sales taxes incrementally over the period of time it actually uses it. In both cases, the manufacturer

---

<sup>2</sup> A "published determination" is an administrative decision of tax liability published by the Department after redaction of the taxpayer's identity. RCW 82.32.410. The Department's published determinations are not binding on the courts but they are entitled to "some deference" if not inconsistent with the governing tax statutes. *Cashmere Valley Bank v. Dep't of Revenue*, 181 Wn.2d 622, 635-36, 334 P.3d 1100 (2014). The Department publishes tax determinations to apprise taxpayers of how it interprets and applies the taxing statutes to particular factual circumstances. The Department's published determinations are available through a searchable online database, <http://taxpedia.dor.wa.gov/>.

is the person enjoying the use value of the pallet it acquires.

The Department's interpretive rule and tax determinations on pallets reasonably and consistently differentiate transactions in which pallets are acquired primarily for use by a manufacturer from those where it is appropriate to defer the imposition of the sales or use tax. The Department correctly interpreted and applied its own rule in determining that Advanced H2O and Tyson were the consumers of the rented pallets.

### **III. CONCLUSION**

Advanced H2O and Tyson are the consumers of the pallets they rented from CHEP because they acquired and used the pallets for a purpose other than resale or sublease. The Department correctly determined that Advanced H2O and Tyson were required to pay sales or use taxes on their pallet rental fees. In reaching a contrary conclusion, the Board misinterpreted and misapplied the lease-for-sublease exemption, the sale-for-resale exemption, and the Department's interpretive rule on packaging materials. The superior court correctly reversed the Board's decisions, and this Court should affirm.

///

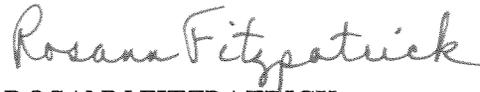
///

///

///

RESPECTFULLY SUBMITTED this 24th day of December, 2018.

ROBERT W. FERGUSON  
Attorney General

A handwritten signature in cursive script that reads "Rosann Fitzpatrick".

ROSANN FITZPATRICK,  
Assistant Attorney General, WSBA No. 37092  
Attorneys for Respondent Department of Revenue  
OID No. 91027

**PROOF OF SERVICE**

I certify that I served a copy of this document, via electronic mail,  
per agreement, on the following:

Brett Durbin  
Stoel Rives LLP  
Brett.Durbin@stoel.com

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

DATED this 24<sup>th</sup> day of December, 2018, at Tumwater, WA.

  
\_\_\_\_\_  
Rebekah Harris, Legal Assistant

**ATTORNEY GENERAL'S OFFICE - REVENUE & FINANCE DIVISION**

**December 24, 2018 - 1:32 PM**

**Transmittal Information**

**Filed with Court:** Court of Appeals Division II  
**Appellate Court Case Number:** 51468-1  
**Appellate Court Case Title:** Advanced H2O, LLC & Tyson Fresh Meats, Inc., Appellants v. Dept. of Revenue, Respondent  
**Superior Court Case Number:** 17-2-00672-3

**The following documents have been uploaded:**

- 514681\_Briefs\_20181224132901D2519444\_8040.pdf  
This File Contains:  
Briefs - Respondents Reply  
*The Original File Name was ReplyBr.pdf*

**A copy of the uploaded files will be sent to:**

- JamieF@atg.wa.gov
- RebekahH@atg.wa.gov
- brett.durbin@stoel.com

**Comments:**

---

Sender Name: Rebekah Harris - Email: RebekahH@atg.wa.gov

**Filing on Behalf of:** Rosann Fitzpatrick - Email: rosannf@atg.wa.gov (Alternate Email: revolyef@atg.wa.gov)

Address:  
PO Box 40123  
Olympia, WA, 98504-0123  
Phone: (360) 753-5528

**Note: The Filing Id is 20181224132901D2519444**