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COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

ARUP LABORATORITES, INC.

Appellant,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

REPLY BRIEF OF THE APPELLANT

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I. INTRODUCTION

ARUP Laboratories, Inc. (“ARUP”)¹ seeks a refund of the B&O tax it paid on gross receipts from its laboratory pathology services that it performed in Utah. ARUP claimed that the tax was not properly due, because WAC 458-20-19402 (“Rule 19402”), specifically section (303)(b), assigns the gross receipts from such services to Utah. In the alternative, ARUP argued that it is an arm of the State of Utah, and therefore, it is not a “person” as that term is defined in RCW 82.04.030. The B&O tax applies only to “persons” under RCW 82.04.290(2). Further, based on the premise that ARUP *is* the State of Utah, the B&O tax does not apply to ARUP, because to do so would deny ARUP full faith and credit. This is true, because WAC 458-20-167 (“Rule 167”) exempts universities organized in Washington but fails to afford the same benefit to out-of-state universities. Further, by taxing ARUP, Rule 167 offends U.S. Const. art 1, sec. 8, cl. 3 (“Commerce Clause”), because it discriminates against out-of-state taxpayers. Finally, imposing tax on ARUP violates Utah’s right to sovereign immunity.

Both parties sought summary judgments in cross motions. The trial court granted the Department of Revenue’s (DOR) motion for

¹ ARUP is a non-profit corporation, the sole member of which is the University of Utah, a state university. CP 176.

summary judgment and denied ARUP's cross motion. The trial court's denial of ARUP's motion for summary judgment and granting of the DOR's motion for summary judgment were erroneous. The trial court's denial of ARUP's motion for summary judgment should be reversed and the motion granted, and the trial court's grant of the DOR's motion for summary judgment should be reversed and the motion denied.

II. REPLY ARGUMENT

A. Rule 19402(303)(b) is the applicable section, not Rule 19402(303)(c), based on ARUP's undisputed facts.

Rule 19402(303) explains how to assign (or source) gross receipts when the taxable services are rendered in interstate commerce. These gross receipts are from apportionable activities. RCW 82.04.462(5)(a) and RCW 82.04.460(4)(a). The Rule sources these gross receipts to where the customer benefits from the seller's service. RCW 82.04.462(3)(b)(i) states: "... Except as otherwise provided in this section ... gross income of the business generated from each apportionable activity is attributable to the state: (i) where the customer received the benefit of the taxpayer's service...". The DOR adopted Rule 19402 to implement this section, because determining the location of a benefit is vague and ambiguous.

ARUP specifically relies on Rule 19402(303)(b)(i), (ii) and (iii) as the correct sections to source the gross receipts. App. Br. at 12-21. Rule 19402(303)(b)(ii) sources the gross receipts for services that relate to

tangible personal property to the tangible personal property's principal place of use, and that is the location where the tangible personal property "is expected to be used or delivered."

In this case, the tangible personal property is the specimen, and specimens include "all types of bodily fluids or tissue samples." CP 38. The record is undisputed on this point; specimens were the tangible personal property to be tested, the specimens were delivered to Utah (CP 78-79), and the pathology testing occurred in Utah (CP 126-127). ARUP's fact pattern squarely fits this section of the Rule. This is not disputed.

What is disputed is whether this Rule section applies. DOR and the trial court instead rely on Rule 19402(303)(c) that only applies "[i]f the taxpayer's service does not relate to tangible personal property." DOR argues that it applies, instead of Rule 19402(303)(b)(iii), because ARUP's customers benefit from the test results where the customers are located. DOR relies on RCW 82.04.462 that sources the service income to "where the customer received the benefit of the taxpayer's services." ARUP disagrees, because by its own terms—the words used by that section—Rule 19402(303)(c) is inapplicable.

1. DOR ignores its own authority to adopt rules that define where the customer receives the benefit of the seller's service.

DOR expends considerable effort to explain that the single sales apportionment statute, RCW 82.04.462, sources income to the location where the customer benefits from the taxpayer's services, and DOR argues that this is where ARUP's customers read the reports from its testing on the tangible personal property. Rep. Br. 15-27.

However, DOR's argument misses the point. As DOR notes, RCW 82.04.462 does very little to explain what it meant by "where the customer received the benefit of the taxpayer's service." Resp. Br. 18-19. DOR correctly notes that ARUP "barely mentions" RCW 82.04.462. Resp. Br. 21. ARUP barely mentioned RCW 82.04.462 because the statute provides no effective guidance. Instead, ARUP focused on DOR's Rule 19402, because Rule 19402 provides the guidance that RCW 82.04.462 does not. The Rule provides meaningful guidance, because it provides specific, objective standards that determine where the location of the benefit of the service occurs. Rule 19402(303)(b) is clear that when the services relate to tangible personal property, the *benefit of the service* is where the tangible personal property is used.

RCW 82.04.462 makes Rule 19402 necessary, because the question of where a customer benefits from a service is subjective. How

does a seller get into the mind of a customer to know where the customer benefits from a service? For example, in this case, assume that ARUP performs tests for a Washington doctor. The doctor looks at the ARUP test results and decides to refer the patient and chart to a hospital in Portland, Oregon that has necessary equipment and medical staff to treat the patient. How would ARUP know that the benefit of its services was both in Washington and Oregon? Consequently, to administer the statute's subjective standard, DOR apparently attempted to use objective tests to implement this subjective standard. Rule 19402(303)(b)(i), (ii), and (iii) provides objective standards and eliminates the impossible standard of determining where the customer might have thought it was benefitting from the seller's service.

ARUP focused on Rule 19402(303)(b)—and not RCW 82.04.362—because the Rule is DOR's sourcing instruction of service income related to tangible personal property. ARUP does not dispute that customers may benefit from ARUP's services at their locations,² but it

² The customer benefits from the taxpayer's services at the customer's location can be said regarding all the examples in Rule 19402(303)(b)(iii)(D). If a business is designing personal property in Utah for a Washington customer, then when the designs are sent to the customer in Washington where the designs are viewed, that customer benefits in Washington. If a broker sells intangible personal property in Utah and the proceeds are sent to the Washington customer, that customer benefits from the service in Washington. When an inspector inspects

nevertheless disagrees with DOR's efforts to distance itself from its own words of Rule 19402(303)(b)(i), (ii), and (iii). Taxpayers have no authority to adopt rules; that is DOR's function under RCW 82.32.300³ and 82.01.060(2), which are the sections that it identified when it adopted Rule 19402.⁴

DOR in its arguments before this court now departs from its effort to provide objective standards of where income is sourced when the activities involve tangible personal property at the time of testing. It now contends that those facts are irrelevant. If Rule 19402(303)(b)(i), (ii), and (iii) does not apply to ARUP's facts, then when would it ever apply?

Testing, ARUP submits, is always done for the results. As a result, to use the location where the customer uses the reports, as argued by the DOR,

personal property in Utah and sends the reports back to the Washington customer, the customer benefits from the reports in Washington. The same is true of veterinary services with reports of the condition of the animal located in Utah sent to the customer in Washington. And, finally, with the commissioned sale of tangible or real property when the proceeds are sent to the Washington customer. Consequently, there is never a time that Rule 19402(303)(b) would ever apply.

³ RCW 82.32.300 provides in part: "...The department of revenue shall make and publish rules and regulations, not inconsistent therewith, necessary to enforce provisions of this chapter and chapters 82.02 through 82.23B and 82.27 RCW, and the *liquor control board shall make and publish rules necessary to enforce chapters 82.24 and 82.26 RCW, which shall have the same force and effect as if specifically included therein, unless declared invalid by the judgment of a court of record not appealed from."

⁴ See Appendix A; archived at <http://lawfilesexternal.wa.gov/law/wsr/2012/20/12-19-071.htm>

will never allow Rule 19402(303)(b) to source income; it renders the Rule meaningless or superfluous.⁵ DOR and our courts should be bound to duly adopted regulations.⁶

DOR argues that the test results relate to the customers' business activities. ARUP does not disagree. It is not only the testing that the customers want; they also want the test results. Who would pay for

⁵ As this court recently stated: "If, after consideration of all relevant statutory language, 'the statute remains susceptible to more than one reasonable meaning, the statute is ambiguous and it is appropriate to resort to aids to construction, including legislative history.' *Campbell & Gwinn, LLC v. Dep't of Ecology*, 146 Wn.2d 1, 12, 43 P.3d 4 (2002). We neither construe statutory language to reach absurd or strained consequences nor question the wisdom of a statute, even where its results seem harsh. *Stroh Brewery Co. v. Dep't of Revenue*, 104 Wn. App. 235, 239, 15 P.3d 692 (2001). 'In interpreting and construing a statute, we must give effect to all of the language, rendering no portion meaningless or superfluous.' *Id.* at 239-40." *First Student, Inc. v. Dep't of Revenue*, 4 Wn. App. 2d 857, 866, 423 P.3d 921, 925 (2018). *See also SEIU Healthcare 775NW v. Gregoire*, 168 Wn.2d 593, 620, 229 P.3d 774, 788 (2010) ("Courts should avoid reading a statute in a way that results in unlikely, absurd, or strained consequences; it will not be presumed that the legislature intended absurd results.").

⁶ In an estoppel case, our courts insist that agencies should follow their pronouncements: "A manifest injustice is involved. It is self-evidently unfair to permit the Department to adopt and publicly distribute an interpretive policy memorandum and later deny the memorandum's plain reading after contractors have relied upon it to their detriment." *Silverstreak, Inc. v. Dep't of Labor & Indus.*, 159 Wn.2d 868, 889, 154 P.3d 891, 903 (2007). ARUP is not an estoppel case as ARUP did not rely on Rule 19402 at the time it paid the taxes, but the fundamental notion that an agency could publish its position and then retreat from its position is impractical for both government and businesses. This is especially true as DOR could always amend its rule if it thought the rule was wrong instead of impeaching it in court.

pathology services and not want the result? Common sense as that might sound, that rationale is no justification to reject Rule 19402(303)(b)(i) and (ii) in this case. Only DOR can explain why it chose a different path for testing tangible personal property instead of using where the customer sees the test results. Whatever that reason may be, Rule 19402(303)(b)(iii) stands on its own. And it identifies a non-exclusive list of what services relate to tangible personal property:

- (iii) The following is a nonexclusive list of services that relate to tangible personal property:
 - (A) Designing specific/unique tangible personal property;
 - (B) Appraisals;
 - (C) Inspections of the tangible personal property;
 - (D) *Testing of the tangible personal property;*
 - (E) Veterinary services; and
 - (F) Commission sales of tangible personal property.

Rule 19402(303)(b) (italics supplied).

Here, ARUP tested the tangible personal property to determine the pathology of the specimen and there is no dispute about that fact. The legal question is not whether ARUP's customers used the test results in Washington; the questions are whether the specimens are tangible personal property, whether the principal place of use is Utah (as that is where the property is expected to be used or delivered), and whether the pathology services consist of testing the specimens in Utah. Bodily fluids and tissue constitute tangible personal property. The specimens were

expected to be used in Utah and were in fact delivered in Utah. And, finally, ARUP's Utah activities consisted of testing the tangible personal property.

Under this section of the Rule, it is irrelevant where the customer uses the test results. If the customer's business location where the customer uses the test results is the correct answer, then there is no reason for Rule 19402(303)(b)(i), (ii), and (iii), because no one would commission a test and not want the results.

Further, reviewing Rule 19402(303)(b)(iii)'s list of services related to tangible personal property, the services, to no surprise, all involve tangible personal property. The list includes designing tangible personal property; appraising tangible personal property; inspecting tangible personal property; testing tangible personal property; veterinary services (applying animal medicine to animals that are tangible personal property); and commission sales of tangible personal property. In this case, the tangible personal property is the specimen that consists of bodily fluids or tissue.

Rule 19402(303)(c), does not relate to tangible personal or real property; it only relates to intangible property as ARUP explained in its opening brief. App. Br. 18. The examples include: developing a business plan (a business plan is intangible); commission sales of intangibles; debt

collections (debts are intangible); legal and accounting services related to intangible property (in that this Rule only includes services other than those related to real or tangible personal property); advertising services that are creative marketing ideas (ideas are intangible personal property); and theatre presentations that are a reproduction of intangible creative rights that are again intangible property. The doctrine of ejusdem generis⁷ supports this distinction between Rule 19402(303)(b) that sources the income to the location of the tangible personal property and Rule 19402(303)(b) that does not benefit from an obvious physical location.

The DOR argues that the doctrine of ejusdem generis has no application here because the doctrine only applies when the statutes (in this case, the rules) cannot be harmonized. Resp. Br. 24. ARUP agrees that harmonizing the rules is not necessary, but only if DOR applies the rules as they are written. However, DOR rejects ARUP's application of the Rule that pertains to services related to tangible personal property; instead DOR creates conflict by choosing to apply a different rule that was

⁷ This court also employed the doctrine in *Solvay Chems., Inc. v. Dep't of Revenue*, 4 Wn. App. 2d 918, 928, 424 P.3d 1238 (2018) (whether the taxpayer's working solution was a "device" for purposes of a sales and use tax exemption, the court used ejusdem generis to define "device" in WAC 458-20-13601(2)(c), defining "device" and the general term "not attached to the building or site." Here, ARUP asks that the court apply ejusdem generis to Rule 19402(303)(b)(iii). The court should use the examples in DOR's own words to interpret the meaning of services related to tangible personal property.

not intended to apply services related to tangible personal property. It's misapplication of Rule 19402(303)(c) to ARUP now requires harmonization.

ARUP asks this court to resolve the conflict by looking at the doctrine of *eiusdem generis*. This court has resorted to this doctrine when DOR insists on an interpretation that ignores the plain wording of its rules. In *Solvay Chems., Inc. v. Dep't of Revenue*, 4 Wn. App. 2d 918, 928, 424 P.3d 1238 (2018), the taxpayer argued that it employed a "working solution" in its manufacturing process that created a necessary chemical reaction to create hydrogen peroxide. The taxpayer used the same solution (about 210,000 gallons at any given time) over and over. Periodically, it would be necessary to replenish the working solution to keep the chemical balance. The taxpayer's working solution was a "device" for purposes of a sales and use tax exemption. The taxpayer contended that the working solution functioned like machinery and equipment to produce a new product, because they caused chemical reactions that were necessary to produce hydrogen peroxide. The DOR argued "that chemicals mixed together for purposes of chemical manufacturing are not 'machinery and equipment' under a 'logical, common sense interpretation' of those terms." *Id.* at 923.

The question for the court was whether the working solution is like any other equipment that the manufacturer used to create a new product. The court resorted to ejusdem generis to define “device” in WAC 458-20-13601(2)(c), defining the specific term “device” and the general term “not attached to the building or site,” which the court noted could mean anything. So, by looking at the specific examples, the court was able to determine whether the working solution was a device. It concluded that it was.

Here, ARUP asks that the court apply the ejusdem generis doctrine to Rule 19402(303)(b)(iii), using the examples that DOR chose to define the meaning of “services related to tangible personal property” to determine whether Rule 19402(303)(b)(iii) or Rule 19402(303)(c) is the proper rule section for ARUP’s facts.

DOR also relies on the Board of Tax Appeals’ reasoning in *Associated Reg’l and University Pathologists*, 2016 WL 3262421. In that case, the Board concluded that ARUP was “placing unwarranted emphasis on the test material itself.” Resp. Br. 25. This conclusion, however, is either incorrect or irrelevant. ARUP does not concede that such emphasis was “unwarranted” because ARUP believes that the test material was critical to the service rendered. The Board of Tax Appeals’ was wrong to make that conclusion. *ARUP could not do the pathology test without the*

test material and the customer could not have test reports without the test material. Why would it be unwarranted to place emphasis on the test material?⁸ Further, it is irrelevant because Rule 19402(303)(b)(i), (ii), and (iii) is silent as to how much emphasis on the tangible personal property is warranted. In fact, looking at the examples the DOR used to put context to “services related to tangible personal property”, it simply said “Testing of the tangible personal property.” Rule 19402(303)(b)(iii)(D). If the tangible personal property had to meet a standard of what is “warranted”, then the DOR could easily have provided that guidance. But, it did not. The plain words used in the rule are “testing of the tangible personal property.”

The DOR interpretation of Rule 19402(303)(c) renders Rule 19402(303)(b) meaningless, because the services rendered on tangible personal property will always result in a report that the customer will use where it is located. The court should not read Rule 19402(303)(c) to make Rule 19402(303)(b) meaningless.

This case can be resolved by holding DOR to its adopted rule that a customer benefits from ARUP’s services where the tangible personal

⁸ If ARUP applied its pathology testing to the test material in Washington but then shipped the containers to Utah remove the specimen remnants and sanitized the containers, then ARUP might agree that emphasis on the test material is unwarranted. However, that is not the case. The specimen is critical to obtaining useful test results.

property is intended to be used, in this case, Utah, where the pathology testing occurs. ARUP urges the court to do so.

B. The DOR incorrectly contends that ARUP is a “person.”

If the court applies Rule 19402(303)(c) instead of Rule 19402(303)(b), then ARUP alternatively argues that the B&O does not apply to it because ARUP is not defined as a “person” under RCW 82.04.030. It argues that it is not a “person” for purposes of the B&O tax because the state fails to include states within that definition. App. Br. 21-29.

The DOR contends that ARUP’s choice to exist as a non-profit entity puts it squarely into the definition of “person” because RCW 82.04.030 expressly includes non-profit entities. Resp. Br. 15. ARUP agrees that non-profits are expressly included in the definition of “person,” but ARUP disagrees that the analysis ends with that limited reading. As ARUP explained in its opening brief, the form of its existence (*e.g.* a non-profit corporation) does not mean that ARUP is not an arm of the State of Utah. ARUP contends it is an arm of the state, taking ARUP out of the definition of person for purposes of RCW 82.04.030 regardless of its form of existence. App. Br. 21-29. Without repeating ARUP’s argument in its opening brief, it suffices to say that the State of Utah and its statutorily created University of Utah and its medical school, exercises substantial

control over ARUP to further the University's goals to teach and conduct research. There is no private party (aside from the employees who draw wages) that financially benefits from ARUP's operations. The University transfers all excess funds to itself. CP 251.

C. The DOR's attempt to distinguish ARUP's arm-of-the-state position from tort claims is without merit.

DOR contends that ARUP's reliance on existing case law is not applicable because the cases deal with tort liability. Resp. Br. 27-28. The fact that there is no case law applying the arm-of-the-state doctrine to tax cases does not mean that it does not apply. It only means that the issue has never been raised in a tax context. The case law provides guidance when an entity conducting state functions should be treated as an arm of the state. App. Br. 25-29. DOR offers nothing to support its contention that the courts limit their arm-of-the-state analysis to torts. And ARUP sees no reason why such analysis should be limited.

DOR also cites a 2006 federal case⁹ specifically dealing with ARUP's predecessor, Associated Regional University Pathologists, when the court rejected the defense that it was an arm of the State of Utah for purposes of a federal statute, the Federal False Claims Act. Resp. Br. 28.

⁹ *U.S. ex. Rel. Sikkenga v. Regence Bluecross Blueshield of Utah*, 472 F.3d 702, (10th Cir. 2006) (*Sikkenga*)

The case is not on point. First, as the DOR notes, it is a federal case ruling on federal law, not Washington State law. Second, it conflicts with Washington case law in that it is not clear that a Washington court, using its test for an arm of the state would reach the same result. Third, and most important, ARUP and its predecessor, are different entities with different ownership and management structure. The predecessor was a for-profit entity, started with a loan from the University Hospital and owned by a non-profit group, Associated University Pathologists. CP 175. In 2009, three years after *Sikkenga* was decided, the predecessor was reformed as a non-profit. *Id.* The reformation resulted in the University being the sole member to “align ARUP’s corporate legal status to what it really is, which is a component unit of the University of Utah...”. CP 177. Associated University Pathologists (AUP) was liquidated. CP 176. DOR notes some of the changes that occurred since 2006, but contends that ARUP is still “operated in much the same way.” *Id.* The operation and control¹⁰ over the entity *materially* changed as ARUP was under the direct control of the University. CP 176. The University became the sole voting member of ARUP with AUP dissolved. CP 177. These are material changes in management even though the day-to-day operations of the

¹⁰ See ARUP’s opening brief that explains ARUP’s management. App. Br. 4-10.

pathology laboratory remained the same before and after the conversion to a non-profit. Consequently, DOR errs when it states that “[n]othing material has changed since the tenth circuit decision”. Resp. Br. 33. Whether that federal court would reach the same conclusion based on ARUP’s facts is not known and should not be presumed.

ARUP also disagrees that the tenth circuit would rule in the same way. It is true that ARUP pays liabilities of employee actions. Resp. Br. 34. That is true, but that does not mean that ARUP will always have sufficient funds to pay liabilities for which the University or the state of Utah would be liable. In fact, that wouldn’t be known until a plaintiff or contract creditor sues ARUP for tort or contract disputes, and the court finds that Utah is not liable. There is nothing in the record to support that such an action has occurred.

Further, DOR’s assertion is not consistent with the record. ARUP maintains two employee classes: clinical and technical. CP 253. The clinical employees are the medical directors. CP 254. According to the record:

Well, the technical -- let's first talk about the medical directors. The medical directors are covered under the state -- I can't remember exactly the words because it is - - I'm getting a little punchy with all these questions now. I can't recall the words. *But -- so they're covered under the state -- with any of the other university medical folks*, and I can't bring to the tip of my tongue what that

– that coverage is. But -- and then ARUP has general medical liability practice for its testing.

CP 253 (*italics supplied*). Consequently, the state *does* bear legal liability of ARUP activities conducted by the medical directors.

Further, why would Washington courts create an arm-of-the-state standard for state tort liability but then create a higher standard for tax purposes? The explanation cannot and should not be that a higher standard is necessary so a state affiliate cannot benefit from lower tax liability. ARUP contends that there is no reasonable explanation for any distinction. Missing from the DOR brief is any cogent reason why a separate arm-of-the-state standard should apply when determining tort liability from tax liability. Its argument is essentially that a state affiliated entity should be taxed like non-state affiliated entities.

DOR also argues that the record does not establish that there is actual discrimination. Resp. Br. 27-28, and 38. That requirement is not the law under the Commerce Clause. ARUP is not required to prove actual discrimination, and DOR has lost that exact argument in the past. According to the United States Supreme Court, it is enough that there is a hypothetical risk of discrimination:

Appellee suggests that we should require Armco to prove actual discriminatory impact on it by pointing to a State that imposes a manufacturing tax that results in a total burden higher than that imposed on Armco's competitors in West Virginia. *This is not the*

test. In *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 169 (1983), the Court noted that a tax must have 'what might be called internal consistency -- that is the [tax] must be such that, if applied by every jurisdiction,' there would be no impermissible interference with free trade. In that case, the Court was discussing the requirement that a tax be fairly apportioned to reflect the business conducted in the State. A similar rule applies where the allegation is that a tax on its face discriminates against interstate commerce. A tax that [***214] unfairly apportions income from other States is a form of discrimination against interstate commerce. See also *id.*, at 170-171. Any other rule would mean that the constitutionality of West Virginia's tax laws would depend on the shifting complexities of the tax codes of 49 other [****29] States, and that the validity of the taxes imposed on each taxpayer would depend on the particular other States in which it operated." 467 U.S., at 644-645 (footnote omitted).

Tyler Pipe Indus. v. Wash. State Dep't of Revenue, 483 U.S. 232, 247, 107 S. Ct. 2810, 2820, 97 L.Ed.2d 199, 213-14 (1987) (italics supplied).

DOR also contends that ARUP should be recognized as being separate from the State of Utah. Resp. Br. 29-31. Utah reaps the benefits of ARUP's existence. Resp. Br. 30. And as DOR suspected in its brief, ARUP will not agree with the DOR position. As the DOR points out, DOR's cited cases do not involve a state. *Id.*

Contrary to DOR's statement that such distinction of state taxpayers or non-state taxpayers is insignificant, ARUP disagrees. If the fact that separate entities is enough to determine liability, then ARUP perceives no judicial reason to have adopted the arm-of-the-state analysis unless DOR is correct that there is a different rule for tax liability.

However, DOR has offered no such rule for states as taxpayers. The cases apply only to non-state businesses.

DOR also points to certain isolated facts that suggest that ARUP is not an arm of Utah, because it did not comply with certain Utah laws. However, DOR presumes that such non-compliance means that it is not an arm of the state. Whether a state affiliate is an arm of the state under Washington's analysis is not dependent upon whether the affiliate is complying with laws that apply only to a state. There's nothing in the record that even suggests that Utah has found ARUP to be out of compliance with any Utah laws. However, whether ARUP complied, or failed to comply, are not factors considered in the arm-of-the-state cases¹¹ cited by ARUP. App. Br. 25-29. The only question posed by those cases is whether ARUP is "operated and managed by the state." *Id.* DOR raises the compliance issue but even *if* there were violations, such evidence does not mitigate the facts that ARUP is operated and managed by the State of Utah as explained in ARUP's opening brief. App. Br. 22-24.

DOR also argues that WAC 458-20-167 ("Rule 167") does not apply to ARUP because Rule 167 does not address entities like ARUP.

¹¹ *Hontz v. State*, 105 Wn.2d 302, 714 P.2d 1176 (1986) and *Hyde v. Univ. of Washington Med. Ctr.*, 186 Wn. App. 926, 347 P.3d 918 (2015).

That is literally true. However, if this court agrees that ARUP is an arm of the state, specifically, an arm of the University of Utah, then Rule 167 should apply in that ARUP is the University of Utah, and it violates the Commerce Clause to treat the University of Utah differently from Washington State-sponsored universities by taxing Utah schools but exemption Washington schools.

D. Violation of Full Faith and Credit is supported by the record, contrary to DOR's contention otherwise; Utah is entitled to its sovereign immunity.

DOR urges this court to reject ARUP's full faith and credit argument. Resp. Br. 39-41. In part, because ARUP has not shown discrimination. ARUP does not disagree with DOR's description of the applicable principles. Resp. Br. 39-40. However, this discussion misses ARUP's point. ARUP does not rely on a statute, but it does rely on the states' inherent right to sovereign immunity argued in *Franchise Tax Board of the State of California, v. Hyatt*, No. 17-1299 (2019).¹² In an amicus curiae brief in that matter, the states argued that that the inherent right to sovereign immunity exists by default, to wit:

As the Court recognized in *Hall* [*Hall v. Nevada*, 440 U.S. 410 (1979) permitted a California resident to use a California court to exercise jurisdiction over the State of Nevada] in itself, the Framers assumed that the

¹² A United States Supreme Court heard a third review of the *Hyatt* matter, argued on January 9, 2019. A decision is anticipated any day.

“prevailing notions of comity would provide adequate protection against the unlikely prospect of an attempt by the courts of one State to assert jurisdiction over another.” *Id.* at 419. Stated more directly, “[t]he Constitution never would have been ratified if the States and their courts were to be stripped of their sovereign authority except as expressly provided by the Constitution itself.” *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 239 n.2 (1985). But while *Hall* took that underlying sentiment to mean that an expectation of comity was sufficient protection against interstate jurisdiction, the more appropriate inference is that the inquiry for this Court should be whether anything in the Constitution *allows* jurisdiction of the State courts over sister States – not whether anything *forbids* it.

Amicus Curiae Brief at 11-12.¹³ Thus, this is not a situation where discrimination is a proper inquiry. According to Washington and the other states joining in the brief, the right of sovereign immunity exists as a condition of ratifying the Constitution; it doesn’t exist only if a state can demonstrate discrimination.

ARUP recognizes that Washington is not haling Utah into its courts via a summons. However, Washington has set up a process that coerces Utah and its wholly owned entity, ARUP, to appear in Washington courts, because it cannot challenge Washington’s tax statutes without first paying the tax and suing for a refund. App. Br. 41-46.

The states urge the U.S. Supreme Court to overturn *Hall*, arguing that the power to tax is a critical state function, and allowing sister states

¹³ See Appendix 1 of the App. Br.

to affect another state's power to tax is an insult to the state's sovereign dignity. Amicus Curiae Brief at 2. The states identify cases today where taxpayers are suing in their home states to determine a sister state's power to tax. *Id.* at 9-10. At first blush, one could view the states' brief as supporting the power of the states, like Washington in this case, to tax. And if the state of Utah were not involved, ARUP would agree that is a valid distinction.

However, ARUP presents a different situation from that described in the states' amicus curiae brief, because in the circumstances cited in their brief, the taxpayers do not enjoy sovereign immunity. In this case, Utah and its affiliate, ARUP, do have sovereign immunity rights that have not been waived. Thus, this court has before it dueling sovereign rights and it must decide which prevails; the sovereign right to tax and the sovereign right not to be haled into a sister state's court. Washington may not coerce Utah into Washington courts through a subpoena, but it has done so with the method it has adopted to compel entities that DOR contends must pay tax to defend themselves. This court should reject Washington's tax appeal method as it applies to states, and avoid insult to a foreign state's right not to be haled into another state's court for a reason that the foreign state has not waived.

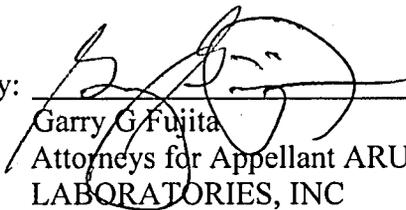
III. CONCLUSION

ARUP believes that this court can resolve all disputes by applying Rule 19402(303)(b) as it is written and not allow DOR to render it meaningless. However, if the court agrees with DOR, then it should find that ARUP is an arm of the state and should exclude ARUP from the definition of "person" for purposes of the B&O tax. Alternatively, if the court defines non-profits as a taxable "person" then it should nevertheless find that ARUP is an arm of the State of Utah, and in so doing, strike down this tax as facially discriminatory under Rule 167, failing to afford Utah full faith and credit, and failing to respect Utah's sovereign immunity. ARUP respectfully requests that this court vacate the summary judgment in favor of DOR, and remand the matter to the Thurston County Superior Court to grant ARUP's motion for summary judgment.

RESPECTFULLY SUBMITTED this 5th day of April, 2019.

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APPENDIX A

WSR 12-19-071

PERMANENT RULES

DEPARTMENT OF REVENUE

[Filed September 17, 2012, 4:43 p.m. , effective October 18, 2012]

Effective Date of Rule: Thirty-one days after filing.

Purpose: Chapter 23, Laws of 2010 1st sp. sess. changed the apportionment requirements for apportionable activities, effective June 1, 2010. The department had previously adopted emergency rules while it worked with stakeholders to develop permanent rules explaining the implications of this legislation.

The department is at this time adopting a new permanent rule WAC 458-20-19402 (Rule 19402) Single factor receipts apportionment -- Generally. This rule provides general guidance on single factor receipts apportionment, how to attribute receipts, how to determine the receipts factor, and computing Washington taxable income.

Statutory Authority for Adoption: RCW 82.32.300 and 82.01.060(2).

Adopted under notice filed as WSR 12-06-080 on March 7, 2012.

Changes Other than Editing from Proposed to Adopted Version:

- Subsection (106), which provided an explanation of the use of examples, was moved to subsection (302) to be closer to the examples and further explanation was added to clarify that more than one reasonable method of proportionally attributing the benefit of a service may exist.
- Subsection (304)(c), example 22 was modified to state that the use of population in the customer's market may be a reasonable method of proportionally attributing the benefit of a service.
- Subsection (304)(c), example 24. This example was changed from general business services to human resources services to avoid confusion.
- Subsection (304)(c), example 29. This example was removed from the rule. The remaining examples were renumbered.
- Subsection (306), example 35 (formerly example 36) was modified to more accurately explain what is commercially reasonable.

Number of Sections Adopted in Order to Comply with Federal Statute: New 0, Amended 0, Repealed 0; Federal Rules or Standards: New 0, Amended 0, Repealed 0; or Recently Enacted State Statutes: New 1, Amended 0, Repealed 0.

Number of Sections Adopted at Request of a Nongovernmental Entity: New 0, Amended 0, Repealed 0.

Number of Sections Adopted on the Agency's Own Initiative: New 1, Amended 0, Repealed 0.

Number of Sections Adopted in Order to Clarify, Streamline, or Reform Agency Procedures: New 0, Amended 0, Repealed 0.

Number of Sections Adopted Using Negotiated Rule Making: New 0, Amended 0, Repealed 0; Pilot Rule Making: New 0, Amended 0, Repealed 0; or Other Alternative Rule Making: New 0, Amended 0, Repealed 0.

Date Adopted: September 17, 2012.

Alan R. Lynn
Rules Coordinator

NEW SECTION

WAC 458-20-19402 Single factor receipts apportionment -- Generally.

PART 1. INTRODUCTION.

(101) **General.** RCW 82.04.462 establishes the apportionment method for businesses engaged in apportionable activities and that have nexus with Washington for business and occupation (B&O) tax liability incurred after May 31, 2010. The express purpose of the change in the law was to require businesses "earn(ing) significant income from Washington residents from providing services" to "pay their fair share of the cost of services that this state renders and the infrastructure it provides." Section 101, chapter 23, 1st special session, 2010.

(102) **Guide to this rule.** This rule is divided into six parts, as follows:

1. Introduction.
2. Overview of single factor receipts apportionment.
3. How to attribute receipts.
4. Receipts factor.
5. How to determine Washington taxable income.
6. Reporting instructions.

(103) **Scope of rule.** This rule applies to the apportionment of income from engaging in apportionable activities as defined in WAC 458-20-19401, except:

(a) To the apportionment of income received by financial institutions and taxable under RCW 82.04.290, which is governed by WAC 458-20-19404; and

(b) To the attribution of royalty income from granting the right to use intangible property, which is governed by WAC 458-20-19403.

(104) **Separate accounting and cost apportionment.** The apportionment method explained in this rule replaces the previously allowed separate accounting and cost apportionment methods. Separate accounting and cost apportionment are not authorized for periods after May 31, 2010.

(105) **Other rules.** Taxpayers may also find helpful information in the following rules:

(a) WAC 458-20-19401 **Minimum nexus thresholds for apportionable activities.** This rule describes minimum nexus thresholds applicable to apportionable activities that are effective after May 31, 2010.

(b) WAC 458-20-19403 **Royalty receipts attribution.** This rule describes the attribution of royalty income for the purposes of single factor receipts apportionment and applies only to tax liability incurred after May 31, 2010.

(c) WAC 458-20-19404 **Single factor receipts apportionment -- Financial institutions.** This rule describes the application of single factor receipts apportionment to certain income of financial institutions and applies only to tax liability incurred after May 31, 2010.

(d) WAC 458-20-194 **Doing business inside and outside the state.** This rule describes separate accounting and cost apportionment and applies only to tax liability incurred from January 1, 2006, through May 31, 2010.

(e) WAC 458-20-14601 **Financial institutions -- Income apportionment.** This rule describes the apportionment of income for financial institutions for tax liability incurred prior to June 1, 2010.

(106) **Definitions.** The following definitions apply to this rule:

(a) **"Apportionable activities"** has the same meaning as used in WAC 458-20-19401 Minimum nexus thresholds for apportionable activities.

(b) **"Apportionable income"** means apportionable receipts less the deductions allowable under chapter 82.04 RCW.

(c) **"Apportionable receipts"** means gross income of the business from engaging in apportionable activities, including income received from apportionable activities attributed to locations outside this state.

(d) **"Business activities tax"** means a tax measured by the amount of, or economic results of, business activity conducted in a state. The term includes taxes measured in whole or in part on net income or gross income or receipts. In the case of sole proprietorships and pass-through entities, the term includes personal income taxes if the gross income from apportionable activities is included in the gross income subject to the personal income tax. The term "business activities tax" does not include retail sales, use, or similar transaction taxes, imposed on the sale or acquisition of goods or services, whether or not named a gross receipts tax or a tax imposed on the privilege of doing business.

(e) **"Customer"** means a person or entity to whom the taxpayer makes a sale, grants the right to use intangible property, or renders services or from whom the taxpayer otherwise directly or indirectly receives gross income of the business. If the taxpayer performs apportionable services for the benefit of a third party, the term "customer" means the third party beneficiary.

Example 1. Assume a parent purchases apportionable services for their child. The child is the customer for the purpose of determining where the benefit is received.

(f) **"Reasonable method of proportionally attributing"** means a method of determining where the benefit of an activity is received and where the receipts are attributed that is uniform, consistent, and accurately reflects the market, and does not distort the taxpayer's market.

(g) "State" means a state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any foreign country or political subdivision of a foreign country.

(h) (i) "Taxable in another state" means either:

(A) The taxpayer is subject to a business activities tax by another state on the taxpayer's income received from engaging in apportionable activity; or

(B) The taxpayer is not subject to a business activities tax by another state on the taxpayer's income received from engaging in apportionable activity, but the taxpayer meets the substantial nexus thresholds described in WAC 458-20-19401 for that state.

(ii) The determination of whether a taxpayer is taxable in a foreign country or political subdivision of a foreign country is made at the country or political subdivision level.

Example 2. Assume Taxpayer A is subject to a business activity tax in State X of Mexico (e.g., Taxpayer pays tax to State X), but nowhere else in Mexico. Also, assume that Taxpayer A is not subject to any national business activity tax in Mexico and does not meet the substantial nexus thresholds described in WAC 458-20-19401 for Mexico as a whole. In this case, Taxpayer is taxable in State X, but not taxable in any other portion or any other State of Mexico.

Example 3. Assume Taxpayer B is not subject to any business activity taxes in Mexico, but satisfies the substantial nexus thresholds described in WAC 458-20-19401 for Mexico as a whole. Taxpayer B is taxable in all of Mexico.

PART 2. OVERVIEW OF SINGLE FACTOR RECEIPTS APPORTIONMENT.

(201) **Single factor receipts apportionment generally.** Except as provided in WAC 458-20-19404 persons earning apportionable income who have substantial nexus with Washington as specified in WAC 458-20-19401 and who are also taxable in another state must use the apportionment method provided in this rule to determine their taxable income from apportionable activities for B&O tax purposes. Taxable income is determined by multiplying apportionable income from each apportionable activity by the receipts factor for that apportionable activity.

This formula is:

$$\text{(Taxable income)} = \text{(Apportionable income)} \times \text{(Receipts factor)}$$

See Part 4 of this rule for a discussion of the receipts factor.

(202) **Tax year.** The receipts factor applies to each tax year. A tax year is the calendar year, unless the taxpayer has specific permission from the department to use another period. (RCW 82.32.270.) For the purposes of this rule, "tax year" and "calendar year" have the same meaning.

PART 3. HOW TO ATTRIBUTE RECEIPTS.

(301) **Attribution of receipts generally.** Except as specifically provided for

in WAC 458-20-19403 for the attribution of apportionable royalty receipts, this Part 3 explains how to attribute apportionable receipts. Receipts are attributed to states based on a cascading method or series of steps. The department expects that most taxpayers will attribute apportionable receipts based on (a)(i) of this subsection because the department believes that either the taxpayer will know where the benefit is actually received or a "reasonable method of proportionally attributing receipts" will generally be available. These steps are:

(a) Where the customer received the benefit of the taxpayer's service (see subsection (302) of this rule for an explanation and examples of the benefit of the service);

(i) If a taxpayer can reasonably determine the amount of a specific apportionable receipt that relates to a specific benefit of the services received in a state, that apportionable receipt is attributable to the state in which the benefit is received. This may be shown by application of a reasonable method of proportionally attributing the benefit among states. The result determines the receipts attributed to each state. Under certain situations, the use of data based on an attribution method specified in (b) through (f) of this subsection may also be a reasonable method of proportionally attributing receipts among states (see Examples 4 and 5 below).

(ii) If a taxpayer is unable to separately determine or use a reasonable method of proportionally attributing the benefit of the services in specific states under (a)(i) of this subsection, and the customer received the benefit of the service in multiple states, the apportionable receipt is attributed to the state in which the benefit of the service was primarily received. Primarily means, in this case, more than fifty percent.

(b) If the taxpayer is unable to attribute an apportionable receipt under (a) of this subsection, the apportionable receipt must be attributed to the state from which the customer ordered the service.

(c) If the taxpayer is unable to attribute an apportionable receipt under (a) or (b) of this subsection, the apportionable receipt must be attributed to the state to which the billing statements or invoices are sent to the customer by the taxpayer.

(d) If the taxpayer is unable to attribute an apportionable receipt under (a), (b), or (c) of this subsection, the apportionable receipt must be attributed to the state from which the customer sends payment to the taxpayer.

(e) If the taxpayer is unable to attribute an apportionable receipt under (a), (b), (c), or (d) of this subsection, the apportionable receipt must be attributed to the state where the customer is located as indicated by the customer's address:

(i) Shown in the taxpayer's business records maintained in the regular course of business; or

(ii) Obtained during consummation of the sale or the negotiation of the contract, including any address of a customer's payment instrument when readily available to the taxpayer and no other address is available.

(f) If the taxpayer is unable to attribute an apportionable receipt under (a), (b), (c), (d), or (e) of this subsection, the apportionable receipt must be attributed to the commercial domicile of the taxpayer.

(g) The taxpayer may not use an attribution method that distorts the apportionment of the taxpayer's apportionable receipts.

(302) **Examples.** Examples included in this rule identify a number of facts and then state a conclusion; they should be used only as a general guide. The tax results of all situations must be determined after a review of all the facts and circumstances. The examples in this rule assume all gross income received by the taxpayer is from engaging in apportionable activities. Unless otherwise stated, the examples do not apply to tax liability prior to June 1, 2010.

When an example states that a particular attribution method is a reasonable method of proportionally attributing the benefit of a service, this does not preclude the existence of other reasonable methods of proportionally attributing the benefit depending on the specific facts and circumstances of a taxpayer's situation.

Example 4. Assume Law Firm has thousands of charges to clients. It is not commercially reasonable for Law Firm to track each charge to each client to determine where the benefit related to each service is received. Assume the scope of Law Firm's practice is such that it is reasonable to assume that the benefits of Law Firm's services are received at the location of the customer as reflected by the customer's billing address. Under these circumstances, Law Firm can use the billing addresses of each client as a reasonable method of proportionally attributing the benefit of its services.

Example 5. Same facts as Example 4 except, Law Firm has a single client that represents a statistically significant portion of its revenue and whose billing address is unrelated to any of the services provided. In this case, using the billing address of this client would not relate to the benefit of the services. Using the billing address for this client to determine where the benefit is received would significantly distort the apportionment of Law Firm's receipts. Therefore, Law Firm would need to evaluate the specific services provided to that client to determine where the benefits of those services are received and may use billing address to attribute the income received from other clients.

Example 6. Assume Taxpayer R attributes an apportionable receipt based on its customer's billing address, using (c) of this subsection, and the billing address is a P.O. Box located in another state. Taxpayer R also knows that mail delivered to this P.O. Box is automatically forwarded to the customer's actual location. In this case, use of the billing address is not allowed because it would distort the apportionment of Taxpayer R's receipts.

(303) **Benefit of the service explained.** The first two steps (subsection (301) (a) (i) and (ii) of this rule) used to attribute apportionable receipts to a state are based on where the taxpayer's customer receives the benefit of the service. This subsection explains the framework for determining where the benefit of a service is received.

(a) **If the taxpayer's service relates to real property, then the benefit is received where the real property is located.** The following is a nonexclusive list of services that relate to real property:

- (i) Architectural;
- (ii) Surveying;
- (iii) Janitorial;
- (iv) Security;
- (v) Appraisals; and
- (vi) Real estate brokerage.

(b) If the taxpayer's service relates to tangible personal property, then the benefit is received where the tangible personal property is located or intended/expected to be located.

(i) Tangible personal property is generally treated as located where the place of principal use occurs. If the tangible personal property is subject to state licensing (e.g., motor vehicles), the principal place of use is presumed to be where the property is licensed; or

(ii) If the tangible personal property will be created or delivered in the future, the principal place of use is where it is expected to be used or delivered.

(iii) The following is a nonexclusive list of services that relate to tangible personal property:

- (A) Designing specific/unique tangible personal property;
- (B) Appraisals;
- (C) Inspections of the tangible personal property;
- (D) Testing of the tangible personal property;
- (E) Veterinary services; and
- (F) Commission sales of tangible personal property.

(c) If the taxpayer's service does not relate to real or tangible personal property, the service is provided to a customer engaged in business, and the service relates to the customer's business activities, then the benefit is received where the customer's related business activities occur. The following is a nonexclusive list of business related services:

- (i) Developing a business management plan;
- (ii) Commission sales (other than sales of real or tangible personal property);
- (iii) Debt collection services;
- (iv) Legal and accounting services not specific to real or tangible personal property;
- (v) Advertising services; and
- (vi) Theatre presentations.

(d) If the taxpayer's service does not relate to real or tangible personal property, is either provided to a customer not engaged in business or unrelated to the customer's business activities, and:

(i) The service requires the customer to be physically present, then the benefit is received where the customer is located when the service is performed. The following is a nonexclusive list of services that require the customer to be physically present:

- (A) Medical examinations;
- (B) Hospital stays;
- (C) Haircuts; and

(D) Massage services.

(ii) The taxpayer's service relates to a specific, known location(s), then the benefit is received at those location(s). The following is a nonexclusive list of services related to specific, known location(s):

(A) Wedding planning;

(B) Receptions;

(C) Party planning;

(D) Travel agent and tour operator services; and

(E) Preparing and/or filing state and local tax returns.

(iii) If (d)(i) and (ii) of this subsection do not apply, the benefit of the service is received where the customer resides. The following is a nonexclusive list of services whose benefit is received at the customer's residence:

(A) Drafting a will;

(B) Preparing and/or filing federal tax returns;

(C) Selling investments; and

(D) Blood tests (not blood drawing).

(e) **Special rule for extension of credit.** See subsection (304) of this rule for special rules attributing income related to loans (secured and unsecured) and credit cards that is received by persons who are not financial institutions as defined in WAC 458-20-19404.

(304) Examples of the application of the benefit of service analysis and reasonable methods of proportionally attributing receipts.

(a) **Services related to real property:**

Example 7. Architect drafts plans for a building to be built in Washington. Architect's services relate to real property which is located in Washington, therefore the customer receives the benefit of that service in Washington at the location of the real property. Architect's receipts for this service are solely attributed to Washington because the entire benefit is received in Washington.

Example 8. Franchisor hires Taxpayer, an architect, to create a design of a standardized building that will be used at four locations in Washington and two locations in Oregon. Taxpayer's services relate to real property at those six locations, therefore the customer receives the benefit of the service at the four Washington locations and the two Oregon locations. Taxpayer will attribute 2/3 (4 of 6 sites) of the receipts for this service to Washington and 1/3 (2 of 6 sites) of the receipts to Oregon.

Example 9. Assume the same facts as Example 8 except Franchisor will use the same design in all 50 states for all its franchisee's locations. Taxpayer and Franchisor do not know at the time the service is provided (and cannot reasonably estimate) how many franchise locations will exist in each state. Therefore, there is no reasonable means of proportionally attributing receipts at the time the services are performed and it is clear that no state will have a majority of the franchise locations. Accordingly, the apportionable receipts must be attributed following the steps in subsection (301)(b) through (f) of this rule.

Example 10. Real estate broker located in Florida receives a commission for arranging the sale of real property located in Washington. The real estate broker's service is related to the real property, therefore the benefit is received in Washington, where the real property is located, and the commission income is attributed to Washington.

(b) Services related to tangible personal property.

Example 11. Big Manufacturing hires an engineer to design a tool that will only be used in a factory located in Brewster, Washington. Big Manufacturing receives the benefit of the engineer's services at a single location in Washington where the tool is intended to be used. Therefore, 100% of engineer's receipts from this service must be attributed to Washington.

Example 12. The same facts as in Example 11, except Big Manufacturing will use the tool equally in factories located in Brewster and in Kapa'a, Hawai'i. Therefore, Big Manufacturer receives the benefit of the service equally in two states. Because the benefit of the service is received equally in both states, a reasonable method of proportionally attributing receipts would be to attribute 1/2 of the receipts to each state.

Example 13. Taxpayer, a commissioned salesperson, sells tangible personal property (100 widgets) for Distributor to XYZ Company for delivery to Spokane. Distributor receives the benefit of Taxpayer's service where the tangible personal property will be delivered. Therefore, Taxpayer will attribute the commission from this sale to Washington.

Example 14. Same facts as in Example 13, but the widgets are to be delivered 50 to Spokane, 25 to Idaho, and 25 to Oregon. In this case, the benefit is received in all three states. Taxpayer shall attribute the receipts (commission) from this sale 50% to Washington, 25% to Idaho, and 25% to Oregon where the tangible personal property is delivered to the buyer.

Example 15. Training Company provides training to Customer's employees on how to operate a specific piece of equipment used solely in Washington. Customer receives the benefit of the service where the equipment is used, which is in Washington. Therefore, Training Company will attribute 100% of its receipts received from Customer to Washington.

(c) Services related to customer's business activities. The examples in this subsection assume that the customer is engaged in business and the services relate to the customer's business activities.

Example 16. Manufacturer hires Law Firm to defend Manufacturer in a class action product liability lawsuit involving Manufacturer's Widgets. The benefit of Law Firm's services relates to Manufacturer's widget selling activity in various states. A reasonable method of proportionally attributing receipts in this case would be to attribute the receipts to the locations where the Manufacturer's Widgets were delivered, which relates to Manufacturer's business activities.

Example 17. Debt Collector provides debt collection services to ABC. The benefit of Debt Collector's services relates to ABC's selling activity in various states. It is reasonable to assume that where the debtors are located is the same as where ABC's business activity occurred. If Debt Collector is able to attribute specific receipts to a specific debtor, then the receipt is attributed to where the debtor is located.

Example 18. Same facts as Example 17, except Debt Collector is unable to attribute specific benefits with specific debtors. In this case, a reasonable method of proportionally attributing benefits/receipts should be employed. Depending on Debt Collector's specific facts and circumstances, a reasonable

method of proportionally attributing benefits/receipts could be: Relative number of debtors in each state; relative debt actually collected from debtors in each state; the relative amount of debt owed by debtors in each state; or another method that does not distort the apportionment of Debt Collector's receipts.

Example 19. Training Company provides training to Customer's employees who are all located in State A. The training is provided in State B. The training relates to the employees' ethical behavior within Customer's organization. Customer receives the benefit of Training Company's service in State A, where Customer's office is located and the employees presumably practice their ethical behavior. Training Company must attribute the apportionable receipts to State A where the benefit is solely received.

Example 20. Same facts as Example 19, except the training is provided for employees from several states and Training Company knows where each employee works. The benefit of the Training Company's services is received in those several states. Attributing receipts from the training based on where the employees work is a reasonable method of proportionally attributing the receipts income.

Example 21. Call Center provides "customer service" services to Retailer who has customers in all 50 states. Call Center's services relate to Retailer's selling activity in all 50 states, therefore Retailer receives the benefit of Call Center's services in all 50 states. Call Center has offices in Iowa and Alabama that answer questions about Retailer's products. Call Center records Retailer's customer's calls by area code. Call Center may attribute receipts received from Retailer based on the number of calls from area codes assigned to each state. This would be a reasonable method of proportionally attributing receipts notwithstanding the fact that mobile phone numbers and related area codes may not exactly reflect the physical location of the customer in all cases.

Example 22. Taxpayer provides internet advertising services to national retail chains, regional businesses, businesses with a single location, and businesses that operate solely over the Internet. Generally, the benefit of the advertising services is received where the customer's related business activities occur. Depending on what products or services are being provided by Taxpayer's customers, the use of relative population in the customer's market may be a reasonable method of proportionally attributing the benefit of Taxpayer's services.

Example 23. Oregon Newspaper sells newspaper advertising to Merlin's Potion Shop. Merlin's only makes over-the-counter sales from its single location in Vancouver, Washington. Merlin's Potion Shop receives the benefit of the Oregon Newspaper's advertising services in Washington where it makes sales to its customers. In this case Oregon Newspaper will report 100% of its receipts received from Merlin's to Washington.

Example 24. Company A provides human resources services to Racko, Inc. which has three offices that use those services in Washington, Oregon, and Idaho. Racko sells widgets and has customers for its widgets in all 50 states. The benefit of the service performed by Company A is received at Racko's locations in Washington, Oregon, and Idaho. Assuming that each office is approximately the same size and uses the services to approximately the same extent, then attributing 1/3 of the receipts to each of the states in which Racko has locations using the services is a reasonable method of proportionally attributing Company A's receipts from Racko.

Example 25. Director serves on the board of directors for DEF, Inc. Director's services relate to the general management of DEF, Inc. DEF, Inc. is Director's customer and receives the benefit of Director's services at its corporate domicile. Therefore, Director must attribute the receipts earned from Director's services to DEF to DEF's corporate domicile.

(d) Services not related to real or tangible personal property and either provided to customers not engaged in business or unrelated to the customer's business activities.

Example 26. A Washington resident travels to California for a medical procedure. Because the Washington resident must be physically in California, the Washington resident receives the benefit of the service in California. Therefore, the service provider must attribute its income from the procedure to California.

Example 27. Washington accountant prepares a Nevada couple's Arizona and Oregon state income tax returns as well as their federal income tax return. The benefit of the accountant's service associated with the state income tax returns is attributed to Arizona and Oregon because these returns relate to specific locations (states). The benefit associated with the federal income tax return is attributed to the couple's residence. The fees for the state tax returns are attributed to Arizona and Oregon, respectively, and the fee for the federal income tax return is attributed to Nevada.

Example 28. Tour Operator provides cruises through Washington's San Juan Islands for four days and Victoria, British Columbia for one day. The benefit of the tour is received where the tour occurs. Tour Operator may use a reasonable method of proportionally attributing the benefit to determine that its customers receive 80% of the benefit in Washington and 20% outside of Washington. Therefore, Tour Operator must attribute 80% of apportionable receipts to Washington and 20% to British Columbia.

Example 29. A Washington couple hires a Washington attorney to prepare a last will and testament for Daughter who lives in California. Daughter is a third-party beneficiary and receives the benefit of the attorney's services in California because that is where Daughter lives. Washington Attorney must attribute the fee to California.

Example 30. A Washington couple hires a California accountant to prepare their joint federal income tax return. Because the couple does not have to be physically present for the accountant to perform services and services are not related to a specific location, the Washington couple receives the benefit of the accountant's services at their residence in Washington. California accountant must attribute its fee for this service to Washington.

Example 31. An Arizona resident retains a Washington stock broker to handle its investments. The stock broker receives orders from the client and executes trades of securities on the New York Stock Exchange. Because (a) the Arizona resident is not investing as part of a business; (b) the activity does not relate to real or tangible personal property; (c) and the client does not need to be physically present for the stock broker to perform its services; and (d) the services are not related to a specific location, the client receives the benefit of the services at client's place of residence. Washington stockbroker must attribute the fee to Arizona.

Example 32. Investment Manager manages a mutual fund. Investment Manager receives a fee for managing the fund based on the value of the assets in the fund on particular days. Investment Manager knows or should know the identity of the investors in the fund and their mailing addresses. The fees received by Investment Manager (whether from the mutual fund or from individual investor's accounts) are for the services provided to the investors. Investment Manager's services do not relate to real or tangible personal property and do not require that the client be physically present, therefore, the benefit of Investment Manager's services is received where the investors are located and Investment Manager's apportionable receipts must be attributed to those locations.

(305) **Special rules related to extending credit performed by nonfinancial institutions.** Businesses not included in the definition of a financial institution under WAC 458-20-19404 that provide services related to the extension of credit must attribute their income from such activities as follows:

(a) **Activities related to extending credit where real property secures the debt.** Such activities include, but are not limited to, servicing loans, making loans subject to deeds of trust or mortgages (including any fees in the nature of interest related to the loan), and buying and selling loans. Apportionable receipts from these activities are attributed in the same manner as a financial institution attributes these apportionable receipts under WAC 458-20-19404.

(b) **Activities related to credit cards.** Such activities include, but are not limited to, issuing credit cards, servicing, and billing. Apportionable receipts from these activities are attributed to the billing address of the card holder.

(c) **Other activities related to extending credit where real property does not secure the debt.** Such activities include, but are not limited to, servicing loans, making loans (including any fees related to such loans), and buying and selling loans. Apportionable receipts from these activities are attributed in the same manner a financial institution attributes income under WAC 458-20-19404.

(d) **All other apportionable receipts from such businesses are attributed using subsections (301) through (304) of this rule or WAC 458-20-19403.**

(306) **What does "unable to attribute" mean?** A taxpayer is "unable to attribute" apportionable receipts when the taxpayer has no commercially reasonable means to acquire the information necessary to attribute the apportionable receipts. Cost and time may be considered to determine whether a taxpayer has no commercially reasonable means to acquire the information necessary to attribute apportionable receipts.

Example 33. One office of ZYX LLC has information that can easily be used to determine a reasonable proportional attribution of receipts, but does not provide this information to the office preparing the tax returns. ZYX LLC must use the information maintained by the marketing office to attribute its receipts.

Example 34. CBA, Inc. is entitled to receive information from an affiliate or unrelated third party which it could use to determine where the benefit of its services is received but chooses not to obtain that information. CBA, Inc. must use the information maintained by the affiliate or unrelated third party to attribute its apportionable receipts.

Example 35. Same facts as Example 34, except that the information is raw data that must be formatted and otherwise processed at a cost that exceeds a reasonable estimate of the possible difference in the amount of tax CBA, Inc. would owe if used another attribution method authorized in subsection 301(b) through (f). In this case, it is not commercially reasonable for CBA, Inc. to use this data to determine where to attribute its income.

PART 4. RECEIPTS FACTOR.

(401) **General.** The receipts factor is a fraction that applies to apportionable income for each calendar year. Taxpayers must calculate a separate receipts factor for each apportionable activity (business and occupation tax classification) engaged in.

(402) **Receipts factor calculation.** The receipts factor is: Washington attributed apportionable receipts divided by world-wide apportionable receipts less throw-out income (see subsection (403) of this section). The receipts factor expressed algebraically is:

$$\text{(Receipts factor)} = \frac{\text{(Washington apportionable receipts)}}{\text{((World-wide apportionable receipts) - (Throw-out income))}}$$

(a) The numerator of the receipts factor is: The total apportionable receipts attributable to Washington during the calendar year from engaging in the apportionable activity.

(b) The denominator of the receipts factor is: The total (world-wide, including Washington) apportionable receipts from engaging in the apportionable activity during the calendar year, less throw-out income.

Example 36. NOP, Inc. has \$400,000 of receipts attributed to Washington and \$1,000,000 of world-wide receipts. Assuming that there is no throw-out income, NOP's receipts factor is 40% (400,000/1,000,000).

(c) In the very rare situation where the receipts factor (after reducing the denominator by the throw-out income) is zero divided by zero, the receipts factor is deemed to be zero.

(403) **Throw-out income.** Throw-out income includes all apportionable receipts attributed to states where the taxpayer:

(a) Is not taxable (see subsection (107) of this rule); and

(b) At least part of the activity of the taxpayer related to the throw-out income is performed in Washington.

Example 37. XYZ Corp. performs all services in Washington and has apportionable receipts attributed using the criteria listed in subsections (301) through (305) of this rule or WAC 458-20-19403 as follows: Washington \$500,000; Idaho \$200,000; Oregon \$100,000; and California \$300,000. XYZ Corp. is subject to Oregon and Idaho corporate income tax, but does not owe any California business activities taxes. XYZ does not have any throw-out income because Oregon and Idaho impose a business activities tax on its activities and it is deemed to be taxable in California because it satisfies the minimum nexus standards explained in WAC 458-20-19401 (more than \$250,000 in receipts). XYZ's receipts factor is: 500,000/1,100,000 or 45.45%.

Example 38. Same facts as Example 37 except Idaho does not impose any tax on XYZ Corp. The \$200,000 attributed to Idaho is throw-out income that is excluded from the denominator because: XYZ Corp. is not subject to Idaho business activities taxes; does not have substantial nexus with Idaho under Washington standards; and performs in Washington at least part of the activities related to the receipts attributed to Idaho. The receipts factor is 500,000/900,000 or 55.56%.

Example 39. The same facts as Example 38 except XYZ Corp. performs no activities in Washington related to the \$200,000 attributed to Idaho. In this situation, the \$200,000 is not throw-out income and remains in the denominator. The receipts factor is: 500,000/1,100,000 or 45.45%.

PART 5. HOW TO DETERMINE WASHINGTON TAXABLE INCOME.

(501) **General.** Washington taxable income is determined by multiplying apportionable income by the receipts factor for each apportionable activity the taxpayer engages in. While the receipts factor is calculated without regard to deductions authorized under chapter 82.04 RCW, apportionable income is determined by reducing the apportionable receipts by amounts that are deductible under chapter 82.04 RCW regardless of where the deduction may be attributed. This formula can be expressed algebraically as:

$$\text{(Taxable Income)} = \text{(Receipts Factor)} \times \text{(Apportionable receipts - deductions)}$$

Example 40. Calculating apportionable income. Corporation A received \$2,000,000 in apportionable receipts from its world-wide apportionable activities, which included \$500,000 of receipts that are deductible under Washington law. Corporation A's total apportionable income is \$1,500,000 (\$2,000,000 minus \$500,000 of deductions). If Corporation A's receipts factor is 31.25%, then its taxable income is \$468,750 (\$1,500,000 multiplied by 0.3125).

PART 6. REPORTING INSTRUCTIONS.

(601) **General.**

(a) Taxpayers required to use this rule's apportionment method may report their taxable income based on their apportionable income for the reporting period multiplied by the receipts factor for the most recent calendar year the taxpayer has available.

(b) If a taxpayer does not calculate its taxable income using (a) of this subsection, the taxpayer must use actual current calendar year information.

(602) **Reconciliation.** Regardless of how a taxpayer reports its taxable income under subsection (601)(a) or (b) of this rule, when the taxpayer has the information to determine the receipts factor for an entire calendar year, it must file a reconciliation and either obtain a refund or pay any additional tax due. The reconciliation must be filed on a form approved by the department. In either event (refund or additional taxes due), interest will apply in a manner consistent with tax assessments. If the reconciliation is completed prior to October 31st of the following year, no penalties will apply to any additional tax that may be due.

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NO. 52349-3-II

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COURT OF APPEALS
DIVISION II
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STATE OF WASHINGTON
BY 

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

ARUP LABORATORITES, INC.

Appellant,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

CERTIFICATE OF SERVICE

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CERTIFICATE OF SERVICE

The undersigned certifies under the penalty of perjury under the laws of the State of Washington that I am now and at all times herein mentioned a resident of the State of Washington, over the age of eighteen years, not a party to or interested in the above-entitled action, and competent to be a witness herein.

On the date given below, I caused to be served Reply Brief of the Appellant on the following persons and in the manner listed below:

Ms. Kelly Owings Mr. Joshua Weissman Assistant Attorney General Office of the Attorney General 7141 Cleanwater Lane SW P.O. Box 40123 Olympia, WA 98504-0123 kellyo2@atg.wa.gov joshuaw@atg.wa.gov CarrieP@Atg.wa.gov kyleeni@atg.wa.gov REVOlyFF@atg.wa.gov	<input type="checkbox"/> Via Hand delivery <input checked="" type="checkbox"/> Via U.S. Mail, 1 st Class, Postage Prepaid <input type="checkbox"/> Via Overnight Delivery <input type="checkbox"/> Via Facsimile <input checked="" type="checkbox"/> Via Email per E-Service Agreement
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I hereby declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED at Tacoma, Washington this 5th day of April, 2019.


Cindy Rochelle

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STATE OF WASHINGTON
BY _____ DEPUTY