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**SUPREME COURT  
OF THE STATE OF WASHINGTON**

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**U.S. SMOKELESS TOBACCO BRANDS INC.,  
PREVIOUSLY KNOWN AS  
UNITED STATES TOBACCO SALES AND  
MARKETING COMPANY INC.,**

**Petitioner,**

**v.**

**STATE OF WASHINGTON,  
DEPARTMENT OF REVENUE,**

**Respondent.**

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**AMICI CURIAE MEMORANDUM OF THE  
COUNCIL ON STATE TAXATION AND THE  
NATIONAL ASSOCIATION OF MANUFACTURERS**

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## I. IDENTITY AND INTEREST OF AMICI

The Council On State Taxation (“COST”) is a non-profit trade association formed in 1969 to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. COST represents nearly 600 of the largest corporations in the United States, including Washington-based businesses and companies from every industry segment.

The National Association of Manufacturers (“NAM”) is the nation’s largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. A mission of the NAM is to enhance the competitiveness of manufacturers by helping develop a legislative and regulatory environment conducive to U.S. economic vitality.

COST and NAM (“Amici”) submit this memorandum, pursuant to RAP 13.4(h), as *amici curiae* in support of the Petitioner’s request for discretionary review of the Court of Appeals decision in *United States Tobacco Sales and Marketing Company, Inc. v. Washington State Department of Revenue*, 128 Wn. App. 426, 115 P.3d 1080 (2005) (“*U.S. Tobacco II*”). This case involves the valuation standard and evidentiary proof necessary to establish the tax base – in this case, for a tax that is measured by the price at which goods are exchanged between affiliated entities. Members of both of these associations confront these issues on a daily basis in a variety of contexts. Thus, Amici and their members have a significant interest in the establishment of clear, uniform, and fair

standards for evaluating affiliate transaction prices, and in assuring that taxpayers are provided a fair and speedy remedy for resolving tax disputes.

## II. ISSUES OF CONCERN TO AMICI

The core issue in this case is: what price is the correct base for Washington's OTP tax, when the manufacturer and the distributor are related entities? Until 2005, Washington imposed its OTP tax on the "wholesale sales price," which was defined as "the established price for which a manufacturer sells a tobacco product to a distributor." Former RCW 82.26.010(7). Here, the manufacturer, United States Tobacco Manufacturing Company, Inc. ("Manufacturing Company"), and distributor, United States Tobacco Sales and Marketing Inc. ("Sales Company"), are corporate affiliates. In *U.S. Tobacco Sales & Marketing Co. v. Dep't of Revenue*, 96 Wn. App. 932, 982 P.2d 652 (1999) ("*U.S. Tobacco I*"), the Court of Appeals held that the tax is to be measured by the manufacturer's price, but that where the manufacturer and distributor are affiliates, the actual price is to be compared to fair market value, presumably to assure that the affiliates do not set an artificially low price.

The taxpayer presented substantial, uncontested evidence of the fair market value price for the sale by Manufacturing Company to Sales Company. That evidence included a full market value appraisal by an experienced appraiser, and an extensive transfer price study prepared pursuant to the arm's-length valuation standard and procedures under

Internal Revenue Code § 482. In *U.S. Tobacco II*, of which review is requested, the Court of Appeals rejected that evidence as inadequate and remanded the case again for further evidence, without instructing what valuation standard is apply on remand, why the evidence in the record is inadequate to show market value, or what additional evidence is required. Under the RAP 13.4(b) standards, the Supreme Court should review this case because it involves (1) issues of substantial public interest – i.e., the nature and proof of fair market value is an issue of wide significance (in many tax, condemnation, and other contexts) and the Court of Appeals has repeatedly failed to provide a clear and usable standard for determining the taxable price for the transfer of goods between affiliates, and (2) an interpretation of fair market value by the Court of Appeals that conflicts with the decisions of this Court.

### III. ARGUMENT

#### A. **Adherence to a Recognized, Valid, Consistent Valuation Standard for Affiliate Transactions is a Matter of Substantial Public Interest.**

Prior to 2005, the Washington tobacco excise tax was measured by “the established price for which a manufacturer sells a tobacco product to a distributor, exclusive of any discount or other reduction.” Former RCWA § 82.60.010. In *U.S. Tobacco I*, the Court of Appeals held that, in the case of affiliated companies, the established price must be based upon fair market value of the products. Thus, determining an objective standard for judging affiliate transaction pricing is at the heart of this litigation.

Federal statutes have long used the “arm’s length standard” for testing the price of goods or services transferred between commonly controlled taxpayers. Treas. Reg. 86, art. 45 (1935). It is undisputed that this standard is equivalent to the fair market value standard. The § 482 regulations establish methods for determining the arm’s length price that have been developed over decades and have been tested and interpreted repeatedly in federal courts. These methods are regularly used by the taxing agencies and courts of other states to determine the appropriate price in related-party transactions for a variety of taxes. It is in both Washington State’s and taxpayers’ interest to employ the well developed, time-tested, widely recognized § 482 standards and methods in evaluating affiliate transactions. Doing so achieves the purpose that the Court of Appeals identified in *U.S. Tobacco I*, and promotes a uniform standard for affiliate transactions, which reduces transaction and compliance costs for taxpayers, and enforcement costs for the State.

“Fair market value is the amount a willing buyer would pay a seller who is willing but no obligated to sell.” *U.S. Tobacco I*, 96 Wn. App. at 940. The arm’s length standard measures the same thing, valuing a related party transaction as if the parties had dealt with each other at arm’s length (as unrelated third parties). Marc M. Levey & Steven C. Wrappe, *Transfer Pricing* 16 (CCH Incorporated 2001). The Court of Appeals has not suggested that there is any theoretical or practical justification for its rejection of the nationally accepted § 482 valuation standards and

methodologies in determining the fair market value price for affiliate transactions in calculating the Washington OTP tax.

If actual transaction prices for affiliate transactions are to be reviewed against a market value standard, that standard should be as uniform as possible. Internal Revenue Code § 482 provides a uniform standard. If, for no good reason, Washington rejects that uniform standard here, it would undermine uniformity (of which Washington is normally a strong proponent, *see, e.g.*, RCW 82.56.010, Article I) and encourage other jurisdictions to adopt inconsistent standards of their own. It is expensive and unproductive to force taxpayers to comply with such diversity, and that deters voluntary compliance and undermines economic efficiency.<sup>1</sup>

Corporate families that conduct national and international operations are familiar with the § 482 arm's length price standard for

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<sup>1</sup> The 2005 legislation has not resolved all transfer price issues even for the Washington OTP tax. For example, if a taxpayer only sells to affiliated entities, but also distributes tobacco products as a gift for purposes of advertising or promotion, or under other circumstances not addressed in the statute, the taxable sales price is "the price, determined as nearly as possible according to the actual price, that the taxpayer or other distributors sell the same tobacco products or similar tobacco products of like quality and character to unaffiliated [entities]." RCWA 86.26.010(18)(a)(iii), (v), and (vi). Without any specified method to determine the taxable sales price, each taxpayer (like Sales Company) would be put in the position of struggling to develop a proper method to value the transfer price without clear and rational guidance in the law. Hence, even under the 2005 amendments, there remains a substantial advantage to adopting the arm's length valuation methods under I.R.C. § 482.

testing their affiliate pricing. Tax fairness and economic efficiency are compromised if individual jurisdictions reject that uniform standard and instead create a patchwork of standards – inconsistent from one jurisdiction to another and from one tax to another – for no important reason.

**B. The Court of Appeals' Remand Denies the Taxpayer a Speedy and Adequate Remedy and Fosters Needless Litigation.**

The Court of Appeals' decision also deserves review because it requires the taxpayer to go through another trial without even a logical explanation of what facts are necessary to meet its burden of proof. The remand instruction directs the parties to provide evidence of the price an unaffiliated entity would pay to purchase tobacco products ("OTP") *from* Manufacturing Company. *U.S. Tobacco II*, 128 Wn. App. at 437-8. Based on the convoluted history of this case, it is not even possible to discern what this means. Is the appellate court asking for proof what Manufacturing Company *actually* would have sold its products to an unaffiliated entity? Or, is the court asking for an estimate of the price for an arm's length sale by a manufacturer to an unrelated party?

If the court is seeking the latter evidence, *i.e.*, the objective market value price that a manufacturer, performing the functions that Manufacturing Company performs, would charge to an unaffiliated distributor, performing the functions that Sales Company performs, then the taxpayer has already submitted that evidence in the previous trial. The taxpayer provided a full appraisal of the fair market value price for

Manufacturing Company's sales to Sales Company. That evidence was undisputed. Furthermore, the State did not provide any valuation evidence to support an alternative price contention. In spite of this complete absence of disputed facts on the fair market value of the product sold by Manufacturing Company to Sales Company, the Court of Appeals disregarded the appraisal and arm's length study and remanded the case yet again,<sup>2</sup> instructing the parties to provide evidence that is (1) inconsistent with its earlier remand ruling, (2) not required by any statute, (3) contrary to this court's holdings as to what evidence is admissible to show fair market value, and (4) contrary to the accepted standards established by § 482 for testing whether affiliate transaction prices are at market value. Further, as noted above, the Court of Appeals' new remand order is so vague as to leave the taxpayer without notice and the trial court without direction as to what evidence the Court of Appeals would find sufficient. Where the taxpayer has repeatedly provided uncontroverted evidence which, by any reasonable standard, meets the burden of proving fair market value, it is patently unfair to require another remand for taking more evidence (especially with no notice or explanation of what it is expected to prove).

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<sup>2</sup> The first appeal was based on the trial court's decision on cross summary judgment motions and the appellate court remand for an actual trial on the facts. It was at this trial, following the first remand, that the pricing and valuation studies were presented as evidence.

Alternatively, if the appellate court's remand order is seeking evidence of a subjective price that Manufacturing Company itself (as opposed to a hypothetical proxy company) would charge to an unaffiliated entity, that is not evidence of fair market value and it is not evidence that exists. Such transactions never took place. In the tax year in question, as part of a comprehensive business plan, Manufacturing Company did not sell OTP to any unaffiliated entities. CP 128. Where a transaction did not and would not have occur, there is no basis for speculation regarding the price that would have been charged.<sup>3</sup> Such "evidence" of a seller's subjective opinion does not prove fair market value, and is contrary to this Court's decisions. *See Motor Mill Co. v. Wilson*, 128 Wash. 592, 594-95, 223 P. 1041 (1924)("proof of value cannot be shown by proving what the owner would take for his property").

Under the Court of Appeal's decision, the taxpayer is left with a guessing game and is denied a fair and speedy remedy for contesting its tax liability. The decision does not even provide fair notice of what the taxpayer is supposed to prove on remand or how its tax liability is to be measured. The Court of Appeals' decision is not justified by the evidence or the applicable statutes.

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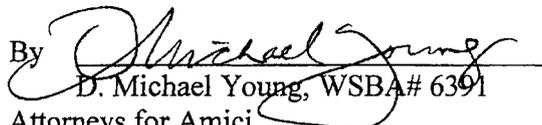
<sup>3</sup> Such evidentiary speculation is like interrogating a faithful servant to explain how much he could have gotten on the black market for the family jewels that he did **not** steal a decade ago.

#### IV. CONCLUSION

Amici respectively submit that there is a substantial public interest in adopting a uniform standard for testing affiliate transactions, and that there is no justification for the Court of Appeals' rejection of the arm's length pricing standards or methodologies under I.R.C. § 482. The arm's length valuation method implements Washington's fair market value standard and has long proved to be effective and efficient. The Court of Appeals decision effectively denies the taxpayer the right to a plain, speedy, fair and adequate remedy. The record in this case does not establish any material issues of disputed fact. A remand for a fourth trial court proceeding (after two summary judgment proceedings and a full trial) will waste judicial resources and needlessly prolong the litigation. Amici therefore support the Petitioner's Motion for Discretionary Review.

DATED: December 2, 2005.

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