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CLERK OF SUPREME COURT
STATE OF WASHINGTON
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No. 79661-1

IN THE SUPREME COURT OF THE STATE OF
WASHINGTON

TESORO REFINING AND MARKETING COMPANY,

Petitioner,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

MEMORANDUM OF AMICUS CURIAE
ASSOCIATION OF WASHINGTON BUSINESS
SUPPORTING PETITION FOR REVIEW

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RAP 13.4(b)(4)2

I. INTRODUCTION

This case is about the taxation of “refinery gas,” a byproduct of the manufacturing process whereby crude oil is transformed into gasoline, propane, asphalt, and other finished products. Clerk’s Papers (“CP”) at 40-41. Indeed, by the time the reader finishes this page, assuming the Tesoro refinery near Anacortes is presently operating, the entire life span of a quantity of refinery gas will have run its course. That is because this byproduct is created from chemical reactions within the refining process and is immediately consumed as an integral part of that process or, if excess, burnt off in the refinery flare. CP at 42-44. This life is indeed short; from creation to vaporization, refinery gas lasts for approximately thirty seconds. CP at 19, 44. Should this ephemeral vapor be subject to the state’s Hazardous Substance Tax (“HST”) when it is fully consumed within the same process that creates it and Tesoro has no legally significant control over it, that is, no power to sell or use it under RCW 82.21.020(3)?

This case is not merely about the taxation of vapor, anymore than *Agrilink Foods, Inc. v. Dept. of Revenue*, 153 Wn.2d 392, 103 P.3d 1226 (2005) was merely about the taxation of canned chili. Two important legal principles are at stake in this case and were erroneously decided by the Court of Appeals. First, as in *Agrilink*, the court is presented with a tax rule capable of two or more reasonable constructions. This *ambiguous* tax rule must be construed, therefore, in favor of the taxpayer. Yet the Court of Appeals construed the rule in favor of the state. Secondly, the court is presented with a properly promulgated administrative rule of the Department of Revenue which has never been amended or repealed, but which the Department has abandoned in this case and against which the Department now argues. It is a manifest outrage to taxpayers that the Department would be permitted, as below, to assess a tax contrary to one of its own duly adopted rules. These are matters of substantial public interest that merit Supreme Court review. RAP 13.4(b)(4). The court should grant the petition.

II. IDENTITY AND INTEREST OF AMICUS CURIAE

AWB, founded in 1904, is the state's oldest and largest general business trade association. AWB represents over 6,100 member businesses, of whom 85 percent are small businesses employing fewer than 50 workers, and who are engaged in all sectors of industry and aspects of commerce in Washington. In total, AWB members employ over 750,000 individuals in Washington. Despite their manifest diversity, AWB members share in common that they are taxed under the various business tax laws of this state. AWB therefore frequently engages as amicus curiae in tax cases of consequence to its membership. *See, e.g., Aaro Medical Supplies, Inc. v. Dept. of Revenue*, 132 Wn. App. 709, 132 P.3d 1143 (2006) (petition for review pending); *Texaco Refining and Marketing, Inc.*, 131 Wn. App. 385, 127 P.3d 771 (2006), *rev. denied*, 158 Wn.2d 1012 (2006); *Agrilink v. Dep't of Revenue*, 153 Wn.2d 392, 103 P.3d 1226 (2005).

III. ISSUES OF CONCERN TO AMICUS CURIAE

Was it error for the Court of Appeals to construe the HST tax-imposing statute in the Department of Revenue's favor, and uphold the Department's imposition of HST on refinery gas?

Cf. Pet. for Review at 1 (Issue 1).

May a state administrative agency retroactively impeach its own administrative rule? *Cf. Pet. for Review* at 2 (Issue 2).

IV. STATEMENT OF THE CASE

For brevity's sake, AWB adopts, as if set forth herein, the Statement of the Case provided by Tesoro in its *Petition for Review* at pages 2-5.

V. REASONS TO ACCEPT REVIEW

AWB urges the court to grant review for two reasons.

First, the Court of Appeals' conclusion that the HST applies to refinery gas is based on a misapplication of the taxpayer deference rule in cases of ambiguous taxing authorities.

Secondly, the Department has assessed the HST and litigated this case in complete disregard of its own duly promulgated

administrative rule, which taxpayers should be able to rely upon, a move which if upheld completely eviscerates taxpayer reliance on Department rules. This court should therefore accept review and reverse the Court of Appeals' holding that the HST applies to refinery gas.

**A. THE COURT OF APPEALS INCORRECTLY
CONSTRUED RCW 82.21.020(3) IN FAVOR OF
THE DEPARTMENT.**

The Legislature has adjudged that a taxpayer should not be liable for tax on a hazardous substance not within its control, and so RCW 82.21.020(3) defines "control" for purposes of the HST: "Control means the power to sell or use a hazardous substance or to authorize the sale or use by another." The issue turns on whether "power to sell or use" is a conjunctive or disjunctive phrase. The case law is clear that while the default interpretation of "or" is disjunctive, it is susceptible to a conjunctive interpretation if such an interpretation furthers legislative intent. *See Childers v. Childers*, 89 Wn.2d 592, 595, 575 P.2d 201 (1978) (allowing for a conjunctive construction of

“or”). The question for the court is whether a conjunctive reading of “power to sell or use” refinery gas is a reasonable construction that furthers the legislative intent of the HST to tax products that “present at threat to human health or the environment.” RCW 82.21.010. That is because an ambiguous statute is one which may be construed in two or more reasonable ways. *Agrilink*, 153 Wn.2d at 396.

Here, two judges of the Court of Appeals determined that RCW 82.21.020(3) can only be read in the disjunctive:

... when the legislature uses the disjunctive “or” in its definition of control, the legislature intends that a taxpayer has control of a hazardous substance when the taxpayer has the power to sell or use the hazardous substance.

Tesoro Refining and Marketing Co., 135 Wn. App. 411, 423, 144 P.3d 368 (2006).

But the Department had already interpreted RCW 82.21.020(3) conjunctively, in that a taxpayer is not subject to the HST for substances that are created in the manufacturing process and that are “consumed during the manufacturing or

processing activity.” WAC 458-20-252(7)(b) (“Rule 252”).

Rule 252 specifies:

When any hazardous substance(s) is first produced during and because of any physical combination or chemical reaction which occurs in a manufacturing or processing activity, the intermediate possession of such substance(s) within the manufacturing or processing plant is not considered a taxable possession if the substance(s) becomes a component or ingredient of the product being manufactured or processed or is otherwise consumed during the manufacturing or processing activity.

The logic of Rule 252 is that “control” over a hazardous substance must mean the power to use and the power to sell because specifically excluded within the rule is a certain use of the substance – consumption during the manufacturing process.

In other words, the power to use is not enough without the concomitant power to sell the hazardous substance.

This interpretation was upheld by one Court of Appeals judge in dissent. Chief Judge Quinn-Brintnall stated that while the portion of refinery gas flared off into the environment may pose a taxable incident, “under rule 252(7)(b), Tesoro is entitled

to a refund of taxes it paid on gas that was created and immediately recycled and consumed during the refining process.” *Tesoro*, 135 Wn. App. 429 (Quinn-Brintnall, C.J., concurring in part and dissenting in part).

In sum, the Department, through Rule 252, which it duly adopted in furtherance of its responsibility for administering the tax laws of the state, as well as a Court of Appeals judge, have both construed the statute as not applying to refinery gas consumed in the refining process. These are objective indicia that Tesoro’s conjunctive construction of section .020(3) is at least a reasonable construction of the HST statute. In the face of this alternative reasonable construction, the statute must be found ambiguous and thus construed in favor of the taxpayer according to the long line of cases mandating pro-taxpayer construction of ambiguous taxing authorities. *See, e.g., City of Puyallup v. Pacific Northwest Bell*, 98 Wn.2d 443, 448-49, 656 P.2d 1035 (1983). The court should grant review to correct the Court of Appeals’ legal error.

B. THE COURT OF APPEALS INCORRECTLY ALLOWED THE DEPARTMENT TO IGNORE ITS OWN ADMINISTRATIVE RULE.

Alternatively, regardless of whether Rule 252 is a reasonable construction of the HST statute, the Department should not be allowed to assess a tax contrary to one of its own duly adopted rules. *See Group Health Coop. of Puget Sound, Inc. v. Washington State Tax Comm'n*, 72 Wn.2d 422, 428, 433 P.2d 201 (1967) (holding that the Department may not “retroactively impeach its own lawful rulings.”).

If the Department should come to believe that a duly adopted rule is erroneous, the proper procedure is for the Department to follow the provisions of the Administrative Procedures Act, RCW ch. 34.05 (“APA”), and repeal or amend the rule. Such a change would be prospective only. It is fundamentally unfair to taxpayers and contrary to the purpose of administrative rules for the Department to retroactively renounce a rule and assess a taxpayer in a manner contrary to the rule. Even if a court later comes to determine that a rule is

inconsistent with an underlying statute, at least taxpayers relying in good faith on the Department's rulemaking are protected in the meantime prior to the court's determination. There is no such protection from a Department unilaterally, and without the due process protections of the APA, disregarding its own rule. Not only is this poor governance, but it was legal error of the Court of Appeals to countenance the Department's actions. The court should accept review to direct agencies how to properly amend or suspend prior interpretations of the law relied upon by the taxpaying public.

VI. CONCLUSION

AWB urges the court to accept review and reverse the decision of the Court of Appeals.

Respectfully submitted this 5th day of March, 2007.


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