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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,

vs.

STATE OF WASHINGTON  
DEPARTMENT OF REVENUE,

Respondent.

**FILED**  
DEC 13 2005  
CLERK OF SUPREME COURT  
STATE OF WASHINGTON  
*[Signature]*

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**AMICUS CURIAE MEMORANDUM  
OF THE INSTITUTE FOR PROFESSIONALS  
IN TAXATION IN SUPPORT OF  
PETITION FOR REVIEW**

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George A. Kresovich, WSBA #8017  
HILLIS CLARK MARTIN & PETERSON, P.S.  
Attorneys for Amicus Curiae Institute for Professionals in Taxation

500 Galland Building  
1221 Second Avenue  
Seattle, Washington 98101-2925  
(206) 623-1745

**ORIGINAL**

## TABLE OF CONTENTS

	<b>Page</b>
I. INTRODUCTION .....	1
II. IDENTITY AND STATEMENT OF INTEREST OF THE INSTITUTE FOR PROFESSIONALS IN TAXATION.....	1
III. STATEMENT OF THE CASE .....	2
IV. REASONS WHY THE SUPREME COURT SHOULD ACCEPT DISCRETIONARY REVIEW .....	4
A. The Court of Appeals Decision Is Fundamentally Inconsistent with Widely-Accepted Valuation Principles and Standards Which Have Been Adhered to by This Court. ....	4
B. The Court of Appeals Misunderstood the Appraisers' Application of the Trade Level Concept. ....	8
C. A Remand Denies the Taxpayer a Prompt and Fair Remedy for Erroneous Taxation.....	9
V. CONCLUSION .....	10

## **I. INTRODUCTION**

The Institute for Professionals in Taxation (“IPT”) supports the Petition for Supreme Court Review filed by U.S. Smokeless Tobacco Brands, Inc., formerly known as United States Tobacco Sales and Marketing Company Inc. (“Tobacco Sales” or “the taxpayer”).

## **II. IDENTITY AND STATEMENT OF INTEREST OF THE INSTITUTE FOR PROFESSIONALS IN TAXATION**

IPT is a non-profit educational association serving over 4,100 members throughout the United States and Canada. IPT members represent a broad spectrum of businesses and industries, ranging in size from small firms to most of the Fortune 500 companies. IPT’s guiding principles are to foster the professionalism of its members, to promote the uniform and equitable administration of ad valorem taxation and other forms of state and local taxation, and to minimize the costs of administration and compliance. IPT’s purposes include the elimination of inequitable, discriminatory or otherwise illegitimate methods of determining tax liabilities. Where appropriate to the accomplishment of this purpose, IPT presents its views as amicus curiae in cases presenting issues of great importance to its members. A more detailed description of IPT’s mission and activities can be found at [www.ipt.org/Index.cfm](http://www.ipt.org/Index.cfm).

IPT urges review of decision by the Court of Appeals in this case for two reasons. First, the decision is inconsistent with fundamental and

universally accepted principles for determining market value. Second, the Court of Appeals decision violates basic standards of procedural fairness. IPT's members are vitally interested in both of these concerns. If this Court does not grant review, the Court of Appeals decision is likely to be used to the detriment of taxpayers in Washington and elsewhere. This Court should not allow that to happen. It should grant review in order to make it clear that Washington adheres to accepted principles for determining market value and will not allow taxpayers to be treated in such an unfair manner.

### **III. STATEMENT OF THE CASE**

IPT adopts the Statement of the Case in the taxpayer's Petition for Review. The following facts are particularly relevant to IPT's concerns.

The taxpayer presented undisputed evidence of the fair market value price for its purchase of smokeless tobacco products ("OTP") from its manufacturing affiliate ("Tobacco Manufacturing"). The taxpayer's evidence consisted of a detailed appraisal by a well-known appraisal expert. The appraisal was based on an arm's-length transfer price study prepared using the valuation standards and methodologies that are approved for use under Internal Revenue Code ("IRC") § 482.

The Department of Revenue presented no valuation evidence of its own and no evidence to impeach or undermine the taxpayer's valuation

evidence. The Department's valuation expert agreed with the taxpayer's experts that the arms-length price standard under IRC § 482 is equivalent to the fair market value standard. The Department's valuation expert also agreed that, if the valuation standard applied by the taxpayer's experts was the legally correct standard, he had no dispute with that expert's valuation.

Nevertheless, the Court of Appeals rejected the taxpayer's valuation evidence with only the following explanation:

But certain language from those studies and the testimony from which they were presented suggest that the qualifier "level of trade" include the affiliation between Tobacco Manufacturing and Tobacco Sales. As such, the court's market price would not reflect the price of OTP sold between unaffiliated entities.

*U.S. Tobacco Sales & Mktg. Co. v. Dep't of Revenue*, 128 Wn. App. 426, 437, 115 P.3d 1080 (2005). Based on this conclusion regarding the valuation evidence, the Court of Appeals remanded the case for a second time and directed the parties to "provide evidence on remand of the price a *completely unaffiliated entity* would have had to pay to purchase OTP from Tobacco Manufacturing in 1992." *Id.* at 437-38.<sup>1</sup>

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<sup>1</sup> The Court of Appeals would subject the taxpayer to the expense and hazard of yet another trial even though the Department "did not present any evidence as to the fair market value of OTP sold by Tobacco Manufacturing. Instead it maintained its position, *a position which this court rejected in the first appeal*, that the correct measure of the OTP tax should be Tobacco Sales's selling price." *U.S. Tobacco II*, 128 Wn. App. at 431. (Emphasis supplied.) In such circumstances it would be grossly unfair to the taxpayer to give the Department yet another bite at the apple.

The Court of Appeals misunderstood the testimony and evidence regarding the “level of trade” at which the OTP was valued by the experts. It also appears that the Court of Appeals misunderstood and misapplied the fair market value standard. The evidence that the Court of Appeals would substitute for the taxpayer’s appraisal analysis and testimony would not be admissible evidence of fair market value. Therefore, this Court should accept review, reverse the Court of Appeals, and rule that judgment be entered in favor of the taxpayer based on the evidence that was presented at trial.

**IV. REASONS WHY THE SUPREME COURT SHOULD ACCEPT DISCRETIONARY REVIEW**

**A. The Court of Appeals Decision Is Fundamentally Inconsistent with Widely-Accepted Valuation Principles and Standards Which Have Been Adhered to by This Court.**

Fair market value is an objective measure that reflects the price at which property would exchange, under competitive market conditions, between a typically motivated seller and a typically motivated buyer.<sup>2</sup> The market value standard is not based upon the desires or preferences of the actual property owner. Market value is based on a judgment as to the price at which the property would transfer in an arm’s-length transaction between hypothetical, typically motivated parties.

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<sup>2</sup> See, e.g., the definition of “market value” in Appraisal Institute, *DICTIONARY OF REAL ESTATE APPRAISAL* (4th ed. 2002).

This Court's decisions are fully consistent with this widely recognized principle. Indeed, the Court has held that the selling price preferences of an actual property owner are irrelevant and inadmissible as evidence of fair market value. *Motor Mill Co. v. Wilson*, 128 Wash. 592, 594-95, 223 P. 1041 (1924); *Port Townsend S. Railway Co. v. Barbare*, 46 Wash. 275, 277, 89 P. 710 (1907). *See also Chicago, M. & S. P. R. Co. v. Alexander*, 47 Wash. 131, 134, 47 Wash. 131 (1907); *North C. R. Co. v. Newman*, 66 Wash. 374, 119 P. 823 (1911) (offer to purchase not admissible to prove fair market value). The Court of Appeals decision is directly at odds with these cases. It would substitute irrelevant and inadmissible evidence of the selling price preferences of the actual property owner for proper evidence of fair market value.

Tobacco Sales presented undisputed evidence using the acknowledged standard for determining fair market value. The taxpayer's appraiser described this standard as follows:

In making this appraisal, we have applied the market value standard as established in the Uniform Standards of Professional Appraisal Practice ("USPAP"). (*See USPAP Glossary; American Society of Appraisers Business Valuation Standards p. 20; Internal Revenue Service Revenue Ruling 59-60; International Business Brokers Association, Business Brokerage Glossary.*) This appraisal thus estimates the market price at which OTP would transfer in a competitive open market transaction between unaffiliated entities with the same functional allocation as

exists in the existing relationship between USTM and USTSM.

*See* Plaintiff's Ex. 1, at 3. This appraisal reflects "the price at which transactions would occur in a competitive open market under all conditions required for a fair sale." Plaintiff's Ex. 1, at 6. This standard is consistent with the decisions of this Court. It is also consistent with the articulation of the fair market value standard by the Court of Appeals, "what a willing buyer would pay a willing seller in an arm's-length transaction in a free market." *U.S. Tobacco II*, 128 Wn. App. at 436. Applying this standard, the taxpayer's experts presented direct, uncontested evidence of fair market value for Tobacco Manufacturing's sales to Tobacco Sales.<sup>3</sup>

The Court of Appeals, however, rejected the taxpayer's evidence of fair market value. Instead, it called on the parties to present evidence of the price at which Tobacco Manufacturing *itself* would sell the OTP to an unaffiliated entity.<sup>4</sup> A remand for purposes of taking this inadmissible

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<sup>3</sup> The Department's appraiser, Mr. Cook had only one point of disagreement with the taxpayer's experts: he took the view that Tobacco Sales is a tobacco manufacturer and, therefore, that its selling price is the manufacturer's price that measures the OTP tax. RP 378. That view, however, was twice rejected by the Court of Appeals. Mr. Cook did not dispute that "the valuation evidence presented by Mr. Reilly reflects the fair market value of the transaction between Tobacco Manufacturing and Tobacco Sales." RP 361. He characterized Mr. Reilly's and Mr. Lotfi's reports as "quite credible." RP 359.

<sup>4</sup> Footnote 8 of the Court of Appeals decision suggests that the unaffiliated transaction contemplated by the Court of Appeals would be a sale to a non-

evidence would be a futile waste of judicial resources and place an unfair and inappropriate burden on the taxpayer.

The Department of Revenue argues that the Court of Appeals remand instruction “simply requires the parties to produce evidence of the type that always is required to determine fair market value in the absence of an actual sale.” Answer to Petition for Review at 11. To the contrary, Tobacco Sales has already presented the type of evidence that is typically used to prove fair market value – expert testimony of a qualified appraiser. *See Gilmartin v. Stevens Inv. Co.*, 43 Wn.2d 289, 294, 261 P.2d 73 (1953) (fair market value proved by expert opinion testimony). By refusing to accept this uncontroverted evidence, the Court of Appeals has created unnecessary uncertainty for Tobacco Sales and all litigants in cases where fair market value is placed in dispute. The Court of Appeals apparently wants a different type of evidence, but the evidence that it would require would not be admissible for the purpose of establishing fair market value.

The Court of Appeals ignores undisputed expert appraisal evidence of fair market value in favor of speculative evidence of the selling preferences of a particular property owner. That speculation is not proper evidence of fair market value under any recognized valuation standards,

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exclusive purchaser under conditions that are vastly different from those which actually apply in the transaction between Tobacco Manufacturing and Tobacco Sales. That evidence would not reflect the fair market value for the sale from Tobacco Manufacturing to Tobacco Sales.

and it is not proper evidence of market value under the decisions of this Court. The Court of Appeals' misinterpretation and misapplication of the fair market value standard threatens established law in a broad spectrum of cases in which fair market value is the issue.

**B. The Court of Appeals Misunderstood the Appraisers' Application of the Trade Level Concept.**

The Court of Appeals believed that the appraisers improperly considered the affiliation between Tobacco Manufacturing and Tobacco Sales in their valuation through their application of the trade level concept.<sup>5</sup> There is nothing in the evidence to support this claim. The trade level concept reflects the fact that articles of personal property have different values depending on their location in the manufacturing and distribution chain.<sup>6</sup> The taxpayer's experts did not apply the trade level concept to reflect the affiliation between Tobacco Manufacturing and

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<sup>5</sup> *U.S. Tobacco II*, 128 Wn. App. at 436 (“[C]ertain language from those studies and the testimony from which they were presented suggest that the qualifier ‘level of trade’ included the affiliation between Tobacco Manufacturing and Tobacco Sales.”). This statement by the court illustrates its confusion. Because a determination of fair market value assumes an arm’s-length transaction between a willing buyer and a willing seller in a free market, a market value appraisal, by definition, excludes consideration of the affiliation of the parties.

<sup>6</sup> Articles of commerce generally increase in value as they progress from the manufacturer into the hands of the final consumer. This increase in value reflects the value added at each level of trade. For example, a manufacturer adds value by converting raw materials into a finished product. A retailer adds value by providing a convenient and well-known location at which consumers can purchase products. Intermediaries may add value in a variety of ways, for example, by moving the products closer to the consumer, storing the products, and by advertising and marketing the products.

Tobacco Sales. Rather, they used the trade level concept to identify the correct market value transaction to use to obtain a fair market value for the sale by Tobacco Manufacturing to Tobacco Sales.

In the case of unaffiliated entities, the actual selling price by the manufacturer to the first distributor establishes the measure of the OTP tax. Tobacco Sales appraisers applied the trade level concept to assure that they measured fair market value at that same level of trade, i.e., a sale from a manufacturer to the first distributor. The Court of Appeals misunderstood this evidence and wrongly concluded that it improperly reflected the affiliation between Tobacco Manufacturing and Tobacco Sales. Another trial will not correct this misunderstanding.

**C. A Remand Denies the Taxpayer a Prompt and Fair Remedy for Erroneous Taxation.**

IPT believes that the measure of any tax should be based on a clearly articulated, objective standard. The tax measure also should be set in advance of the imposition of the tax. Taxes should not depend on arbitrary, after-the-fact interpretations of vague standards. Taxpayers are entitled to a prompt and fair opportunity to challenge an illegal tax. If taxpayers are denied fair treatment, it breeds resentment, undermines faith in the tax system and erodes voluntary compliance. The Court of Appeals decision needlessly prolongs litigation that has already gone on far too

long. This Court should accept review and not allow the taxpayer to continue to be run-through unnecessary trials when there are no disputed issues of fact.

**V. CONCLUSION**

This Court's longstanding interpretation and application of fair market value principles is consistent with generally accepted appraisal standards and the application of the fair market value concept in other jurisdictions. The Court of Appeals decision is fundamentally inconsistent with those principles. The taxpayer's experts correctly interpreted the fair market value standard and presented credible and uncontested evidence of fair market value. The Court of Appeals' rejection of that evidence is based on a misunderstanding of the evidence and a misunderstanding of the fair market value standard. Therefore, this Court should grant discretionary review and reverse the Court of Appeals decision.

DATED this 2nd day of December, 2005.

HILLIS CLARK MARTIN & PETERSON, P.S.

By George A. Kresovich  
George A. Kresovich WSBA #8017  
Attorneys for Amicus Curiae  
Institute for Professionals in Taxation