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

FPR II, LLC,

Appellant,

v.

STATE OF WASHINGTON DEPARTMENT OF REVENUE,

Respondent.

BRIEF OF RESPONDENT

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I. INTRODUCTION

Appellant FPR II, LLC is a staffing company that provides employees to businesses in the recycling industry. FPR's employees work at material recovery facilities located throughout the United States, including Washington. At these facilities, FPR's employees primarily sort and bundle commingled recyclable materials. The question for this Court to resolve on appeal is how to classify the sorting and bundling activities of FPR's employees for business and occupation (B&O) tax purposes.

Like the trial court, this Court should resolve that question in favor of the Department, not FPR. To do so, this Court should reject FPR's primary argument that it is entitled to the processing for hire B&O tax classification. To be a processor for hire, FPR's employees must be engaged in manufacturing activities on property belonging to others. RCW 82.04.280(1)(a), (c); WAC 458-20-136(3)(a). Here, the undisputed facts demonstrate that FPR employees were merely sorting and bundling recyclable materials at the facilities of the recycling businesses. Because such activities do not cause any significant change to the underlying recyclable materials, they do not amount to manufacturing under RCW 82.04.120, the Department's guidance, and the relevant case law. Thus, as a matter of law, FPR's employees were not processing for hire.

This Court also should reject FPR's alternative argument for the wholesaling B&O tax classification. To be wholesaling, FPR's employees must have performed certain services for persons other than consumers. The undisputed evidence shows that this was not the case for FPR employees providing services to the recycling businesses. Instead, the recycling businesses met the definition of a "consumer" under RCW 82.04.190(5) because they owned the recyclable materials that FPR employees sorted and bundled. Accordingly, FPR's wholesaling claim also fails as a matter of law.

Finally, this Court should reject FPR's new claim for the retailing B&O tax classification as well. FPR never raised this claim in its complaint or in its arguments to the trial court. Because FPR did not bring its retailing claim to the trial court's attention, this Court should not consider it now for the first time on appeal. Instead, this Court should affirm the trial court's ruling granting summary judgment to the Department.

II. COUNTERSTATEMENT OF THE ISSUES

1. The processing for hire B&O tax classification applies to persons engaging in manufacturing on property owned by others to create a "new, different, or useful" article of property. RCW 82.04.280(1)(c); RCW 82.04.120; WAC 458-20-136. Does FPR qualify as a processor for

hire when it provided employees to sort and bundle recyclable materials for recycling businesses?

2. The wholesaling B&O tax classification applies to persons performing certain services on property that the purchaser of the services does not own. RCW 82.04.270; RCW 82.04.060; RCW 82.04.190(5).

Does FPR qualify as wholesaling when its employees sorted and bundled recyclable materials for recycling businesses that owned the materials?

3. The retailing B&O tax classification applies to persons “installing, repairing, cleaning, altering, imprinting, or improving of tangible personal property of or for consumers.” RCW 82.04.250; RCW 82.04.050(2)(a). Should this Court consider FPR’s retailing claim when FPR never raised the claim in its complaint or in its summary judgment briefing to the trial court?

III. COUNTERSTATEMENT OF THE CASE

A. Washington’s B&O Tax System

This case involves the proper B&O tax classification of FPR’s business activities. Washington’s B&O tax is imposed upon every person “for the act or privilege of engaging in business activities.” RCW 82.04.220(1). The amount of the B&O tax owed is calculated by multiplying the applicable rate against the “value of products, gross proceeds of sales, or gross income of the business, as the case may be.” *Id.*

Thus, when determining the B&O tax, this Court “must first identify a business activity and then determine which tax measure and rate applies depending on the business activity.” *Steven Klein, Inc. v. Dep’t of Revenue*, 183 Wn.2d 889, 896-97, 357 P.3d 59 (2015).

The Legislature has imposed different tax measures and rates to a variety of business activities to create B&O tax classifications. *Id.* at 897. A common B&O tax classification is retailing. Under the retailing classification, every person “in the business of making sales at retail” must pay B&O tax “equal to the gross proceeds of sales of the business, multiplied by the rate of 0.471 percent.” RCW 82.04.250(1). In contrast to retailing is the wholesaling B&O tax classification, which applies to every person “in the business of making sales at wholesale.” RCW 82.04.270. Such persons are subject to B&O tax on “the gross proceeds of sales of such business multiplied by the rate of .484 percent.” *Id.*

Another specific B&O tax classification relates to processors for hire. RCW 82.04.280(1)(c). A processor for hire is a person who engages in manufacturing on property belonging to others. WAC 458-20-136(3)(a). Under this classification, a person engaging in “processing for hire” is subject to B&O tax “equal to the gross income of the business multiplied by the rate of 0.484 percent.” RCW 82.04.280(1)(c). Thus, while the

measure of the tax is different, processing for hire has the same B&O tax rate as wholesaling.¹

Finally, the Legislature also has created a catchall B&O tax classification. This classification is for “service and other” activities not expressly taxed in another B&O tax classification. RCW 82.04.290(2)(a). Persons engaging in “service and other” activities must pay B&O tax “equal to the gross income of the business multiplied by the rate of 1.5 percent.” *Id.*

B. FPR Provided Employees To Recycling Businesses At Their Material Recovery Facilities

FPR is a staffing company that provided employees to businesses in the recycling industry. CP 103, 400, 433. During the tax period, FPR contracted with four recycling businesses to provide its staffing services in Washington. CP 171-72, 399-431. The following recycling businesses were FPR’s customers in Washington: Pioneer Recycling Services (formerly known as SP Newsprint), Allied Waste North America, Waste Connections (formerly Columbia Resource Corporation), and Waste Management Recycle America. *Id.* Under the contracts, FPR agreed to

¹ The manufacturing B&O tax classification also has the same tax rate of 0.484 percent, but a different measure of the tax. RCW 82.04.240. For manufacturing, the amount of tax is equal to the “the value of the products, including by-products, manufactured, multiplied by the rate of 0.484 percent.” *Id.*

supply employees to help operate the recycling businesses' material recovery facilities. *Id.*

The vast majority of the employees FPR provided to recycling businesses worked as sorters in the material recovery facilities. CP 173-74 (more than 75 percent of the total employees FPR provided to clients were sorters). As FPR's President and CEO put it, "the primary position in these plants is the sorter. That's where most of the labor is on the line." CP 104. FPR's expert also confirmed that the bulk of the employees FPR provided at material recovery facilities were sorters. CP 473.

As sorters, employees were responsible for sorting the incoming commingled recyclable materials. CP 178. Specifically, sorters separated garbage from the recyclable materials, and separated recyclable material by type, such as cardboard, metal, aluminum, plastic, and paper. *See, e.g.*, CP 119, 125, 178. To perform this work, FPR trained new employees on the safety and basics of sorting, but did not require any certification. CP 106, 116-17, 154.

Beyond the sorters, FPR provided employees for a variety of other positions at the material recovery facilities. CP 174-183. Similar to a sorter, FPR supplied employees known as quality control personnel, who were responsible for conducting a final inspection to remove any remaining contaminants from the sorted recyclable materials. CP 178.

FPR also provided employees that operated different equipment at the material recovery facilities, including loaders, forklifts, and balers. CP 121, 127, 179-82. In addition, some FPR employees maintained the material recovery facilities by cleaning and assisting with repairs. CP 104, 180, 183. Finally, FPR provided employees to perform the management and administrative aspects of running the material recovery facilities. CP 104, 175-77, 82

FPR billed the recycling businesses each week for providing employees at the material recovery facilities. CP 109-10, 193-202. FPR charged the recycling businesses a specified amount for each FPR employee multiplied by the number of hours that each particular employee worked during the week. CP 109-10, 192-202. The specified amount for each FPR employee was based upon the wage for that particular position, plus a markup to account for FPR's staffing services. CP 107, 192-202, 406-07, 424-25.

C. FPR Employees Sorted and Bundled Commingled Recyclable Materials at Material Recovery Facilities

The operations at a material recovery facility involved using equipment and labor to sort and bundle commingled recyclable materials by material type. CP 124, 162-63, 185-86. "Commingled recyclable materials" is a term the recycling industry utilizes to refer to a mixture of

different material types, including paper, cardboard, plastic, glass, steel, aluminum, and non-recyclables, i.e. garbage. CP 123, 303. After the sorting and bundling process, the recycling businesses sold each type of recyclable material to a variety of industries. CP 140-41.

To operate the material recovery facilities, the recycling businesses first had to obtain the commingled recyclable materials. To do so, the recycling businesses purchased the comingled recyclable materials from municipalities or private companies that had collected the materials from homes and commercial businesses. CP 124, 222. During the tax period, the price of the commingled recyclable materials was approximately \$6 per ton. CP 327. Thus, as the purchaser, the recycling businesses owned the commingled recyclable materials. CP 124.

After the purchase, the municipalities, private companies, or the recycling businesses themselves delivered the commingled recyclable materials to the material recovery facilities. CP 108, 124. Depending upon the size of the material recovery facility, the recycling businesses received 300 to 800 tons of commingled recyclable materials per day. CP 124. Approximately 20 percent of the incoming commingled recyclable materials was garbage that FPR employees later sorted from recyclable materials. CP 140, 185-86.

After delivery, an FPR employee loaded the commingled recyclable materials into a metering bin, which fed the materials onto a conveyor belt. CP 125. The conveyor belt moved the commingled recyclable materials to the first sorting station within the material recovery facility, known as the pre-sort deck. *Id.* At the pre-sort deck, FPR sorters removed larger pieces of garbage (garden hoses, diapers, etc.), materials that could not pass through the sorting equipment (plastic bags, plastic banding, etc.), hazardous objects (chemicals, syringes, etc.), and other items that would damage the sorting equipment (concrete blocks, car parts, wood, etc.). CP 125, 185. FPR provided six to twenty sorters to occupy the pre-sort deck. CP 125.

After the pre-sort deck, the conveyor belt transported the remaining commingled recyclable materials to the next step in the sorting system, which was a series of screens designed to separate materials by size and shape. CP 125-26, 186. The first screen separated larger pieces of cardboard from the commingled recyclable materials. CP 125-126. After being separated, the cardboard passed along the conveyor belt to another sorting station, where two to four FPR sorters were located. CP 126. At this station, the sorters removed any remaining garbage and dropped it into a nearby container that fed onto another conveyor belt designated for garbage. *Id.* The sorters also removed any recyclable materials that were

not cardboard and placed them into the appropriate container so they could be sorted according to their material type. *Id.*

The next screen in the sorting system separated glass from the commingled recyclable materials. *Id.* The screen to sort glass consisted of very small spacing between disks, which caused the screen to crush the glass into small pieces. CP 126, 162. After passing through the screen, the glass typically ranged in size from two-inch pieces to very fine particles. CP 126-27, 162. The glass then moved through another screen that sorted the larger glass pieces from the fine particles. CP 127, 162. Finally, the larger glass pieces were transported into a cylindrical, rotating drum that used gravity and air pressure to remove any remaining non-glass materials, such as plastic bottle caps. CP 127. FPR employees did not further sort, clean, or process the glass. *Id.*

The remaining commingled materials then moved along the conveyor belt to several screens meant to sort paper. CP 128. The first screen separated newspapers, which were then conveyed to another station with eight to eighteen FPR sorters. *Id.* The sorters removed any remaining garbage or recyclable materials that were not newspapers. *Id.*

After sorting the newspapers, another screen separated mixed paper, which included junk mail, colored paper, and magazines. *Id.* At this point, some material recovery facilities utilized optical sorting equipment

to further separate brown fiber paper from white fiber paper. CP 470-71. A conveyor belt then transported the separated mixed paper to another station with six to sixteen FPR sorters. CP 128. The sorters removed any remaining garbage or materials that were not mixed paper. *Id.* Finally, the last paper screen captured any smaller pieces of paper that had not yet been sorted. CP 128-29.

The commingled recyclable materials on the main conveyor belt now consisted of metals, plastics, and garbage that FPR sorters had not removed yet. CP 128-29. These materials then passed under a magnet to separate steel, such as soup cans or pet food cans. CP 129, 163. The steel items move to another station where an FPR sorter is located to remove any non-steel materials or garbage. CP 129.

The next step for the remaining commingled recyclable materials was to pass through an eddy current. CP 129, 163, 190-91. An eddy current produced an electromagnetic field to separate non-magnetic metals – primarily, aluminum – from other materials. CP 129, 190-91. After the eddy current, two FPR sorters typically separated any remaining non-magnetic items or garbage from the aluminum. CP 130.

The last material type to sort on the main conveyor belt was plastics. *Id.* Some material recovery facilities relied upon optical sorters to separate the plastics by grade and color. CP 130, 163. The optical sorters

used light and bursts of air to identify and separate different plastic types. CP 130, 189-90. For example, the optical sorters separated plastic drinking bottles from other plastic types, like detergent bottles or milk jugs. CP 130. After passing through the optical sorter, FPR employees removed any remaining garbage or plastics of the wrong grade or color. *Id.* For material recovery facilities without optical sorters, FPR provided up to 12 sorters to separate plastic types by hand. *Id.*

At this point, the material on the main conveyor belt primarily consisted of garbage. CP 131-32. However, two to five FPR sorters conducted a final review to remove any recyclables that remained on the conveyor belt. *Id.* The FPR sorters then placed the recyclables in a designated container for that particular material type. *Id.*

As the FPR employees and equipment completed the sorting process, each type of recyclable material moved on a conveyor belt to a large bunker. CP 132. From the bunker, most of the recyclable materials passed on to a baler. CP 132-33. A baler is a machine that compresses and bundles together each type of recyclable material with steel wire. CP 132-33, 191. Some materials, however, did not move to the baler. CP 133. For example, the crushed glass and larger pieces of steel were not baled. CP 133, 140. Instead, these recyclables remained loose when delivered to the customers of the recycling businesses. *Id.*

The material recovery facilities typically contained one to three balers, which were operated by FPR employees or employees hired by the recycling businesses. CP 132, 174. A single bundle of baled recyclable materials weighed between 1,000 to 2,000 pounds. CP 133. Baling the recyclable materials allowed for easier storage, handling, and transportation. CP 133, 165-66.²

After baling, three to twelve FPR employees performed a final inspection of the bundled recyclable materials. CP 118, 133. During this final inspection, FPR employees examined the outside of the bale for any obvious garbage or dissimilar recyclable materials that were inadvertently included in the bundle. *Id.* If possible, FPR employees used pliers or a pry bar to remove the undesirable materials. CP 140. Following the final inspection, the bundled recyclable materials were ready for sale by the recycling businesses. CP 140-41.

² FPR points to the opinion of its expert to assert that bundling the recyclable materials serves an additional purpose. *See* Br. Appellant at 17-18 (citing to CP 485 for proposition that certain metals need to be compressed to reach the correct combustion point for more processing). On appeal, this Court should not consider the expert's opinion because the trial court excluded it as untimely, and FPR failed to assign error to this exclusion in its opening brief. *See* VRP 28; RAP 10.3(a)(4), (6) (requiring separate statement of each error trial court made, along with supporting argument); *Jackson v. Quality Loan Serv. Corp.*, 186 Wn. App. 838, 845, 347 P.3d 487 (2015) (appellant's failure to assign error to and argue against the trial court's decision on particular issues waives any argument on those claims). The *Folsom v. Burger King* case that FPR relies upon does not require a different result. Br. Appellant at 18 n.4. That case simply concluded that a trial court's evidentiary rulings are reviewed de novo when made in conjunction with a summary judgment motion. 135 Wn.2d 658, 662-63, 958 P.2d 301 (1998).

D. The Recycling Businesses Sold Recyclable Materials To Various Industries

After the sorting and bundling process, the recycling businesses sold the recyclable materials to a variety of customers. CP 132-33, 140-41. The industries purchasing the bundled recyclable materials required the recycling businesses to meet certain standards relating to the quality of the bundles. CP 137, 332-92. Specifically, each industry identified the amount of contaminants allowed in a bundle of recyclable materials. *Id.*

Contaminants included garbage and recyclables of a different type than the primary material in the bundle. CP 137. Some standards also regulated how the material should be bundled, including specifications for the size of the bundle. *See, e.g.*, CP 340 (describing dimensions for bundle of aluminum cans). The standards for each industry changed depending upon the market at that time. CP 137.

The largest market for selling the bundled recyclable materials was overseas. CP 141. The specific customer making the purchase depended upon the type of recyclable material at issue. CP 141-42. For example, beverage companies purchased bundled aluminum cans. CP 141. For other materials, such as glass and plastics, secondary processors often purchased the material for further sorting and separating. CP 141, 168, 240-41, 275-76. After receiving the bundled recyclable materials, the customers

typically broke the bundle up by using the material in their own specific process. CP 133, 168.

The recycling businesses sold the bundled recyclable materials for a particular price per ton or per pound. CP 142. In doing so, the recycling businesses sold most of the recyclable materials at a higher price than what they paid to purchase the commingled recyclable materials. CP 327-30. For glass, however, the recycling businesses typically paid a secondary processor to pick up the material. CP 145, 475. While the recycling businesses paid secondary processors to take the glass, this payment was less than the amount they would have paid to dispose of the glass in a landfill as garbage. CP 475.

E. The Trial Court Upheld The Department's Tax Assessment Against FPR

The Department audited FPR for the period of January 2011 through December 2014. CP 67-71. During the audit, the Department reviewed FPR's business records to verify that FPR had been correctly reporting and paying its taxes. *Id.* From this review, the Department concluded that FPR's employees were primarily sorting and bundling recyclable materials at material recovery facilities for recycling businesses. *Id.*

This conclusion was very different from how FPR had previously described its business activities to the Department. Prior to the audit, FPR had made a request for a tax ruling to the Department, describing itself as “a contractor that brings in its own employees into a firm to do a specific job.” CP 62. According to FPR, the specific job its employees performed was “running a material recovery facility, [and] manufacturing a product via recycled materials that are sold via wholesale methods.” *Id.* FPR further explained that it had been filing tax returns under the manufacturing and wholesaling classifications, and then taking a multiple activities tax credit. *Id.* Based on the information provided, the Department issued a tax ruling to FPR, agreeing with its method of reporting. CP 64-65. In doing so, the Department expressly stated that the tax ruling was binding upon FPR and the Department “under the facts presented.” CP 65.

After the audit, the Department’s understanding of the facts relating to FPR’s business activities changed. CP 68-69. Rather than manufacturing or selling a product, FPR’s employees sorted and bundled recyclable materials for recycling businesses. *Id.* With this new understanding, the Department issued an assessment against FPR consisting of \$416,368 in service and other B&O tax, penalties, and interest. CP 67.

FPR challenged the assessment before the Department's appeals division, arguing that its income should be subject to the processing for hire classification, or alternatively the wholesaling classification. CP 73-82. The Department rejected FPR's arguments and upheld the assessment. *Id.* FPR then petitioned for reconsideration, arguing not only the classification issue, but also raising an estoppel claim based on the Department's tax ruling from 2009. CP 84-93. The Department denied FPR's petition for reconsideration. *Id.*

Shortly thereafter, FPR paid the assessment and filed this action seeking a refund of \$673,139.85 for the tax period of January 1, 2011 through December 31, 2016. CP 1-8. In its complaint, FPR raised the same claims it had brought before the Department. CP 3-7 (alleging FPR was entitled to the processing for hire or wholesaling classification, and raising an estoppel claim). After completing discovery, the Department moved for summary judgment on all three claims. CP 10-32. In response, FPR abandoned its estoppel claim, but primarily argued that genuine issues of material fact existed in relation to the proper B&O tax classification of its business activities. CP 435-56. The trial court disagreed, and granted summary judgment to the Department. CP 715-16. FPR now appeals to this Court.

IV. ARGUMENT

This Court reviews appeals from a summary judgment order de novo, engaging in the same inquiry as the trial court did below. *Wash. Imaging Servs., LLC v. Dep't of Revenue*, 171 Wn.2d 548, 555, 252 P.3d 885 (2011). As the taxpayer, however, FPR still bears the burden of proving that the tax it paid is incorrect and that it is entitled to a refund. *Id.* (citing RCW 82.32.180). On appeal, FPR now agrees that there are no genuine issues of material fact in this case. Accordingly, only a legal question remains for this Court to resolve: the proper B&O tax classification of FPR's business activities. Like the trial court, this Court should resolve that question in the Department's favor.

In this case, FPR provided employees to recycling businesses as a staffing company. For staffing companies, the proper B&O tax classification is based upon the services the employees of the staffing company perform. RCW 82.04.220; WAC 458-20-274(10); "Staffing Companies," Excise Tax Advisory 3100.2009 (Dec. 28, 2009). Thus, this Court must examine the particular services FPR employees performed to determine the correct B&O tax classification of FPR's income.

The undisputed facts establish that FPR primarily supplied recycling businesses with employees to sort and bundle recyclable materials that the recycling businesses later sold. Based on this undisputed

evidence, FPR challenges the Department's conclusion that the work its employees performed falls within the "service and other" B&O tax classification. Instead, FPR argues that the services its employees provided qualify for the processor for hire B&O tax classification, or alternatively, the wholesaling B&O tax classification. For the first time on appeal, FPR also asserts that the services of its employees qualify for the retailing B&O tax classification.

All three of FPR's arguments fail. While the sorting and bundling services FPR employees performed were valuable to the recycling businesses, those services do not constitute manufacturing a "new, different, or useful" article of tangible personal property under RCW 82.04.120(1). Thus, the processing for hire B&O tax classification does not apply. FPR's alternative argument for the wholesaling B&O tax classification also does not apply because FPR's employees sorted and bundled materials for "consumers," i.e., the recycling businesses that owned the materials. Nor should this Court consider FPR's argument for the retailing B&O tax classification when FPR failed to raise the claim before the trial court. Accordingly, the Department properly classified FPR's business activities under the "service and other" B&O tax classification. This Court should affirm the trial court's decision granting summary judgment to the Department.

A. The Processing For Hire B&O Tax Classification Does Not Apply Because The Sorting And Bundling Services FPR's Employees Performed Do Not Constitute Manufacturing

FPR primarily argues that the services its employees performed should be classified for B&O tax purposes as processing for hire. Br. Appellant at 23. FPR is wrong under the relevant statutes, Department guidance, and caselaw.

RCW 82.04.280(1)(c) establishes the processing for hire B&O tax classification. To qualify for that classification, a person must perform “labor and mechanical services upon property belonging to others so that as a result a new, different, or useful article of tangible personal property is produced for sale or commercial or industrial use.” WAC 458-20-136(3)(a). Thus, a processor for hire is any person who would be a manufacturer if that person were performing the labor and mechanical services upon his or her own materials. *Id.*

Here, the undisputed evidence establishes that FPR's employees primarily sorted and bundled commingled recyclable materials for recycling businesses. Such services, however, do not result in a significant enough change for FPR employees to qualify as manufacturers if they were performing those services upon their own materials. Accordingly, the trial court correctly concluded as a matter of law that FPR's employees

were not engaged in manufacturing, and thus, FPR was not entitled to a refund of B&O tax under the processing for hire classification.

1. Under RCW 82.04.120(1) and WAC 458-20-136, FPR's employees were not engaged in manufacturing

FPR's employees were not manufacturers because they do not produce new, different, or useful articles for sale or commercial or industrial use. A manufacturer "means every person who, either directly or by contracting with others for the necessary labor or mechanical services, manufactures for sale or for commercial or industrial use from his or her own materials or ingredients any articles, substances, or commodities." RCW 82.04.110(1). RCW 82.04.120(1) in turn defines the term "[t]o manufacture" as "embrac[ing] all activities of a commercial or industrial nature wherein labor or skill is applied, by hand or machinery, to materials so that as a result thereof a new, different or useful substance or article of tangible personal property is produced for sale or commercial or industrial use." The statute provides a number of examples of manufacturing, such as "[t]he production or fabrication of special made or custom made articles," and exclusions such as "[t]he growing, harvesting, or producing of agricultural products." RCW 82.04.120(1)(a), (2)(c).

The Department's rule explains the types of activities that rise to the level of manufacturing. Specifically, WAC 458-20-136(6) (Rule 136)

distinguishes between manufacturing and repairing or refurbishing tangible personal property, and explains, that “[t]o be considered ‘manufacturing,’ the application of labor or skill to materials must result in a ‘new, different, or useful article.’” If the activity merely restores an existing article of tangible personal property to its original utility, the activity is considered a repair or refurbishing of that property.” *Id.* Thus, simply repairing or refurbishing an article is not considered manufacturing. *Id.* The rule identifies factors to consider in determining whether an activity is manufacturing as opposed to a repair or reconditioning activity, including the following:

- (i) Whether the activity merely restores or prolongs the useful life of the article;
- (ii) Whether the activity significantly enhances the article’s basic qualities, properties, or functional nature; and
- (iii) Whether the activity is so extensive that a new, different, or useful article results.

WAC 458-20-136(6)(a).

If the activity merely restores or prolongs the useful life of the article, it would not constitute manufacturing. But if the activity significantly enhances the article’s qualities, properties or functional nature, or is so extensive that a new, different, or useful product results, it would qualify as manufacturing. Rule 136 identifies rebuilding engine cores as an example that despite numerous steps involved in the process,

does not constitute manufacturing because it merely extends the engine core's useful life. WAC 458-20-136(6)(b).

In contrast to refurbishing or repairing, Rule 136 explains that “[t]he physical assembly of products from various components is manufacturing because it results in a ‘new, different, or useful’ product.” WAC 458-20-136(7). This is so “even if the cost of the assembly activity is minimal when compared with the cost of the components.” For example, the bolting of a motor to a pump is a manufacturing activity because “[o]nce physically joined, the resulting product is capable of performing a pumping function that the separate components cannot.” WAC 458-20-136(7). The rule thus establishes a continuum along which activities must be evaluated in determining whether they rise to the level of manufacturing, with repairing and refurbishing at one end and the assembly of products at the other.

Here, FPR's sorting and bundling activities are more akin to refurbishing the recyclable materials because they are restoring and prolonging their useful life, rather than enhancing their basic qualities, properties, or functional nature. The bundled materials do not perform any function that is different from the commingled recyclable materials; rather, they are separated by type and packaged for transport to the customers of the recycling businesses. CP 133, 165-66. Thus, the value in FPR's

services is the separation of the materials by type and not in the creation of a new, different, or useful product. In fact, this is precisely the type of activity that the Department has described as falling within the service and other B&O tax classification in its staffing industry guide. CP 686 (“The Service and Other Activities classification includes merely inspecting, sorting, counting, moving, packing, loading, or unloading or operating machinery that performs these tasks even when they are performed at a manufacturing facility.”). Accordingly, under RCW 82.04.120 and the Department’s guidance, FPR is not engaged in manufacturing and is not subject to the processing for hire classification.

2. FPR employees were not engaged in manufacturing under the relevant Washington Supreme Court cases

The Washington Supreme Court cases applying the manufacturing definition also follow a continuum along which to evaluate when activities become manufacturing. This continuum supports the trial court’s conclusion that FPR employees were not engaged in manufacturing.

In determining whether a new, different, or useful article has been produced, courts evaluate “whether a significant change has been accomplished when the end product is compared with the article before it was subjected to the process.” *Bornstein Sea Foods, Inc. v. State*, 60 Wn.2d 169, 175, 373 P.2d 483 (1962). In *Bornstein*, the Court compared

the mere cleaning and freezing of whole fish with the process of filleting fish, and concluded that “a fillet, once produced, is different from a fish, and hence a new and different article has been created.” *Id.* at 174. The Court found “there is clearly a significant difference” between the whole fresh fish and the frozen packaged fish, and that the process of filleting transformed near valueless whole fish into useful and salable consumer items. *Id.* at 175-77.

The Court made a similar distinction in *McDonnell & McDonnell v. State*, 62 Wn.2d 553, 383 P.2d 905 (1963), when it compared the processing and packaging of whole peas for sale on the wholesale market with the splitting of peas, recognizing the latter was manufacturing but the former was not. The processing of whole peas involved using two types of specialized equipment: a clipper cleaner to remove undersized peas, parts of stalks, pods, vines, and other less useful and foreign materials, and a gravity cleaner to separate substandard and defective peas infected with small beetles from those uninfected. *Id.* at 554-55. Though this process improved the value of the dried peas so they could be sold on the wholesale market, it did not constitute a significant enough change to constitute manufacturing.

Rather, it was only when the peas were transformed into split peas that the Court and the Department concluded that manufacturing was

taking place. *Id.* at 555-56. During that process, the peas were subjected to further processing through a steam auger that softened the hulls and shells, a splitter machine that used the exertion of centrifugal force to split the peas, another clipper cleaner to grade and further remove undesirable portions, and a polisher that improved the appearance. *Id.* at 555. After that extensive processing, the peas were finally packed for shipment. *Id.*

In evaluating whether the splitting of peas constituted manufacturing, the Court explained the test for deciding whether there has been a significant change “is somewhat general in nature and may seem easier as a matter of articulation than as a matter of application.” *Id.* at 556. It identified the following factors that should be considered in deciding whether the product or substance has undergone a significant change: “[A]mong others, changes in form, quality, properties (such changes may be chemical, physical, and/or functional in nature), enhancement in value, the extent and the kind of processing involved, differences in demand, et cetera, which may be indicative of the existence of a ‘new, different, or useful substance.’” *Id.* at 557. In *McDonnell*, the fact that the peas were still peas at the end of the processing was not dispositive. Rather, the Court concluded that the extensive processing and physical transformation from whole to split peas, combined with the

higher consumer demand for split peas, satisfied the criterion for manufacturing. *Id.* at 556-57.

Other cases further demonstrate the type of significant change that must take place for activities to constitute manufacturing. *See J & J Dunbar v. State*, 40 Wn.2d 763, 245 P.2d 1164 (1952) (whiskey production of removing charcoal and mixing water to reduce alcohol content from 120-proof to 85-proof was manufacturing because it transformed raw whiskey not suitable for consumption into one capable of such); *Stokely-Van Camp, Inc. v. State*, 50 Wn.2d 492, 312 P.2d 816 (1957) (sorting, cleaning, cutting, blanching, and freezing vegetables and fruit constituted manufacturing because the extensive processing changed their form into one that may be usable for months or years); *Cont'l Coffee Co. of Wash. v. State*, 62 Wn.2d 829, 384 P.2d 862 (1963) (blending and roasting of coffee beans constituted manufacturing because the beans underwent a significant physical and functional change that created an edible, usable consumer product).

Here, FPR's employees were not creating a new, different, or useful substance significantly different from the commingled recyclable materials that entered the facilities. The undisputed evidence in this case makes clear that the primary activity performed by FPR employees is sorting and bundling recyclable materials. In describing the actions that

FPR employees performed on the recyclable materials, FPR explained its employees removed large contaminants, wrappable materials, hazardous materials, and items that may damage the equipment. CP 185. Mechanical sorting equipment sorted the materials by size and type, and FPR employees performed further manual sorting to remove remaining contaminants at designated sort stations with specific functions based on the material presented. CP 185-86. After sorting, the materials were fed into a baler where they were bundled and strapped together with multiple steel wires. Finally, FPR employees removed visible contamination “prior to storage for shipment to the end market.” CP 186.

FPR’s employees engaging in the sorting and bundling process, while providing a valuable service to the recycling facilities, were not creating substantially different products when compared with the material entering the facilities. By removing contaminants and sorting the materials by type, FPR employees were performing activities more like the processing of whole peas in *McDonnell*. The whole peas were put through mechanized equipment to remove undersized peas, parts of stalks, pods, vines, and other less useful or foreign materials, and another machine to separate the weevily peas from those uninfected. *McDonnell*, 62 Wn.2d at 554-55. They were bagged and sold on the wholesale market. *Id.* at 555. The removal of contaminants, the separation of inedible portions of peas,

and the packaging for wholesale sale, while adding value, did not rise to the level of a significant change required to constitute manufacturing. *Id.* Similarly, FPR employees removed contaminants, separated material by type, and packaged the materials in bundles for wholesale sale. The fact that FPR employees added value to the process and that the customers of the recycling businesses required the materials to be packaged to certain specifications does not mean that the work FPR employees performed constitutes manufacturing. There was no change in form—physical, chemical, functional, or otherwise—when FPR’s employees sorted the commingled recyclables into separated bundles of materials by type.

While FPR emphasizes that the underlying substance of the initial material need not change because the split peas were still peas and the filleted fish was still fish, Br. Appellant at 31, a significant change still needs to take place. *Bornstein*, 60 Wn.2d at 175. The sorting of the recyclable materials involved a number of steps and pieces of equipment, but FPR employees did not change the form, properties, or quality of each piece of recyclable material. Instead, FPR employees have simply removed any garbage from the commingled recyclable materials and separated recyclable materials by type. These activities have not created a new, useful, or different article, nor have they combined or assembled the materials to achieve a special purpose.

Likewise, the bundling process allows for easier transportation, handling, and storage, but does not cause a significant change to each piece of recyclable material. In fact, as FPR admits, most of the bundled recyclable materials are broken up to undergo processing by the customers of the recycling businesses. CP 133, 168. Thus, without a significant change to the materials in any physical or functional manner, FPR employees were not engaging in manufacturing.

FPR also contends that the extent and nature of processing shows that new, different, or useful products have been created as a result of the work performed by its employees, but the facts do not support that conclusion. *See* Br. Appellant at 37. Instead, as described above, FPR employees were primarily engaged in sorting. FPR compares its processing to the filtering and mixing of raw whiskey in *J & J Dunbar. Id.* (citing 40 Wn.2d at 766). But in that case, the whiskey was mixed with water to reduce the alcohol content and render it suitable for consumption. *J & J Dunbar*, 40 Wn.2d at 764-65. Here, in contrast, FPR employees engaged in sorting were not changing the physical or chemical properties of the underlying materials. The recyclable materials do not become something other than sorted and bundled recyclable materials. Because no *significant* change occurred to the commingled recyclable materials as a result of the sorting and bundling services, FPR employees were not

manufacturing. Accordingly, Washington caselaw further confirms that FPR was not entitled to processing for hire B&O tax classification.

3. Department precedent supports the conclusion that FPR employees were not manufacturing

In a published determination, the Department previously considered whether a material recovery facility was engaged in manufacturing, and determined that it was not. CP 35-40 (Det. No. 10-0108, 31 WTD 1 (2012)). In that determination, the Department concluded that the activities at the material recovery facility did not constitute manufacturing because the sorted and bundled materials had not undergone a significant change. *Id.* As the Department explained, while the “Taxpayer’s activities certainly create a product that has more value than the single stream materials that it starts with . . . [the] Taxpayer’s sorting activities do not physically change the form or character of the underlying property at issue” and “the form of those materials does not become something other than recyclable materials.” CP 40. The same analysis applies to the sorting and bundling services of FPR employees.

In its brief, FPR fails to mention this published determination, even though it directly relates to a material recovery facility exactly like those to which FPR provided employees. Instead, FPR compares the work of its employees to another determination the Department published involving a

scrap metal processing facility that sorted and compacted scrap sheet metal into cubes. Br. Appellant at 37-39 (discussing Det. No. 95-170, 16 WTD 43 (1995) at CP 42-46). FPR's comparison is misguided.

For the scrap metal processing facility, the Department found significant that in addition to creating a more valuable product, "the compacting process . . . significantly changed the combustion point of the product" such that "the metal scraps [could] be melted down into molten steel without burning up," and thereby created a new, different, and useful substance. CP 45. While FPR contends that its employees performed work that is "nearly identical" to the work at the scrap metal processing facility, no evidence supports this contention. Br. Appellant at 39. Indeed, the majority of the sorting that FPR employees performed related to paper, steel cans, aluminum, and plastics, not pieces of scrap sheet metal. Nor is there any evidence that FPR employees sorted and bundled the recyclable materials to change the combustion point of such materials. Thus, the determination upon which FPR relies is not on point. Instead, this Court should reach the same conclusion as the Department did in its determination relating to material recovery facilities: the sorting and bundling of commingled recyclable materials does not constitute manufacturing. CP 35-40.

4. The Department's position is consistent with the Legislature's intent

The legislative history of the manufacturing statute further supports the conclusion that FPR is not engaged in manufacturing, as the Legislature has contemplated the term. In 1962, the Washington Supreme Court noted “we have come to the position now where we are classifying as ‘manufacturing’ activities which realistically are not manufacturing in the ordinary sense at all.” *Bornstein*, 60 Wn.2d at 173.

However, the Legislature in more recent years has amended RCW 82.04.120 in ways that suggest it contemplates a more precise interpretation of the term manufacturing. For example, after the Court of Appeals concluded in *Valley Fruit v. Dep't of Revenue*, 92 Wn. App. 413, 963 P.2d 886 (1998), that a company was manufacturing by treating apples with fungicide, brushing them clean of mineral deposits, rinsing, waxing, drying, and storing them in a controlled atmosphere, the Legislature amended the definition to exclude such activities. Specifically, the following activities are not manufacturing, “[p]acking of agricultural products, including sorting, washing, rinsing, grading, waxing, treating with fungicide, packing, chilling, or placing in controlled atmospheric storage.” RCW 82.04.120(2)(d); Laws of 1999, Spec. Sess., ch. 9, § 1 (1999); *see also* Final Bill Rep. on H.B. 2295, 56th Leg., Spec. Sess., at 1

(Wash. 1999) (explaining the Legislature’s intent to address the recent Court of Appeals case holding that apple packing was manufacturing).

It is relevant that the Legislature’s basis for this amendment in part was to address certain unanticipated tax consequences of the Court of Appeals’ decision. The Department explained in a later published determination that deeming the apple packers manufacturers caused both the grower and packer to owe additional B&O tax: the packer on the payment it receives for the packing activity and the grower on every apple sold, either inside or outside the state. Det. No. 99-351, 19 WTD 670, 673 (2000) (attached as Appendix A). This rendered farmers statewide liable for millions of dollars in unanticipated taxes. *Id.*³

The Legislature also made clear it did not intend for the “conditioning of seed for use in planting” to constitute manufacturing. Laws of 1987, ch. 493, § 1 (1987). The Legislature added this exclusion

³ Similar unanticipated tax consequences could result if FPR employees were held to be engaged in “manufacturing” because FPR’s clients would become liable for manufacturing B&O taxes under RCW 82.04.240, measured on the value of the products. Currently, because the manufacturing tax does not apply, the value of the products is not taxed. It is only the wholesale sales that are taxed, measured on the gross proceeds of sale, and only on those sales taking place within Washington. The sales destined for outside of Washington are not taxable as wholesaling under RCW 82.04.270. *See* RCW 82.04.4286. For sales taking place within Washington, a multiple activities tax credit would be available to apply against manufacturing taxes, but no such credit would be available to apply to sales destined outside Washington. RCW 82.04.440. Thus, FPR’s clients would face increased taxes. *See McDonnell*, 62 Wn.2d at 557-58 (explaining “those sales made without the state are not *taxable* under RCW 82.04.270; therefore, the manufacturing of those products may be taxed under RCW 82.04.240”).

after the Board of Tax Appeals had concluded such activities constituted manufacturing. *See Alf Christianson Seed Co. v. Dep't of Revenue*, BTA Dkt. No. 28880, 1985 WL 62240 (1985) (concluding conditioned vegetable seeds had undergone a significant change because the company had removed undesirable materials and excess moisture and had improved the quality and value of the seeds). These examples indicate that simply adding value through a processing activity does not render the activity manufacturing under RCW 82.04.120. This is consistent with the Department's conclusion that FPR employees were not significantly changing the recyclable materials, and thus, were not engaging in manufacturing. Accordingly, this Court should affirm the trial court's conclusion that the processing for hire classification does not apply here.

5. The Department did not concede the legal questions presented in this appeal during discovery

Finally, the Court should reject FPR's argument that the "Department conceded in discovery that FPR was engaged in activities that qualify as manufacturing" because this is a legal question for the Court to decide, not a factual question for a witness. *See Br. Appellant at 40-42*. In this de novo tax refund action under RCW 82.32.180, the opinions of a Department employee about how statutes and case law may

apply to hypothetical scenarios are not relevant. The trial court recognized this when it ruled on the Department's summary judgment motion:

I believe the state makes some good points about how that information should and shouldn't be used, and specifically their point is that opinion is just an opinion; ultimately, it's the court's responsibility to determine whether or not there should be a legal ruling for whichever party . . . I considered Mr. Yrjanson's answers in the deposition that were given, and I put them in that context, however.

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As the trial court properly noted, the Department does not concede legal conclusions through deposition questions on how cases apply to hypothetical factual scenarios. The Court, not Mr. Yrjanson, is responsible for interpreting the statutes, rules, and cases at issue in this appeal, and determining how they apply to FPR's activities. *Ball v. Smith*, 87 Wn.2d 717, 722-23, 556 P.2d 936 (1976); *see also State v. Clausing*, 147 Wn.2d 620, 628, 56 P.3d 550 (2002) ("Each courtroom comes equipped with a 'legal expert,' called a judge, and it is his or her province alone to instruct the jury on the relevant legal standards.") (Internal quotations omitted). A deponent "may not be compelled to answer questions seeking legal and factual conclusions or questions asking him or her to draw inferences from the facts." *See Kaye v. Tee Bar Corp.*, 58 N.Y.S.3d 695, 697, 151 A.D.3d 1530 (N.Y. 2017) ("Asking a party to explain the legal implications of a case is by its nature significantly prejudicial to that party's interests.").

This Court should likewise disregard such deposition testimony and conclude that FPR employees were not engaged in manufacturing based on the law described above. Because the work they performed was not manufacturing, this Court should affirm the trial court's ruling that FPR is not entitled to the processing for hire B&O tax classification.

B. The Wholesaling B&O Tax Classification Does Not Apply to FPR Because The Recycling Businesses To Which It Provided Employees Are "Consumers" under RCW 82.04.190(5).

If this Court agrees with the Department that FPR's business activities do not rise to the level of manufacturing, it still must consider FPR's alternative argument for an entirely different B&O tax classification. Under this argument, FPR attempts to recast its business activities as qualifying for the wholesaling B&O tax classification. Br. Appellant at 43. In doing so, FPR misapplies the definition of a "wholesale sale" to the undisputed facts in this case. Accordingly, as the trial court did, this Court should reject FPR's wholesaling argument.

Every person engaged in the business of making wholesales sales is subject to B&O taxes at the wholesaling rate. RCW 82.04.270. RCW 82.04.060 sets forth several definitions of the term "wholesale sale." In this case, FPR claims that its sale of employees to perform sorting and bundling qualifies as a "wholesale sale" under the definition set forth in RCW 82.04.060(1)(b). That provision defines a "wholesale sale" to

include “[a]ny sale, which is not a sale at retail, of . . . [s]ervices defined as a retail sale in RCW 82.04.050(2) (a) or (g).” Services defined as a retail sale in RCW 82.08.050(2)(a) include “[t]he installing, repairing, cleaning, altering, imprinting, or improving of tangible personal property of or for consumers.”⁴ Based on these statutes, FPR must satisfy two requirements to meet RCW 82.04.060(1)(b)’s definition of a “wholesale sale”: (1) FPR’s employees must have performed a particular type of service, i.e., “installing, repairing, cleaning, altering, imprinting, or improving tangible personal property,” and (2) FPR’s sales of employees to perform such services must have been “not a sale at retail.”

FPR asserts that the Department conceded before the trial court that FPR’s employees met the first requirement of the “wholesale sale” definition. Br. Appellant at 44 (citing CP 27-28). This is not true. In fact, the portion of the record to which FPR cites to support this alleged concession demonstrates just the opposite. CP 27-28 (Department’s summary judgment motion will address whether FPR’s customers were consumers, not whether FPR’s employees were performing a particular type of service). Thus, rather than conceding the first requirement, the

⁴ Services defined as a retail sale in RCW 82.04.050(2)(g) include “[t]he installing, repairing, altering or improving of digital goods for consumers.” RCW 82.04.050(2)(g) is not at issue here.

Department simply focused on the second requirement for summary judgment purposes. The Department will do the same before this Court.⁵

To meet the second requirement of RCW 82.04.060(1)(b)'s definition of "wholesale sale," FPR's sales of employees to perform sorting and bundling services must have been "not a sale at retail." A sale is a "not a sale at retail" when it is provided to a purchaser who is not a "consumer." *See* RCW 82.04.050(2)(a) (retail sale includes certain services to tangible personal property "of or for consumers"). The Department adopted WAC 458-20-173 to make this distinction even clearer for taxpayers. Under that rule, the Department explains that "[p]ersons installing, cleaning, decorating, beautifying, repairing or otherwise altering or improving tangible personal property of consumers or for consumers are taxable under the retailing classification." In contrast, persons who render such services "for others than consumers" are taxable under the wholesaling classification. WAC 458-20-173. Thus, the critical question for this Court to decide is whether FPR was selling employees to perform services for persons that are not consumers.

⁵ FPR also argues that the Department conceded in discovery that if FPR employees were altering tangible personal property, wholesaling would be the appropriate B&O tax classification. Br. Appellant at 49 (citing deposition testimony at CP 663). As described above, however, the proper B&O tax classification of FPR's business activities is a legal question for this Court to decide, not a Department witness.

RCW 82.04.190 contains multiple sections explaining the meaning of the term “consumer.” As FPR recognizes, the relevant section in this case is RCW 82.04.190(5), which defines “consumer” to include “[a]ny person who is an owner, lessee, or has the right of possession to personal property which is being constructed, repaired, improved, cleaned, imprinted, or otherwise altered by a person engaged in business.” FPR does not dispute that its recycling clients owned the commingled recyclable materials that its employees sorted and bundled. Br. Appellant at 3; CP 124. For summary judgment purposes, this Court also can assume that FPR’s employees were in fact improving, cleaning, or altering the commingled recyclable materials as FPR alleges. Accordingly, FPR’s recycling clients clearly fall within RCW 82.04.190(5)’s definition of “consumer.” Because FPR’s employees performed sorting and bundling services for “consumers,” FPR was not making “wholesale sales.”

To circumvent the plain language of RCW 82.04.190, FPR argues that as long as it was selling its services to a “reseller,” such sales qualify as wholesale sales. Br. Appellant at 45. In support of this argument, FPR refers to RCW 82.04.050(14), a provision known as the “sale-for-resale exemption.” *Id.*; see *Corix Utilities v. Dep’t of Revenue*, BTA Dkt. No. 14-080, 2017 WL 5999414 (2017) (referring to RCW 82.04.050(14) as the “sale-for-resale” exemption). FPR’s arguments demonstrate a fundamental

misunderstanding of the distinction between a “retail sale,” and a “wholesale sale.”

Under RCW 82.04.050(14), a “retail sale” does not include “the sale for resale of any service described in this section if the sale would otherwise constitute a ‘sale at retail.’” Thus, the key requirement of the exemption is that the person purchasing the service at issue then resells the same service. Here, the recycling businesses did not resell the sorting and bundling services FPR’s employees performed. Instead, the recycling businesses were in the business of selling bundled recyclable materials. CP 140-41. Even FPR recognizes this undisputed fact. Br. Appellant at 45 (“the MRF owners were in the business of reselling that personal property to secondary processors or end users.”). Because the recycling clients were not reselling the services FPR’s employees provided, FPR was not making “wholesale sales.”

Despite acknowledging that the recycling businesses were not reselling the labor it provided, FPR insists that the recycling businesses were not the “ultimate consumers” of its services. Br. Appellant at 45. According to FPR, the recycling businesses could not be the “ultimate consumers” of the services its employees performed because the recycling businesses were resellers of the bundled recyclable materials. Br. Appellant 45-46. Thus, under FPR’s logic, any sale to a reseller would

constitute a wholesale sale, regardless of what the reseller is actually purchasing and reselling. FPR's logic has no basis in the record or the law.

In this case, the recycling businesses clearly meet the definition of a "consumer" because they owned the materials upon which FPR employees were performing sorting and bundling services. *See* RCW 82.04.190(5). The fact that the recycling businesses later sold the recyclable materials that FPR employees had sorted and bundled does not change this conclusion. Instead, this fact confirms that the recycling businesses were the consumers of FPR's services. Indeed, the labor FPR provided was a cost of doing business that the recycling businesses incurred to be able to sell the bundled recyclable materials to their own customers. *See* RCW 82.08.010(1)(a)(i) ("selling price" means the total amount of consideration without any deduction for "labor or service cost"); RCW 82.04.080(1) ("gross income of the business" means the value gained from engaging in business without any deduction for expense, such as "labor costs"). While the recycling businesses may have accounted for their labor costs when setting the prices for the bundled recyclable materials, the customers purchasing such materials were not the consumers of the services FPR's employees provided.

Ignoring the actual business activities of the recycling businesses, FPR points to reseller permits as evidence that allegedly "establish" it was

making wholesale sales. Br. Appellant at 46. FPR's reliance on such evidence is misplaced for two reasons. First, the reseller permits alone do not guarantee FPR its chosen B&O tax classification of wholesaling. While FPR is correct that RCW 82.04.470 allows a seller to demonstrate that a sale is a wholesale sale with reseller permits, it misunderstands the purpose of that statute. RCW 82.04.470 is meant to protect sellers from liability for uncollected retail sales tax. *See* RCW 82.08.050(3), (7) (sellers personally liable to the state for uncollected retail sales tax, unless they obtain "fully completed exemption certificate" within certain timeframes), (11)(a) (exemption certificate includes reseller permit). Thus, even with reseller permits, this Court still must consider FPR's business activities, and whether such activities fall within the definition of a "wholesale sale." As described above, the undisputed evidence demonstrates that the services FPR employees performed were not wholesale sales.

Second, the reseller permits that FPR has produced are completely inadequate to demonstrate that it was making wholesale sales. As the seller of the services at issue, FPR bears the burden of demonstrating that a sale is a wholesale sale, rather than a retail sale. RCW 82.04.470(1). FPR has failed to meet that burden here. Other than a statement from its attorney that "FPR had received reseller permits from its customers," FPR put forth no evidence regarding the circumstances surrounding its

collection of the reseller permits. CP 594. Such evidence is relevant for determining whether FPR has met its burden under RCW 82.04.470(1). For example, the Legislature has imposed timing requirements upon the collection of reseller permits. *See* RCW 82.04.470(1) (seller may meet its burden by taking a reseller permit from the buyer at the time of sale, or within a reasonable time thereafter as provided by rule); *see also* WAC 458-20-102(7) (setting forth time frames within which a seller may collect a reseller permit). The record, however, contains no information regarding when FPR collected the reseller permits from its customers.

Beyond the lack of context, the reseller permits themselves are insufficient to show FPR was making wholesale sales. In total, FPR produced four reseller permits, only two of which pertain to an entity that FPR identified as a customer and were in effect throughout the entire tax period. CP 611-12 (two reseller permits for Columbia Resource Company between January 1, 2010 and December 31, 2017). The other reseller permits relate to entities that FPR did not identify as customers, and were in effect for only part of the tax period. *See* CP 171-72 (listing FPR's clients in Washington), 613 (reseller permit for SP Fiber Technologies LLC between January 29, 2014 and January 28, 2018), 614 (redacted reseller permit for unknown entity between November 19, 2014 and

November 18, 2016).⁶ With so many deficiencies, the reseller permits fail to support FPR's wholesaling claim.

FPR's attempts to distinguish an analogous Board of Tax Appeals decision also cannot save its wholesaling argument. Br. Appellant at 47 (citing *Corix Utilities v. Dep't of Revenue*, BTA Dkt. No. 14-080, 2017 WL 5999414 (2017)). Like FPR, the taxpayer in *Corix* sought the wholesaling B&O tax classification in relation to services it performed on tangible personal property owned by its customer. 2017 WL 5999414 at *1-*3. Specifically, the taxpayer provided maintenance services on gas meter radios that its customer owned. *Id.* at *1. While FPR is correct that the taxpayer did not collect reseller permits from its customer when providing the maintenance services, this fact alone was not the reason the Board rejected the taxpayer's wholesaling argument. Instead, the Board applied RCW 82.04.190(5) to conclude that the taxpayer performed maintenance services for a "consumer," i.e., the owner of the gas meter

⁶ FPR also relies upon a retail sales tax exemption certificate from one of its customers, but that exemption certificate does not apply in the context of wholesale sales. In fact, the exemption certificate expressly states, "**Not to be used to make purchases for resale.**" CP 615 (Emphasis in original). Even if the exemption certificate did apply, FPR's customer indicated on the form that it was making an exempt purchase of "[l]abor and services rendered to construct, repair, clean, alter or improve *for hire* carrier property." CP 615 (Emphasis in original). This exemption has nothing to do with the sorting and bundling services FPR employees performed. *See* RCW 82.08.0262 (retail sales tax exemption for certain services provided to airplanes, locomotives, railroad cars, or watercraft used in interstate or foreign commerce by transporting people and property for hire); WAC 458-20-175 (same). Accordingly, FPR's reliance on the retail sales tax exemption certificate is misplaced.

radios. *Corix*, 2017 WL 5999414 at *3. This Court should apply the same analysis here.

FPR claims that unlike the customer in *Corix* that owned the gas meter radios, the recycling businesses did not retain ownership of the bundled recyclable materials, but sold them to other industries. Br. Appellant at 47. FPR's claim misses the point. As the Board itself recognized, the owner of the tangible personal property at the time of the services determines who qualifies as the consumer of such services. *See Corix*, 2017 WL 5999414 at *2-*3 (rejecting claim that third party was the consumer of the taxpayer's maintenance services, even though title to the gas meter radios eventually transferred to the third party). Thus, while the recycling businesses later sold the bundled recyclable materials, they still owned the materials at the time FPR provided its services, and therefore, were the consumers of such services. Because the recycling businesses were "consumers," FPR's sales of employees to perform sorting and bundling services did not qualify as wholesale sales. This Court should affirm the trial court's decision concluding that FPR is not entitled to the wholesaling B&O tax classification.

C. This Court Should Not Consider FPR's Retailing Claim Because FPR Raises The Claim For The First Time On Appeal

On appeal, FPR points to retailing as yet another B&O tax classification for which it qualifies. App. Br. 47-48. FPR, however, did not include this claim in its complaint, nor did it argue for this classification in opposing the Department's summary judgment motion before the trial court. Because FPR did not assert its retailing claim before the trial court, this Court should not consider it. *Wash. Fed. Sav. v. Klein*, 177 Wn. App. 22, 29, 311 P.3d 53 (2013) ("As a general matter, an argument neither pleaded nor argued to the trial court cannot be raised for the first time on appeal."); RAP 2.5(a) ("The appellate court may refuse to review any claim of error which was not raised in the trial court."). In fact, the appellate rules are even clearer on this limitation in the context of summary judgment. *See* RAP 9.12 ("On review of an order granting or denying a motion for summary judgment the appellate court will consider only evidence and issues called to the attention of the trial court.").⁷

⁷ FPR argues that the Department conceded it was making retail sales by cleaning, altering or improving tangible personal property for its customers. Br. Appellant at 49 (referring to the Department's determination against FPR and summary judgment motion). The Department did no such thing. Instead, the Department's determination simply noted the tax consequences if it were to accept FPR's argument that its employees were altering or improving tangible personal property. CP 79. Likewise, the Department's summary judgment motion did not make any concession. As already described above, the Department focused on whether FPR's employees were performing services for "consumers," not whether the employees performed a particular type of service. CP 27-28.

Even if this Court considered FPR's retailing claim, it makes no sense, unless FPR is seeking to increase, rather than decrease, its overall tax liability. As described above, the retailing B&O tax rate is generally lower than the processing for hire or wholesaling B&O tax rate. *Compare* RCW 82.04.250(1) (imposing B&O tax rate of .471 percent) with RCW 82.04.270 and RCW 82.04.280(1)(c) (both imposing B&O tax rate of .484 percent). In raising its new retailing claim, FPR focuses on this lower B&O tax rate, but ignores the additional tax liability that arises with making retail sales.

Along with the B&O tax, the Legislature has imposed a retail sales tax equal to 6.5 percent of the selling price upon each "retail sale" in this state. RCW 82.08.020(1). In general, the Legislature requires every person making "retail sales" to collect retail sales tax from the purchaser and remit this tax to the Department. RCW 82.08.050(1). If a person making retail sales fails to collect the retail sales tax from the purchaser, that person is personally liable to the state for the retail sales tax owed. RCW 82.08.050(3). Here, FPR has not demonstrated that it collected and remitted retail sales tax from the recycling businesses. Accordingly, under its retailing claim, FPR could actually owe more taxes than what the Department has currently assessed. *See Qualcomm, Inc. v. Dep't of Revenue*, 171 Wn.2d 125, 127 at n.1, 249 P.3d 167 (2011) (retailing

classification combined with retail sales tax creates higher overall tax rate than service & other classification).

V. CONCLUSION

The sorting and bundling services of FPR's employees do not fall within any of FPR's chosen B&O tax classifications. These activities are not processing for hire because they do not rise to the level of manufacturing as described in RCW 82.04.120, the Department's guidance, and relevant caselaw. Nor do the sorting and bundle services qualify as wholesaling because FPR's employees performed such services for consumers, i.e. the recycling businesses that owned the recyclable materials. Finally, FPR raised its retailing claim for the first time on appeal, and thus, this Court should not consider the argument. Because none of these classifications apply, the Department properly assessed FPR under the service and other B&O tax classification. This Court should affirm the trial court's summary judgment ruling for the Department.

RESPECTFULLY SUBMITTED this 21st day of August, 2019.

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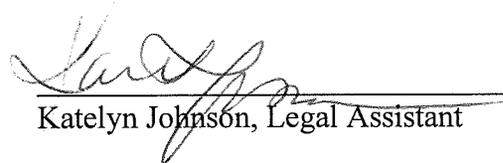
PROOF OF SERVICE

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

DATED this 21st day of August, 2019, at Tumwater, WA.


Katelyn Johnson, Legal Assistant

Cite as Det. No. 99-351, 19 WTD 670 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	<u>D E T E R M I N A T I O N</u>
)	
	)	No. 99-351
)	
...	)	Registration No. . . .
	)	Refund Petition
)	
...	)	Registration No. . . .
	)	Refund Petition
)	
...	)	Registration No. . . .
	)	Refund Petition
)	
...	)	Registration No. . . .
	)	Refund Petition

[1] RCW 82.32.160, RCW 82.32.170: PETITIONS FOR CORRECTION OF ASSESSMENT – PETITIONS FOR REFUND – EXHUASTION OF ADMINISTRATIVE REMEDIES. The opportunities to file a petition for correction of assessment or a petition for refund are not remedies that must be exhausted before seeking a remedy in a court of competent jurisdiction.

[2] PRESUMPTION OF CONSTITUTIONALITY OF LEGISLATION. An administrative body does not have the authority to determine the constitutionality of the law it administers; only the courts have that power.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

Fruit packers seek refunds of sales tax, use tax, and Business and Occupation Tax (B&O) paid in connection with the construction of buildings, purchases of equipment, and the hiring of

“qualified employment positions” involving the storage and packing of fresh apples in an economically distressed area.¹

ISSUES:

1. Whether the taxpayers’ failure to apply for deferral of sales or use tax under ch. 82.60 RCW before initiation of the construction of the investment project and acquisition of equipment or machinery is excused because the Department of Revenue (Department) would not have approved the applications and the law does not require futile acts; and
2. Whether the taxpayers’ failure to apply for B&O tax credits under ch. 82.62 RCW before the actual hiring of “qualified employment positions” is excused because the Department of Revenue (Department) would not have approved the applications and the law does not require futile acts; and
3. Whether the retroactive provision in HB 2295 is barred by case law from applying to the taxpayers; and
4. If the answers to 1, 2, and 3 are yes, whether the taxpayers otherwise qualify for the deferral of sales tax, use tax, and B&O tax under the provisions of ch. 82.60 RCW and ch. 82.62 RCW.

BACKGROUND:

Five taxpayers filed petitions seeking refunds of sales tax, use tax, and B&O tax paid in connection with the construction of buildings, purchases of equipment and the hiring of “qualified employment positions” involving the storage and packing of fresh apples in an economically distressed area. Their appeals have been consolidated for hearing and determination. Each taxpayer, or its representative, has filed a written waiver of the confidentiality provisions of RCW 82.32.330 for the purposes of hearing and determination.

Each taxpayer is engaged in the same business with substantially the same processes. The facts are as follows:

After harvest, the apples are delivered to the taxpayers’ facilities, where the fruit is separated into fruit which will be stored for extended periods of time, and fruit which shortly shall be sent to market. The fruit earmarked for long term controlled atmosphere storage is treated with fungicides to prevent decay. The fruit is also treated with a chemical to prevent scald, which is a disorder of apple immaturity that progresses through time while the fruit is in storage.

The apples are then placed in cold storage localities, and the apples’ core temperature is reduced to approximately 31.5° Fahrenheit. The apples are later removed from cold storage and placed on the packing lines, where they are dumped into treated water to kill any bacteria to prevent

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

individual apples from contaminating the entire lot and to remove deposits. Then the apples are rinsed with a soap that removes any field grime and residual pesticide. The apples are treated with Mertect, which kills harmful bacteria and keeps the apples from decaying before they reach the consumer. The apples are also dried and often waxed. Waxing the apples serves to delay respiration of the apples, which in turn prolongs the apple's life.

After being waxed, the apples are sorted, using a computer and cameras, by color, size, and grade. After sorting, the apples are packed in trays and placed in cardboard boxes.

Once the apples are packed in cardboard boxes, they are placed in a very cold storage area before shipment. Placement in the storage area brings the core temperature of the apples back down to near freezing or below. The apples themselves are not frozen.

In the controlled atmosphere storage facility, the processor displaces the oxygen in the room with nitrogen, so that rather than the normal 22% oxygen level of the atmosphere, the oxygen level inside the facility is reduced to approximately 1%. The reduction of oxygen in the atmosphere essentially puts the enzymatic development of the apple to sleep until the apples are removed from the controlled atmosphere facility and shipped to the consumer. In essence, then, instead of freezing the apples, as is done to corn and peas and other vegetables, but which would destroy apples, the processor preserves the apples by decelerating their growth and keeping them alive in a semicomatose state.

For the sake of convenience in this determination, the taxpayers' business activities will be referred to as "apple packing," although it is plain that considerably more than mere "packing" is involved.

The taxpayers filed their refund requests following a recent appellate decision. Valley Fruit v. Department of Rev., 92 Wn. App. 413, 963 P.2d 886 (1998), is a decision from Division III of the Washington State Court of Appeals that held the business activities engaged in by the plaintiffs to be manufacturing and granted the plaintiffs' requests for sales and use tax exemptions. Douglas Fruit and Valley Fruit applied for a distressed area sales and use tax deferral under ch. 82.60 RCW in 1994. The Department of Revenue's Appeals Division and, subsequently, the Board of Tax Appeals (BTA), denied their petitions, holding the fruit companies' business activities, apple packing, were not manufacturing. The two fruit companies appealed to Superior Court, one in Franklin County, the other in Yakima County, both of which reversed the BTA. The Department appealed to the Court of Appeals, which consolidated the two appeals. The Court of Appeals described the fruit companies' business activities and held:

The fruit companies start with whole, edible apples which are treated with fungicide and brushed clean of mineral deposits. They are then rinsed, waxed, and dried. After they are sorted, the apples are stored in a controlled atmosphere to aid preservation. Although not included in the BTA's findings of fact, the uncontroverted evidence before it indicated the apples have a longer life as a result of this process. Using this process, the fruit companies are able to keep the apples 11 months. Without the processing, the apples

would decay within a month. This undisputed testimony indicates the processing significantly changes the apples into a more useful product. Application of the facts presented to the BTA to the law defining manufacturing indicates these activities should be construed as manufacturing.

Valley Fruit, 92 Wn. App. at 419. The Court of Appeals issued its decision on July 28, 1998. The State Supreme Court denied the Department's petition for review. Valley Fruit v. Department of Rev., 137 Wn.2d 1017, 978 P.2d 1098 (1999). Thus, apple packing constituted manufacturing.

The Department and the legislature had two specific concerns with the Valley Fruit decision. First, in determining that apple packing constituted manufacturing, the implication was that apple packers would be required to pay B&O tax at the manufacturing rate², conflicting with an express exemption from the B&O tax for apple packers.³ The Director of the Department of Revenue summarized the unintended consequences of the Valley Fruit decision in a May 5, 1999 letter to seven agricultural business associations:

However, there are some adverse tax consequences in this situation and these consequences fall upon people who may not be aware that they are affected. In most cases the grower retains ownership of the agricultural product being packed. Since the packers in the above referenced case were successful in their legal argument that their apple handling activities qualify as a manufacturing process, a domino effect occurs. By law, the person who owns a product being manufactured is a manufacturer and the processor is considered a processor for hire. The ultimate result is that the grower is no longer eligible for the B&O exemption for farmers, because the agricultural product is being used as an ingredient in a manufacturing process. The packers are no longer eligible for their B&O exemption because they are packing for growers who are no longer exempt farmers under RCW 82.04.330. Both the grower and the packer will owe B&O tax, the grower on every apple sold, either inside or outside the state. The packer will be taxable on the payment it receives for the packing activity. To make matters worse, it is also now unclear whether the grower is entitled to purchase seedlings, fertilizer, or spray materials without paying sales or possibly use tax. You should at least be aware that farmers statewide will soon be liable for millions of dollars in unanticipated taxes.

The second concern was the substance of the Valley Fruit decision itself. The Department's position has long been that apple packing is not manufacturing and that Douglas Fruit and Valley

² This opinion was not unanimously held within the Department. See, Taxpayer Information & Education Section letter of October 3, 1994 to [a fruit packer], submitted by one of the taxpayers here.

³ RCW 82.04.4287 provides: "In computing tax there may be deducted from the measure of tax amounts derived by any person as compensation for the receiving, washing, sorting, and packing of fresh perishable horticultural products and the material and supplies used therein when performed for the person exempted in RCW 82.04.330, either as agent or as independent contractor."

Fruit, as well as the five taxpayers in this appeal, do not qualify for the tax deferral program in ch. 82.60 RCW.⁴

The Department decided to address these concerns in the 1999 regular legislative session. SB 6085 was an attempt to legislatively reverse the Valley Fruit decision, but the bill did not survive and the regular session ended. In 1999, there was a Special Session of the legislature, and during the First Special Session the legislature approved HB 2295, which was substantially similar to the original SB 6085 of the regular legislative session. The Governor signed HB 2295 on June 7, 1999 and the bill was filed with the Secretary of State the same day.

HB 2295 affects the issues presented in this appeal for two reasons. First, HB 2295 amended the definition of manufacturing⁵ to exclude apple packing:

"To manufacture" shall not include: Conditioning of seed for use in planting; cubing hay or alfalfa; activities which consist of cutting, grading, or ice glazing seafood which has been cooked, frozen, or canned outside this state; the growing, harvesting, or producing of agricultural products; or packing of agricultural products, including sorting, washing, rinsing, grading, waxing, treating with fungicide, packaging, chilling, or placing in controlled atmospheric storage. (Emphasis supplied).

In addition to amending the definition of manufacturing, HB 2295 also amended the definition of "manufacturing" in RCW 82.60.020 and RCW 82.62.010, to make clear that both chapters excluded "apple packing" from their scope.

Second, HB 2295 expressly was retroactive: "This act is intended to clarify that this is the intent of the legislature both retroactively and prospectively." HB 2295 contained an emergency clause and took effect immediately upon filing on June 7, 1999. Const. art. 2, § 1 (amend. 72).

The taxpayers filed applications for deferral of taxes under ch. 82.60 RCW with the Department before the effective date of HB 2295 (June 7, 1999). The Department denied each petition. Subsequently, each taxpayer appealed the denials of their applications to this division.

Each taxpayer acknowledges that it did not file an application with the Department before purchasing equipment and beginning construction, as required in RCW 82.60.030. Each taxpayer makes similar arguments. First, their failure to file applications under RCW 82.60.030 and 82.62.020 is excused because the law does not require the performance of futile tasks. Second, HB 2295 does not apply retroactively to them because each taxpayer was entitled to apply for and receive tax refunds as of the date of their respective filings.

⁴ The Department acknowledged that "Yakima County has continuously qualified as an employment distressed county for the distressed area sales tax deferral program since 1985. Yakima County has also qualified for the new employee credit program since it was created in 1986." Letter of November 17, 1999, from Kim Davis, Department of Revenue, Special Programs Division, Miscellaneous Tax Specialist.

⁵ RCW 82.04.120.

ANALYSIS:

1. Whether the taxpayers' failure to apply for deferral of sales tax or use tax under ch. 82.60 RCW before initiation of the construction of the investment project and acquisition of equipment or machinery is excused because the Department of Revenue (Department) would not have approved the applications and the law does not require futile acts: and
2. Whether the taxpayers' failure to apply for B&O tax credits under ch. 82.62 RCW before the actual hiring of "qualified employment positions" is excused because the Department of Revenue (Department) would not have approved the applications and the law does not require futile acts.

[1] These issues arise because of the following language in RCW 82.60.030 and 82.62.020. RCW 82.60.030 states, "[a]pplication for deferral of taxes under this chapter must be made before initiation of the construction of the investment project or acquisition of equipment or machinery." RCW 82.62.020 states, "[a]pplication for tax credits under this chapter must be made before the actual hiring of qualified employment positions."

None of the taxpayers filed an application with the Department before purchasing equipment, beginning construction, or hiring "qualified employment positions," unlike Valley Fruit and Douglas Fruit in Valley Fruit, *supra*.⁶

Some of the taxpayers argue that the futility exception to the doctrine of exhaustion of administrative remedies should be applied to the failure of the taxpayers to file the required applications for tax deferrals, exemptions and credits because fairness or practicality demand it. The other taxpayers argue simply that the courts will not require vain and useless acts.

The duty to exhaust administrative remedies is described in a leading treatise on administrative law: "[It is] the long settled rule of judicial administration that no one is entitled to judicial relief for a supposed or threatened injury until the prescribed administrative remedy has been exhausted." Kenneth Culp Davis and Richard J. Pierce, Jr., 2 Administrative Law Treatise 307 (1994), citing Myers v. Bethlehem Shipbuilding Corp., 303 U.S. 41, 50-51, 58 S. Ct. 459, 82 L. Ed. 638 (1938). The doctrine is the same in Washington State. "It is a general rule that when an adequate administrative remedy is provided, it must be pursued before the courts will intervene." Orion Corp. v. State, 103 Wn.2d 441, 456, 693 P.2d 1369 (1985).

The taxpayers cite many of the same cases to support their arguments, relying principally on Orion, 103 Wn.2d 441. Orion Corporation had purchased extensive amounts of land for development, but found its plans thwarted by several state and county legislative enactments. The opinion said "Orion's efforts at finding alternative uses for its land proved fruitless." Orion, 103 Wn.2d at 449. "Despite the state development and advertising of the sanctuary, Orion

⁶ Valley Fruit involved applications under RCW 82.60.030 only; the case did not involve applications under RCW 82.62.020.

continued to negotiate with the State over selling its land but the parties were unable to agree on a price. Finally, Orion instituted the present suit.” Orion, 103 Wn.2d at 454. Among other defenses, the defendants argued that Orion failed to exhaust its administrative remedies before filing suit. The Court observed, at the outset:

As the cases make clear there is a strong bias toward requiring exhaustion before resort to the courts. This court recently noted that the policies underlying the exhaustion doctrine are to (1) insure against premature interruption of the administrative process, (2) allow the agency to develop the necessary factual background on which to base a decision, (3) allow the exercise of agency expertise, (4) provide a more efficient process and allow the agency to correct its own mistake, and (5) insure that individuals are not encouraged to ignore administrative procedures by resort to the courts. South Hollywood Hills Citizens Ass'n v. King Cy., 101 Wn.2d 68, 73, 74, 677 P.2d 114 (1984).

Orion, 103 Wn.2d at 456. In making its decision, the Court noted that “resort to the administrative procedures would be futile and vain” (Orion, 103 Wn.2d at 457), that the “record reveals that the State has made a conscious policy choice to preserve Padilla Bay in its natural state” (Orion, 103 Wn.2d at 457), and that a “willingness to consider an application is irrelevant if there is no hope of success if one is submitted.” Orion, 103 Wn.2d at 457. From Orion, the taxpayers argue that they were not required to file applications before beginning construction, as required in RCW 82.60.030, because the Department would never have approved their applications; thus, it was futile.

Most of the cases cited by the taxpayers discuss the duty to exhaust administrative remedies in the context that doctrine arises: when may a person file an action in court where the issue involves an administrative agency?

For example, in Lund v. State Dep't. of Ecology, 93 Wn. App. 329, 969 P.2d 1072 (1998), the Court of Appeals mentioned futility in connection with extraordinary circumstances:

The test for a facial challenge is a high one, in part because the landowner has not presented any evidence about the particular impact of the regulation on his or her parcel of land. To succeed in proving that a statute on its face effects a taking by regulating the permissible uses of property, the landowner must show that the mere enactment of the statute denies the owner of all economically viable use of the property. Orion, 109 Wn. 2d at 658. In facial challenges, landowners need not exhaust administrative remedies. Presbytery of Seattle v. King County, 114 Wn.2d 320, 333, 787 P.2d 907, cert. denied, 498 U.S. 911, 112 L. Ed.2d 238, 111 S. Ct. 284 (1990). Such exhaustion would be futile if indeed the regulation prevented any economically viable use of the land. Orion, 109 Wn.2d at 625 (citing Orion Corp. v. State, 103 Wn.2d 441, 457-60, 693 P.2d 1369 (1985)). Thus, a facial challenge in which the court determines a regulation denies all economically viable use of property "should prove to be a relatively rare occurrence."

In Nolte v. Olympia, 94 Wn. App. 944, 958, 982 P.2d 659 (1999), the Court of Appeals said:

The City claims that Nolte is prevented from claiming that impact fees were improperly imposed, because he failed to exhaust his administrative remedies. A party must exhaust his or her administrative remedies [footnote omitted] unless doing so would be futile. [footnote omitted]. Nolte had no remedy before the hearing examiner, because the latter did not consider the impact fees required by the City's sewer and water ordinances; he considered only whether Nolte should be required to hook up to City sewer and water. Nolte had no remedy before the City, or his remedy was futile, because the City was bound by, and surely would have adhered to, its ordinances. We conclude that Nolte did not fail to exhaust any meaningful administrative remedy.

Baldwin v. Sisters of Providence, 112 Wn.2d 127, 131, 769 P.2d 298 (1989), involved a labor dispute. The duty to exhaust administrative remedies was not at issue in Baldwin; instead, a different doctrine came into play:

Generally, contractual grievance procedures must be exhausted before parties resort to the courts. [citations omitted]. There are exceptions to the exhaustion doctrine based upon considerations of fairness or practicality. [citations omitted]. One such exception is recognized where pursuing the available remedies would be futile. [citations omitted]. Generally, futility addresses a showing of bias or prejudice on the part of discretionary decisionmakers. [citations omitted].

Baldwin qualifies the use of the futility argument by requiring a showing of a bias or prejudice on the part of discretionary decision makers. To the extent that decisions are discretionary to grant or deny applications submitted to the Department under RCW 82.60.030, none of the taxpayers has shown that Department agents are biased or prejudiced. There has been no showing that the Department agents considered anything other than the applicable statutes and other law in making their decisions. Absent evidence to the contrary, public officers are presumed to execute their duties correctly. Somer v. Woodhouse, 28 Wash. App. 262; 623 P.2d 1164 (1981).

Robinson v. Employment Security Dept., 84 Wn. App. 774, 930 P.2d 926 (1996), also involved an issue other than the exhaustion of administrative remedies. The essence of that case is stated in the first paragraph of the case:

Noreen Robinson quit her job as an escrow agent because she feared that continued employment would jeopardize her professional license. The court below ruled that Robinson was disqualified from unemployment compensation benefits under RCW 50.20.050. We reverse because Robinson has established that she quit for good cause after exhausting all reasonable alternatives.

Robinson, 84 Wn. App. at 776. In an unemployment compensation case, “[a]n individual who leaves work voluntarily is disqualified from receiving unemployment benefits, unless she has good cause to quit.” RCW 50.20.050(1). Robinson, 84 Wn. App. at 778. The Employment

Security Department has an administrative rule that recognizes the futility of exhausting all reasonable alternatives prior to termination. WAC 192-16-009(1)(c). The Court of Appeals explained “futility” in the employment security context:

We reverse the ALJ's ruling that Robinson failed to exhaust all reasonable efforts to preserve her employment. While Robinson quit her job without attending the meeting scheduled for July 13, 1994, her attendance would have been a futile act. Zehm testified before the ALJ that the purpose of the second meeting was to discuss personal issues that were unrelated to Home Lending's situation. During the July 12 meeting, Bell and Zehm told Robinson to ignore Home Lending's situation and do her job. There is no evidence that Bell or Zehm were willing to further consider Robinson's concerns about her license and personal liability. Robinson was given no reason to believe that she could avoid processing Home Lending's mortgages while her concerns were investigated further. After being unequivocally told that her supervisor was not going to address Robinson's concerns, it would have been futile to pursue any alternative to quitting.

Robinson, 84 Wn. App. at 780. The Robinson case, and Sweitzer v. State, 43 Wn. App. 511, 718 P.2d 3 (1986) (also cited by the taxpayers), were specifically decided on the basis of RCW 50.20.050 and an administrative rule that are to be applied by the agency “liberally” to provide unemployment benefits. Contrasted with the taxpayers’ situation, there is no authority that the taxpayers may disregard the legislatively imposed requirements to benefit from a tax deferral because they disagree with the Department’s administration of ch. 82.60 RCW, and where the application of tax is the general rule and tax exemptions are to be narrowly construed, as noted below.

We are unconvinced that the duty to exhaust administrative remedies applies in this situation, and consequently, we are unconvinced that the futility exception to the duty to exhaust administrative remedies applies in this situation. The filing requirements in RCW 82.60.030 and RCW 82.62.020 are elements that must be satisfied before certain tax benefits may be realized by any taxpayer. In that regard, they are like any other element for a tax credit, exemption, or deduction:

In determining whether the exemption is available to the taxpayers in this case we must consider that exemptions to taxing statutes are strictly construed in favor of the application of the tax. Yakima Fruit Growers Association v. Henneford, 187 Wn. 252, 60 P. (2d) 62 (1936); Miethke v. Pierce County, 173 Wn. 381, 23 P. (2d) 405 (1933); Boeing Aircraft Company v. Reconstruction Finance Corporation, 25 Wn.2d 652, 171 P. (2d) 838 (1946). It is required that any claim of exemption be studied with care before depriving the state of revenue. Alaska Steamship Company v. State, 31 Wn.2d 328, 196 P. (2d) 1001 (1948). Only where an exemption is clearly required by law should an individual be exempt from tax. North Pacific Coast Freight Bureau v. State, 12 Wn.2d 563, 122 P. (2d) 467 (1942).

Det. No. 99-043, 18 WTD 452 (1999).

The reason the doctrine does not apply here is because there are no administrative remedies that must be exhausted before any taxpayer seeks relief in court. Any taxpayer, having paid the disputed tax, may sue for a refund in Thurston County Superior Court. RCW 82.32.180. Any taxpayer may petition the Department for a refund. RCW 82.32.170. However, no taxpayer is required to petition the Department for a refund under RCW 82.32.170 before seeking relief in court. Any of the taxpayers here could, at any time, have filed a refund action under RCW 82.32.180. However, the judge in the refund action would be asking the same question: "why are you entitled to a refund when you admit you did not satisfy the application-filing requirement in RCW 82.60.030?"

The petition is denied on the "futility" issue.

3. Whether the retroactive provision in HB 2295 is barred by case law from applying to the taxpayers.

[2] Despite the express retroactivity of HB 2295, the taxpayers argue that it does not apply to them because it interferes with fundamental rights. The heart of the taxpayers' argument is that they applied for the tax deferral before the effective date of HB 2295; therefore, as of the date of their filings, the taxpayers were entitled to the tax deferral. The taxpayers challenge HB 2295 both facially and as applied as violative of the Equal Protection and Due Process Clauses of the United States and the Washington State Constitutions.

We cannot rule on facial challenges to statutes. "An administrative body does not have authority to determine the constitutionality of the law it administers; only the courts have that power." Bare v. Gorton, 84 Wn.2d 380, 383, 526 P.2d 379 (1974).

The Department frequently determines whether a tax statute may be enforced constitutionally as to particular persons; e.g., whether nexus exists to support B&O or sales tax on business conducted outside of Washington or transactions occurring outside of Washington. However, on the issue of constitutionality of HB 2295 as applied to the taxpayers, we conclude that this issue must be left for an Article IV court to decide. As was noted in National Can Corp. v. Department of Rev., 109 Wash. 2d 878, 887; 749 P.2d 1286:

Even if the director's opinion was that placed in question the constitutionality of the B & O tax, it was not within his power to stop collecting taxes under a statute which had been properly enacted by the Legislature. The Department of Revenue was collecting taxes under a statute that had been repeatedly upheld and also enjoyed the presumption of constitutionality. The party challenging the statute would have to prove its invalidity beyond a reasonable doubt. High Tide Seafoods v. State, 106 Wn.2d 695, 725 P.2d 411 (1986).

High Tide Seafoods v. State, 106 Wn.2d 695, 698, 725 P.2d 411 (1986), said:

Statutes are presumed constitutional and a party challenging a statute has the burden of establishing its invalidity beyond a reasonable doubt, as well as rebutting the presumption that all legally necessary facts exist. Higher Educ. Facilities Auth. V. Gardner, 103 Wn.2d 838, 843, 699 P.2d 1240 (1985).

This issue is not simply one of the administration of a tax statute, a subject committed to the Department. Chapter 82.01 RCW. We may decide the constitutionality of the application of a statute to a taxpayer. However, the question here is the retroactivity of a statute passed by the legislature and signed by the governor and whether that statute applies to the taxpayers. That is an issue that must be decided by a court of competent jurisdiction. We must assume HB 2295 is constitutional.

The petition is denied on the retroactivity issue.

4. If the answers to 1, 2, and 3 are yes, whether the taxpayers otherwise qualify for the deferral of sales tax, use tax, and B&O tax under the provisions of ch. 82.60 RCW and ch. 82.62 RCW.

Having answered the first, second, and third issues as “no,” it is unnecessary to address the fourth identified issue, whether the taxpayers otherwise qualify for the deferral of B&O tax under the provisions of ch. 82.60 RCW.

The taxpayers and their counsel are commended for the thoroughness of their briefs and their documentation to support their claims for refunds. We will retain the documentation for submission to the Audit Division for verification if this decision is modified or reversed by the Board of Tax Appeals or by a court.

DECISION AND DISPOSITION:

The taxpayers’ petitions are denied.

Dated this 30th day of December, 1999.

ATTORNEY GENERAL'S OFFICE - REVENUE & FINANCE DIVISION

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Transmittal Information

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