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Court of Appeals
Division II
State of Washington
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No. 52783-9-II

DIVISION II, COURT OF APPEALS
OF THE STATE OF WASHINGTON

LENDINGTREE, LLC,

Plaintiff-Appellant

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Defendant-Respondent

ON APPEAL FROM THURSTON COUNTY SUPERIOR COURT
(Hon. Christine Schaller)

REPLY BRIEF

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I. INTRODUCTION

The parties agree on almost everything. They agree that there are no disputed facts. They agree that LendingTree’s customers are lenders, not potential borrowers. They agree that apportionment of LendingTree’s income for B&O tax purposes turns on where LendingTree’s lender customers “received the benefit” of LendingTree’s services. RCW 82.04.462(3)(b). They agree that DOR has interpreted this statutory term to mean that the lenders receive the benefit of LendingTree’s services where the lenders’ “related business activities occur.” WAC 458-20-19402(303)(c). Thus, the parties agree that this appeal boils down to this Court’s consideration of undisputed facts to determine *what* the lenders’ “related business activities” are and *where* they occur.

That is where the agreement ends. DOR ignores the rule and the facts. Rather than focus on the nature and location of the *lenders’* business activities, DOR wrongly focuses on a single aspect of *LendingTree’s* activities. DOR claims that because LendingTree’s activities help make lenders’ loan services available to potential borrowers, the lenders receive the benefit of LendingTree’s services where the potential borrowers reside. But the plain language of Rule 19402 requires a different analysis. All that matters is where the *lenders’* business activities occur—and, here, it is undisputed that *all* the lenders’ related activities occur at their

business locations and *none* occurs where potential borrowers reside. Whether or not LendingTree's services help create a market for lenders' loans in Washington is irrelevant to the question of proper apportionment.

DOR (and the trial court) therefore erred in failing to apportion LendingTree's income based on the business locations of LendingTree's lender customers. Under the statute and rule, those locations—not the borrowers' residences—are where the lenders' "related business activities" occurred and, therefore, where they received the benefit of LendingTree's services. The judgment below should be reversed.

II. REPLY ARGUMENT

Under Rule 19402's two-part inquiry, the first step is to identify the taxpayer's customer's "related business activities." WAC 458-20-19402(303)(c). DOR argues that, in order to do that, "it is important to correctly identify the specific services the taxpayer is performing." DOR Br. at 14. That may be true, but it does not help DOR here. DOR myopically points to LendingTree's marketing function, and argues that LendingTree's services are not related to the lenders' "evaluation or consummation of a loan." *Id.* at 15-16. Wrong. While LendingTree's electronic marketplace provides a means through which lenders are introduced to potential borrowers, LendingTree does far more than that.

When lenders participate in LendingTree's electronic marketplace, they provide LendingTree with detailed loan criteria. CP 168-174 (§§ 2.7, 2.10, 5.1); CP 193-195 (§§ 1.9, 1.14, 3.1). When a potential borrower enters information relevant to his or her loan request on LendingTree's website, LendingTree compares that information against the lenders' loan criteria using "proprietary computerized filter systems," and then refers the potential borrower only to those lenders with matching criteria. CP 168-174 (§§ 4.5, 4.6, 6.1, 6.2, 10.1); CP 193-195 (§§ 2.1(e), 2.1(g), 2.1(k)). So LendingTree doesn't simply market its customer lenders' products, LendingTree participates in the loan origination process by collecting, reviewing and filtering borrower loan request information, and then matching and referring requests based on the lenders' loan criteria.

Thus, the undisputed facts show that LendingTree's services relate to the lenders' core business of offering, evaluating, and consummating loans, not just the marketing of those loans. And the only evidence in the record regarding the lenders' business activities confirms that LendingTree's filtering and matching service is a critical aspect of the lenders' receipt of information needed to process loan requests; there is no evidence of any distinct marketing function. CP 137-138 (Gates Decl.). It was error for DOR (and the trial court) to artificially carve-out and

identify “marketing services” as the relevant “business activity”—for either LendingTree or, more importantly, its lender customers.

When the “related business activities” of LendingTree’s lender customers are properly identified as the processing, evaluation, and action on loan request information gathered, filtered and sent by LendingTree, the second step of Rule 19402’s two-part inquiry becomes equally clear. It is undisputed that the lenders perform all these activities at their specified business locations. CP 151 (Boardwine Decl., ¶¶ 5-6); CP 138 (Gates Decl., ¶¶ 4-7). Thus, with respect to lenders with out-of-state business locations, the rule forbids DOR from allocating LendingTree’s fees to Washington—regardless of where their borrowers reside. Such fees can be allocated to Washington only if the lender is located in this state.

Indeed, this is true even if, as DOR contends, “loan marketing activities” were the only business activities that mattered. DOR Br. at 15. This is so because, under DOR’s strained theory, it is LendingTree—not the lenders—performing marketing services where borrowers reside. But the location of LendingTree’s activities is irrelevant. Under the rule, the only inquiry is where the “*customer’s* related business activities occur”—not where the *taxpayer’s* business activities occur. WAC 458-20-19402(303)(c) (emphasis added). And, here, there is no evidence that

LendingTree’s lender customers conduct marketing activities—or any business activities for that matter—where their potential borrowers reside.

In the absence of such evidence, DOR simply proclaims that “in those cases where the taxpayer’s service is most closely related to its customer’s selling or marketing business activity, the location of that related business activity is the customer’s market—i.e., the location where its sales activity is directed.” DOR Br. at 17. DOR cites no authority to support this overstated proposition, which defies the plain language of Rule 19402. To be sure, neither of the rule’s examples help DOR. In each, the example presumes that the customer’s sales or marketing activity actually occurred in the state where the customer’s customer was located. *See* WAC 458-20-19402(304) (Examples 17 & 21). That is not true here.

Finally, LendingTree does not claim, as DOR falsely posits, that a customer’s “related business activities occur” only where the customer is “physically present.” DOR Br. at 19-21. To be sure, a taxpayer’s out-of-state customers can conduct business in Washington without having in-state locations or employees—but there is *no evidence* that LendingTree’s out-of-state lender customers did so here. The evidence says the opposite.

Moreover, DOR’s argument purposely confuses the question of whether Washington can tax LendingTree’s out-of-state lender customers for the fees they receive from in-state borrowers with the separate question

of how much it can tax LendingTree for the fees it receives from those lenders. The first question is one of nexus between the state and lenders (whether there is sufficient connection between the state and the activity taxed), and the second is one of fair apportionment of LendingTree's income (whether the amount of tax bears a reasonable relationship to the taxpayer's in-state activities). The two standards are different. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). Only apportionment is at issue in this case, and Rule 19402(303) exclusively governs the outcome.

VI. CONCLUSION

The trial court's judgment must be reversed, and judgment entered in favor of LendingTree with instructions to remand the case to DOR for proper allocation and apportionment of LendingTree's income.

Respectfully submitted this 25th day of April, 2019.

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CERTIFICATE OF SERVICE

I hereby certify that on April 25, 2019, I caused to be served a copy of the foregoing document to be delivered in the manner indicated below to the following person at the following address:

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DATED: April 25, 2019.

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