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No. 35733-0-II

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

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DOT FOODS, INC.,

Appellant,

vs.

DEPARTMENT OF REVENUE, STATE OF WASHINGTON,

Respondent.

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DIVISION II  
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STATE OF WASHINGTON  
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APPEAL FROM THE SUPERIOR COURT  
FOR THURSTON COUNTY  
THE HONORABLE RICHARD HICKS

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BRIEF OF APPELLANT

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## I. INTRODUCTION

Under the guise of promulgating an "interpretive rule," the Department of Revenue in 2000 reversed its long-standing interpretation of the statutory direct seller's exemption from B & O tax, RCW 82.04.423,<sup>1</sup> under which an out-of-state seller is exempt

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<sup>1</sup> **RCW 82.04.423 Exemptions--Sales by certain out-of-state persons to or through direct seller's representatives**

(1) This chapter shall not apply to any person in respect to gross income derived from the business of making sales at wholesale or retail if such person:

(a) Does not own or lease real property within this state; and

(b) Does not regularly maintain a stock of tangible personal property in this state for sale in the ordinary course of business; and

(c) Is not a corporation incorporated under the laws of this state; and

(d) Makes sales in this state exclusively to or through a direct seller's representative.

(2) For purposes of this section, the term "direct seller's representative" means a person who buys consumer products on a buy-sell basis or a deposit-commission basis for resale, by the buyer or any other person, in the home or otherwise than in a permanent retail establishment, **or who sells, or solicits the sale of, consumer products in the home or otherwise than in a permanent retail establishment; . . .**

(emphasis added)

from tax if it “sells, or solicits the sale of, consumer products in the home or otherwise than in a permanent retail establishment” “to or through a direct seller’s representative.” RCW 82.04.423(1)(d), (2). Because 99.5% of Dot Foods sales are of consumer products, and all of its products are sold exclusively through sales solicited by a direct seller’s representative “otherwise than in a permanent retail establishment,” RCW 82.04.423(2), Dot Foods continues to qualify for the direct seller’s exemption under the plain language of the statute, as the Department had authorized under a 1997 Private Letter Ruling. Moreover, the Department’s revised interpretation of RCW 82.04.423(2) is procedurally as well as substantively invalid because the Department failed to provide adequate notice to inform and educate affected persons and assist them in voluntarily complying with its new interpretation of the statute. Instead, in 2004, the Department assessed Dot Foods B&O taxes from the date its new regulation went into effect, resulting in a back tax liability in excess of \$700,000. This court should reverse the trial court’s summary judgment and order a refund of all B&O taxes paid by Dot Foods under protest.

## II. ASSIGNMENT OF ERROR

The trial court erred in entering its Order Granting Summary Judgment to Defendant Department of Revenue And Denying Plaintiff Dot Foods, Inc.'s Motion for Summary Judgment. (CP 327-30)

## III. ISSUES RELATING TO ASSIGNMENT OF ERROR

1. Since 1983, the Legislature has authorized a B&O tax exemption to an out-of-state seller who "solicits the sale of consumer products" in Washington State exclusively through a direct seller's representative "otherwise than in a permanent retail establishment." RCW 82.04.423. Did the Department's revised interpretation of that statute to preclude the exemption if such products are ever sold by anyone in a permanent retail establishment improperly rewrite the statute to limit an exemption expressly granted by the Legislature?

2. RCW 82.04.423 defines a "direct seller's representative" as one who "sells or solicits the sale of consumer products in the home or otherwise than in a permanent retail establishment." The statute does not require that those sales "exclusively" constitute consumer products. Did the trial court err in holding that Dot Foods did not qualify for the direct seller's

exemption where 99.5% of Dot Foods' products are consumer products and all of the sales were "otherwise than in a permanent retail establishment?"

3. The Department of Revenue issued a private letter ruling to Dot Foods in 1997 authorizing it to claim the direct seller's exemption in accordance with the Department's longstanding interpretation of RCW 82.04.423. Was the Department entitled to reverse its construction of the statute by issuing an "interpretive" rule that departed radically from its original rule, promulgated 15 years earlier, and to then rely on its new interpretation to assess B&O taxes against Dot Foods, without engaging in the additional notice requirements mandated by the APA where an agency significantly amends its former policy?

#### IV. STATEMENT OF THE CASE

**A. Dot Foods, An Illinois Corporation, Sells Food Products In Washington State To Food Service Distributors And To Food Processors, But Not To Permanent Retail Establishments, Through An Independent Contractor Paid On Commission.**

Dot Foods, Inc. is an Illinois corporation with headquarters in Mt. Sterling, Illinois. (CP 61) Dot Foods sells food products to dairies, meat packers, food processors, and other food service companies. These customers either use Dot Foods' products as

ingredients in products that are, in turn, sold to permanent retail establishments such as grocery stores, or they are wholesalers who resell Dot Foods' products to restaurants or to other food service operators or institutions, such as nursing homes, schools, hospitals and cafeterias. (CP 62) Of the 60,000 products carried by Dot Foods, over 99% are "consumer products,"<sup>2</sup> comprising over 99.5% of Dot Foods gross revenue, such as dry foods, sauces, and refrigerated and foods. (CP 119-34, 306-07) See also CP 169 (Department concedes that "the food products sold by Dot Foods mostly are consumer products.")

On November 1, 1997, Dot Foods entered into a contract with its wholly-owned subsidiary, Dot Transportation, Inc ("DTI"), a Delaware corporation, to solicit sales of Dot Foods' products in Washington State. (CP 71) Dot Foods does not sell its products to DTI for resale in Washington State. (CP 62) Instead, DTI's Washington sales representatives solicit sales of Dot Foods' products by making sales calls in person to food service distributors, meat packers, and dairies in Washington. (CP 62,

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<sup>2</sup> The term "consumer products" is defined by the Department of Revenue as including tangible personal property, or a component thereof, that is sold for personal use and enjoyment, including food products. WAC 458-20-246(4)(b)(ii). See Kunsch, 1B *Wash. Practice*, § 72.32 (4th Ed. 1997).

308-09) All orders are transmitted electronically to Dot Foods' headquarters in Illinois, or are given telephonically to its inside sales representatives in Dot Foods' home state of Illinois. (CP 62) All products sold by Dot Foods to Washington customers through DTI are then shipped to Washington from outside Washington State. (CP 62) Beyond the solicitation activities of DTI on its behalf, Dot Foods conducts no other activity in Washington. (CP 62)

Dot Foods does not sell any of its products to permanent retail establishments. (CP 62) DTI salespersons have never made any sales calls on supermarkets or other permanent retail establishments. (CP 62)

DTI received a commission of .7% of all sales of Dot Foods products sold to customers located in Washington. (CP 63) DTI paid B&O tax to the Department of Revenue on all the commissions it earned from Dot Foods' sales. (CP 231-67)

**B. The Department Of Revenue Issued A Private Letter Ruling In 1997 Exempting Dot Foods From B&O Tax So Long As It Continued To Sell Its Products Through An Independent Contractor And So Long As No Sales Were Made To A Permanent Retail Establishment.**

Washington's Business and Occupation (B&O) tax taxes business activities carried on within the state, except where the

Legislature has granted an exemption. See *Time Oil Co. v. State*, 79 Wn.2d 143, 146, 483 P.2d 628 (1971). The B&O tax applies to an out-of-state taxpayer who solicits orders in Washington through employees based in Washington State. RCW 82.04.250 and .270. However, when an out-of-state vendor uses independent contractors to solicit orders in Washington State, the possibility of double taxation arises because both the Washington-based independent contractor and the out-of-state vendor may be subject to the state's B&O tax on the same transaction. See *Tyler Pipe Industries, Inc. v. Dept of Revenue*, 483 U.S. 232, 250-51, 107 S. Ct. 2810, 2821, 97 L.Ed.2d 199 (1987) (Commerce clause allows Washington to tax sales within the state made by out-of-state vendor).

To alleviate this double taxation burden, to equalize the tax treatment between out-of-state sellers who solicit orders through regular employees and those using independent contractors to solicit sales, and to encourage out-of-state businesses to sell through Washington-based agents, in 1983 the Washington Legislature enacted a "direct seller's" exemption, RCW 82.04.423. See Wash. Dept. of Revenue, *Tax Exemptions 2004 96* (2004) (*reprinted at CP 269*) Under this exemption statute, a product seller

will be exempt from Washington's B&O tax if the out-of-state seller sells exclusively through a "direct seller's representative." RCW 82.04.423(1)(d).

The Legislature established two alternative definitions of "direct seller's representative" – one based on those who "buy consumer products . . . for resale" and another for those who "sell, or solicit the sale of, consumer products" on behalf of an out-of-state seller:

(2) For purposes of this section, the term "direct seller's representative" means a person who buys consumer products on a buy-sell basis or a deposit-commission basis for resale, by the buyer or any other person, in the home or otherwise than in a permanent retail establishment, or who sells, or solicits the sale of, consumer products in the home or otherwise than in a permanent retail establishment;

RCW 82.04.423(2).

Following enactment of the direct seller's exemption, the Washington Department of Revenue interpreted RCW 82.04.423, by rule and in adjudicative proceedings, according to its plain language. In particular, the Department interpreted the second clause of RCW 82.04.423(2) as authorizing the exemption when the taxpayer-seller made no sales in a "permanent retail establishment," even if subsequent sellers might ultimately sell the

taxpayer's products at retail further down the stream of commerce. Former WAC 458-20-246 (defining direct seller's representative as one who solicits the sale of consumer products other than in a permanent retail establishment) (WSR 84-24-028 (Nov. 30, 1984)); 3 WTD 357 (1987) (*reprinted at CP 272-76*).

Consistent with its interpretation of RCW 82.04.423, the Department of Revenue issued a private letter ruling to Dot Foods in 1997, advising Dot Foods that it qualified for the direct seller's exemption under RCW 82.04.423, subject to certain conditions.

Those conditions included the following:

Dot Foods will not own or lease real property in Washington,

Dot Foods will not maintain a stock of product in Washington,

Dot Foods is incorporated under the laws of Illinois,

Dot Foods' Washington sales will be exclusively through a direct seller's representative, a wholly owned subsidiary of Dot Foods, operating under a written contract,

The direct seller will be paid a commission based on a percentage of net sales,

(CP 68)

Under this October 23, 1997 private letter ruling, Dot Foods remained "exempt from B&O tax under RCW 82.04.423 as long as

the subsidiary will not make sales from a permanent retail establishment.” (CP 69) DTI has never made such sales. (CP 62-63)

**C. Without Providing The Notice Of Its Intent To Reverse Its Interpretation Of The Exemption Required By The APA, The Department Of Revenue In 2004 Audited Dot Foods’ Returns And Assessed Over \$700,000 Of B&O Taxes On Sales Made Through Its Independent Contractor.**

In 1999, the Department of Revenue issued a notice of rulemaking for revisions to WAC 458-20-246. The Department claimed that it was promulgating an “interpretive rule” and disavowed the more stringent notice and comment rulemaking requirements of the Administrative Procedure Act mandated for “significant legislative rules.” WSR 99-17-029 (Aug. 11, 1999). See RCW 34.05.328. Reversing its previous interpretation of RCW 82.04.423, the revised rule, effective January 1, 2000, interpreted the second clause of RCW 82.04.423(2) as applying only if “the product is sold at retail in the home or in a nonpermanent retail establishment. . . [r]egardless of to whom the representative sells. . .” WAC 458-20-246(4)(b)(i)(B). See WSR 99-24-007 (Nov. 19, 1999). In other words, if a product was ultimately sold in a permanent retail establishment, the direct seller’s exemption would be disallowed.

On February 1, 2000, the Department of Revenue mailed a form "Special Notice to Direct Sellers" to taxpayers including Dot Foods. (CP 63) That Notice stated that the Department had "updated" its administrative interpretation of RCW 82.04.423, WAC 458-20-246, effective January 1, 2000. (CP 73) The Department's Notice said that the purpose of the revision was to "provide guidance to taxpayers," and that the revised rule "reiterates the express requirements of the statute . . . in a comprehensive way, consistent with the terms of the statute." (CP 73) The Notice quoted the first clause of RCW 82.04.423(2), interpreting the requirement that "the sale of consumer products must be "in the home or otherwise than in a permanent retail establishment," and stated that "if a consumer product is sold by anyone in a permanent retail establishment, the direct sellers' exemption is not available to the direct seller." (CP 73)

The Notice did not mention Dot Foods' Private Letter Ruling. The Notice did not mention the second clause of RCW 82.04.423(2). Dot Foods continued to claim an exemption from B&O tax under the direct seller's exemption as it had since 1997. (CP 65-66)

In 2004, the Department audited Dot Foods' B&O tax returns and disallowed Dot Foods' direct seller's exemptions from the effective date of its new rule, concluding that Dot Foods owed \$707,848 in back B&O taxes for the years 2000-2003, plus statutory interest and penalties. (CP 76, 98-101) Contrary to its previously stated position that its new rule was "interpretive" (WSR 99-17-029), the Department claimed that its 2000 revisions to WAC 458-20-246 have "the same effect as [the] Revenue Act itself." (CP 78) The Department rejected Dot Foods' explanation that it remained eligible for the direct seller's exemption because DTI was a "direct seller's representative" under the second clause of RCW 82.04.423(2) – one who "sells, or solicits the sale of, consumer products in the home or otherwise than in a permanent retail establishment . . ." (CP 80) Although Dot Foods' products had always been sold at retail by its buyers and others, according to the Department, Dot Foods was "no longer" eligible for the direct seller exemption "as your products are ultimately sold in permanent retail establishments." (CP 79)

**D. Dot Foods Began Reporting And Paying Its B&O Tax Without The Direct Seller's Exemption, And Paid The \$707,848 Assessment, Plus Interest. (CP 64) The Trial Court Rejected Dot Foods' Refund Action On Summary Judgment.**

Dot Foods filed this action for refund of B&O taxes in Thurston County Superior Court on May 24, 2005, on the grounds that it remained entitled to the direct seller's exemption under the second clause of RCW 82.04.423(2). (CP 5-10) In August 2006, Dot Foods amended its appeal to include all payments of B&O tax made after the audit, from 2000 through 2004 for a total refund of \$1,112,039.42. (CP 22-31)

On cross-motions for summary judgment, the Honorable Richard Hicks ("the trial court") dismissed Dot Foods' appeal and granted summary judgment in favor of the Department. (CP 327-30) The trial court held that the exemption did not apply "to exempt manufacturers . . . or even redistributors like Dot Foods whose products end up down the line in permanent retail establishments." (RP 11)

The trial court also held that Dot Foods did not meet the requirement that a direct seller's representative "sells, or solicits the sale of, consumer products," even though 99.5% of its revenue was based on the sale of consumer products. Dot Foods had

acknowledged that a tiny percentage of its sales were of non-consumer products:

... I cannot agree with Dot Foods that I should treat the small amount of non-consumable products as de minimus when the legislature has used the term "consumer products" even if we find the exclusivity provision in a different paragraph of the exact same statute.

(RP 8)

Finally, the trial court held that the Department properly changed its policy to reverse its interpretation of RCW 82.04.423, notwithstanding the 1997 private letter ruling that specifically qualified Dot Foods for the exemption. (RP 11-12)

Dot Foods timely appealed. (CP 331-38)

## V. ARGUMENT

### A. **Standard Of Review: The Trial Court's Summary Judgment On An Issue Of Statutory Interpretation Is Reviewed De Novo.**

This court reviews the trial court's interpretation of RCW 82.04.423 de novo. See *Agrilink Foods, Inc. v. Department of Revenue*, 153 Wn.2d 392, 396, 103 P.3d 1226 (2005) ("Statutory interpretation is a question of law that is reviewed de novo."). Similarly, because the trial court resolved the dispositive issues regarding Dot Foods' qualification for the direct seller's exemption

on summary judgment, this court reviews the trial court's decision de novo, and gives no deference to the trial court's decision. See *Savlesky v. State*, \_\_\_ Wn. App. \_\_\_, ¶¶ 11, 136 P.3d 152 (2006).

Although a taxpayer has the burden of establishing the eligibility for an exemption, *Stroh Brewery Co. v. Department of Revenue*, 104 Wn. App. 235, 240, 15 P.3d 692, rev. denied, 144 Wn.2d 1002 (2001), this court interprets a statute in accordance with its plain and unambiguous language, and “will glean the legislative intent from the words of the statute itself, regardless of contrary interpretation by an administrative agency.” *Agrilink*, 153 Wn.2d at 396-97 (interpreting RCW 82.04.260 according to its plain language and rejecting Department's “strained” interpretation). As more fully discussed below, § B.2, the Department's revised interpretation of RCW 82.04.423 is entitled to no deference.

**B. Dot Foods Qualifies For The Direct Seller Exemption Under The Second Clause of RCW 82.04.423(2) Because It Sells Through A Direct Seller's Representative Who Does Not Sell Dot Foods' Consumer Products In A Permanent Retail Establishment.**

**1. Dot Foods Qualifies For The B&O Tax Exemption Under The Plain Language Of The Second Clause Of RCW 82.04.423.**

Dot Foods qualifies for the B&O tax exemption under the plain language of RCW 82.04.423 because it sells consumer

products through a “direct seller’s representative” – one who “sells, or solicits the sale of, consumer products in the home or otherwise than in a permanent retail establishment.” RCW 82.04.423(2). The trial court erred in holding that Dot Foods is ineligible for the exemption because its food products are eventually sold to the public at retail. The Legislature has prohibited an out-of-state taxpayer from claiming the exemption if it uses a direct seller’s representative who buys the taxpayer’s products for resale and “any other person” sells the products in a permanent retail establishment. RCW 82.04.423(2). See ***Stroh Brewery v. Department of Revenue***, 104 Wn. App. 235, 15 P.3d 692 (2001). But the Legislature has also specifically authorized the exemption where the direct seller’s representative solicits sales for the taxpayer to non-retail customers, as DTI does in this case, regardless whether those products are eventually sold in a permanent retail establishment.

It is undisputed that Dot Foods satisfies the first three criteria of RCW 82.04.423(1). Dot Foods does not own or lease real property within this state. RCW 82.04.423(1)(a). Dot Foods does not “regularly maintain a stock of tangible personal property in this state for sale in the ordinary course of business.” RCW

82.04.423(1)(b). Further, Dot Foods “[i]s not a corporation incorporated under the laws of this state.” RCW 82.04.423(1)(c).

This case thus turns on whether Dot Foods satisfies the fourth and final criteria of the statutory exemption – whether it “[m]akes sales in this state exclusively to or through a direct seller’s representative.” RCW 82.04.423(1)(d). Dot Foods satisfies this criteria as well, because the Legislature created two alternative and disjunctive definitions of a “direct seller’s representative,” and Dot Foods satisfies the second definition:

For purposes of this section, the term “direct seller’s representative” means a person who buys consumer products on a buy-sell basis or a deposit commission basis for resale, by the buyer or any other person, in the home or otherwise than in a permanent retail establishment **or** who sells, or solicits the sale of, consumer products in the home or otherwise than in a permanent retail establishment.

RCW 82.04.423(2) (emphasis added). Because Dot Foods uses a direct seller’s representative that solicits sales in return for percentage commission compensation, Dot Foods falls squarely within the second clause of RCW 82.04.423(2).

This court construed the first clause of RCW 82.04.423(2) in ***Stroh Brewery v. Department of Revenue***, 104 Wn. App. 235, 15 P.3d 692 (2001), to disqualify a taxpayer’s sales where the

manufacturer's products were purchased by a wholesaler and then resold "by the buyer or any other person . . . otherwise than in a permanent retail establishment." 104 Wn. App. at 240, quoting RCW 82.04.423(2) (emphasis in original). However, that decision did not construe the second clause of RCW 82.04.423(2), as the taxpayer agreed that its claim for an exemption was limited to the first clause of the statute, which it characterized as a "wholesale" direct seller's exemption. 104 Wn. App. at 240.

Here, unlike in ***Stroh Brewery***, Dot Foods does not sell its products to a direct seller's representative for resale. DTI does not buy and resell Dot Foods' products. Thus, the first clause of RCW 82.04.423(2), under which the taxpayer's products cannot be purchased for resale "by the buyer or any other person . . . in a permanent retail establishment," is inapplicable.

In contrast to the first clause of RCW 82.04.423(2), the second clause of that section allows a taxpayer to claim the exemption if its direct seller's representative "sells, or solicits the sale of, consumer products . . . otherwise than in a permanent retail establishment." This second clause does not contain the "by . . . any other person" language found in the first clause, and thus does not forbid an eventual sale in permanent retail establishments.

Dot Foods qualifies for the direct seller's exemption under the plain language of the second clause of RCW 82.04.423(2). Where the "Legislature uses certain statutory language in one instance and different language in another, there is a difference in legislative intent." *Van Dyk v. Department of Revenue*, 41 Wn. App. 71, 77, 702 P.2d 472, *rev. denied*, 104 Wn.2d 1014 (1985), quoting *United Parcel Serv., Inc. v. Department of Revenue*, 102 Wn. 2d 355, 363, 687 P.2d 186 (1984). Had the Legislature intended to require that an out-of-state taxpayer selling its products through a seller's representatives on a commission basis pay B&O tax, it could "have done so by using a number of alternative constructions," including the "or any other person" language that it employed in the first clause of RCW 82.04.423(2). *Agrilink*, 153 Wn.2d at 397.

Moreover, by using the disjunctive between the two clauses, the Legislature necessarily intended a taxpayer's commission sales to qualify for the direct seller's exemption in a separate and distinct manner than in the case of sales to a wholesale purchaser under the first clause of RCW 82.04.423(2). *Agrilink*, 153 Wn.2d at 398 (use of the term "or" requires court to give effect to disjunctive criteria of tax statute).

Here, the trial court adopted the Department's improper reading of RCW 82.04.423(2) by adding the "any other person" language of the first clause to the definition of direct seller's representative that does not appear in the second clause of subsection (2). See *Cerillo v. Esparza*, 158 Wn.2d 194, 201, 142 P.3d 155 (2006) (courts may not "add language to an unambiguous statute even if it believes the Legislature intended something else but did not adequately express it") (citations omitted). The trial court erred in relying on *Stroh Brewery* in this case because the Legislature used different language in the second clause of RCW 82.04.423(2), exempting a taxpayer's sales through a direct seller's representative without regard to whether its products were subsequently sold downstream in permanent retail establishments.

**2. The Department's Revision To WAC 458-20-246 Improperly Limited The Statutory Exemption Under RCW 82.04.423 Beyond Its Plain Language.**

The Department's revised interpretation of RCW 82.04.423 to deny the direct seller's exemption if "consumer products [are] ultimately sold in permanent retail establishments" (CP 100), improperly limits the exemption beyond the plain language of the RCW 82.04.423. In its 2000 revisions to WAC 458-20-246, the

Department reinterpreted clause one of RCW 82.04.423(2) to be limited to wholesale sales and clause two to be limited to retail sales. The Department's interpretation is not supported by the language of the statute nor its legislative history.

To carry the same force and effect as the tax statutes it purports to interpret, "a regulation adopted by the Department must not be inconsistent with those statutes." ***Duncan Crane Service, Inc. v. Department of Revenue***, 44 Wn. App. 684, 688, 723 P.2d 480 (1986). A taxing agency cannot by regulation modify or amend a tax statute. ***Hansen Baking Co. v. City of Seattle***, 48 Wn.2d 737, 742, 296 P.2d 670 (1956); ***Fisher Flouring Mills Co. v. State***, 35 Wn.2d 482, 492, 213 P.2d 938 (1950). See also ***Bird-Johnson Corp. v. Dana Corp.***, 119 Wn.2d 423, 428, 833 P.2d 375 (1992) ("An administrative agency, however, cannot modify or amend a statute by regulation."). The Department's administrative authority is narrowly proscribed by statutory language and, only where that language is ambiguous, by the intent of the Legislature. See ***Agrilink***, 153 Wn.2d at 396-97.

This court should give no deference to the Department's revised interpretation of RCW 82.04.423 for two reasons. First, the statute is unambiguous and makes no reference to wholesale vs.

retail direct seller's representatives. See *Edelman v. State ex. rel. Public Disclosure Comm'n*, 152 Wn.2d 584, 590, 99 P.3d 386 (2004) (court will not defer to an agency's rule where no ambiguity exists in the statute). To the extent that the Department's 2000 revision to WAC 458-20-246 was merely an "interpretive rule,"<sup>3</sup> as the Department stated in its Notice of Proposed Rulemaking, WSR 99-17-029,<sup>4</sup> the Department's new interpretation is "not binding on the courts and [is] afforded no deference other than the power of persuasion." *Association of Washington Business v.*

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<sup>3</sup> An "interpretive rule" is defined under RCW 34.05.328(5)(c)(ii) as "a rule, the violation of which does not subject a person to a penalty or sanction, that sets forth agency's interpretation of statutory provisions it administers." Such an interpretive rule is distinct from a "significant legislative rule" under RCW 34.05.328(5)(c)(iii), which "subjects a violator of such rule to a penalty or sanction," or which "adopts a new, or makes significant amendments to, a policy or regulatory program." RCW 34.05.328(5)(c)(iii)(A), (C).

As discussed at Section D, *infra*, the new version of WAC 458-20-246 is an invalid "significant legislative rule" because it is being relied upon in assessing new taxes and the Department failed to comply with the more stringent notice and other rulemaking requirements under the APA. See RCW 34.05.328(1)-(4).

<sup>4</sup> The Department represented that "[t]he purpose of the rule is to provide guidance to taxpayers regarding the requirements of the statute [RCW 82.04.423]. The rule reiterates the express requirements of the statute . . ." WSR 99-17-029.

**Department of Revenue**, 155 Wn.2d 430, 447, 120 P.3d 46 (2005).

Second, the Department has failed to articulate any changed circumstances or other substantive basis for its radical departure from its longstanding interpretation of the plain language of the statute. See **Dimension Financial Corp. v. Board of Governors of Federal Reserve System**, 744 F.2d 1402, 1409-10 (10<sup>th</sup> Cir. 1984) (agency must “articulate[] facts . . . show[ing] a purpose for the change” where it radically changes its position on statutory construction.); **Motor Vehicle Ass’n of United States, Inc. v. State Farm Mut. Automobile Ins. Co.**, 463 U.S. 29, 43, 103 S. Ct. 2856, 2867, 77 L.Ed.2d 443 (1983). (“We may not supply a reasoned basis for the agency's action that the agency itself has not given.”). The agency has the burden of justifying a departure from longstanding policy, in contrast to the deference that a reviewing court may give an agency’s interpretation of a newly enacted statute that falls within its area of particular expertise. Compare **Kiblen v. Pickle**, 33 Wn. App. 387, 393, 653 P.2d 1338 (1982) (agency entitled to deference in its interpretation of statute, “especially when a statute is in its initial stage of interpretation and its provisions are yet untried and new.”). The APA specifically

imposes upon the Department the burden of justifying “a significant amendment to a policy” by engaging in a cost-benefit analysis, considering “the least burdensome alternative for those required to comply with” the rule, and requiring a plan to “inform and educate affected persons about the rule.” RCW 34.05.328(1)(d), (e), (3)(b) and (5)(c)(iii)(C). (See § D, *infra*)

Here, the Legislature did not use the terms “wholesale” and “retail” in establishing the two alternative means of qualifying as a “direct seller’s representative” under RCW 82.04.423(2). Instead, the Legislature repeatedly authorized the exemption for sales “to or through” a direct seller’s representative, both in the heading of RCW 82.04.423 (“Exemptions – Sales by certain out-of-state persons to or through direct seller’s representatives.”), and in the first subsection of the statute. RCW 82.04.423(1)(d) (requiring the taxpayer to “make sales . . . exclusively to or through a direct seller’s representatives.”). Similarly, in definitional subsection (2), the legislature exempted sales to a direct seller’s representative in the first clause (“a person who buys consumer products”), and through a direct seller’s representative in the second clause (one who “sells, or solicits the sale of, consumer products”). RCW 82.04.423(2). The plain and unambiguous statutory language

distinguishes between sales “to” and “through” a direct seller’s representative but makes no distinction between wholesale and retail sales.

Even if this statutory language were somehow ambiguous, the legislative intent does not support the “wholesale vs. retail” distinction adopted by the Department in its 2000 revisions to WAC 458-20-246. The Department itself continues to describe the legislative purpose of RCW 82.04.423, “to stimulate trade and encourage out-of-state manufacturers to use Washington-based agents,” and the primary beneficiaries as “out-of-state manufacturers that conduct business in Washington through independent sales representatives.” *Tax Exemptions 2004* at 96. (CP 268) See also 1B *Wash. Practice* § 72.32 (noting that Legislature has elected to “treat out-of-state businesses more favorably than in-state businesses,” although the federal constitution does not require it to do so.)

The Department’s original interpretation of RCW 82.04.423 reflected the Legislature’s statutory language, making no mention of a “wholesale” vs. “retail” distinction. In initially promulgating WAC 458-20-246, the Department clarified that its rule was “necessary to distinguish between out-of-state sellers’ exempt sales

exclusively to or through direct seller's representatives and other out-of-state sellers' taxable sales made through other local activities (nexus) in this state." (CP 270)

That the Department has determined that the federal constitution may grant it more authority to tax out-of-state sales than the Legislature has authorized in enacting RCW 82.04.423 is not a valid basis for thwarting the plain language of the statute. The Department's revised interpretation of the direct seller's exemption ignores both the statute's plain language and the Legislature's intent. This court should reverse the trial court's summary judgment and direct entry of judgment in favor of Dot Foods for a refund of its B&O taxes.

**C. Dot Foods Is Not Barred From Claiming The Exemption Where Consumer Products Comprise 99.5% Of its Direct Seller's Representative Sales.**

The trial court also misinterpreted RCW 82.04.423 in holding that Dot Foods does not qualify for the statutory direct seller's exemption because it does not "exclusively" sell consumer products through a direct seller's representative. (RP 9) RCW 82.04.423 does not use the term "exclusively" to limit the type of products a direct seller's representative may sell. The statute's exclusivity

requirement relates only to the method of selling within the state of Washington, not to the type of product sold.

RCW 82.04.423(1) establishes the scope of the statutory exemption by addressing the method of selling products in Washington – to or through a direct seller’s representative. The statute applies to “any person . . . making sales at wholesale or retail . . .” RCW 82.04.423(1). Subsection (1) does not refer to consumer products at all. The only exclusivity requirement is contained in RCW 82.04.423(1)(d), which states that the B&O tax does not apply “to any person . . . if such person . . . (d) Makes sales in this state exclusively to or through a direct seller’s representative.”

The only reference to “consumer products” is in RCW 82.04.423(2), which defines a “direct seller’s representative” as one who either “buys consumer products for resale . . .” or one who “sells or solicits the sale of consumer products in the home or otherwise than in a permanent retail establishment . . . .” Subsection (2) contains no exclusivity requirement and does not require that the direct seller’s representative sell *only* consumer products. Similarly, the Department’s revised rule interpreting subsection (2) contains no exclusivity requirement. WAC 458-20-

246(4)(b)(ii) (a direct seller's representative "must be selling a consumer product.").

The Department's administrative interpretation of the statute also continues to recognize that the exclusivity provision relates to the "means" by which sales are made, rather than to the type of sales. WAC 458-20-246(4)(a)(iv) provides that a taxpayer "may not claim any B&O tax exemption under RCW 82.04.423 if it has made sales in this state using means other than a direct seller's representative." See Former WAC 458-20-246 ("If an out-of-state seller . . . also has a branch office, local outlet, or other local place of business, or is represented by any other employee, agent, or other representative, no portion of the sales are exempt . . .") Dot Foods meets the requirement of RCW 82.04.430(1)(d) because all of its sales are *exclusively through* a direct seller's representative.

The fact that Dot Foods may occasionally sell a non-consumer product does not disqualify it from the direct seller's exemption for consumer products. In *Agrilink Foods*, the Court held that a taxpayer was entitled to a lower tax rate for products that fell within the lower statutory rate despite the fact that it manufactured other products that fell within the definition of a higher statutory rate. 153 Wn.2d at 397-98. The Supreme Court

has similarly held that a taxpayer's sale of other products that do not qualify for an exemption does not disqualify the taxpayer from claiming the exemption with respect to the products that do qualify for the exemption. See *Lone Star Industries, Inc. v. Department of Revenue*, 97 Wn.2d 630, 647 P.2d 1013 (1982).

Here, the Department has conceded that the vast majority of Dot Food's sales are consumer products. (CP 169) Indeed, it is undisputed that of the 60,000 products carried by Dot Foods, over 99% are "consumer products," comprising over 99.5% of Dot Foods' gross revenue. (CP 306-07)

The trial court erred in adding exclusivity to the requirement that a direct seller's representative sell consumer products. Dot Foods sells its food products exclusively through DTI in the state of Washington, and DTI solicits the sale of consumer products for Dot Foods. This is all the statute requires.

**D. The Department Failed To Provide Adequate Notice To Dot Foods And Other Affected Persons When It Purported To Make A Significant Change To Its Longstanding Interpretation Of The Direct Seller's Exemption.**

When an agency makes a significant change to longstanding policy it is required not only to clearly articulate the reasons justifying a radical shift in its interpretation of legislation, but also to

give affected persons clear notice of its intent to do so. The Department's form notice mailed to Dot Foods did not announce the new regulation as a change in policy, let alone a radical change that would defeat Dot Foods' reasonable reliance on the Department's longstanding interpretation of the direct seller's exemption, most recently and clearly articulated in the Department's 1997 private letter ruling.

The Department is subject to the requirements of RCW 34.05.328 when it adopts a "significant legislative rule," defined as a rule that adopts "substantive provisions of law . . . the violation of which subjects a violator of such rule to a penalty or sanction," or one that "makes significant amendments to a policy or regulatory program." RCW 34.05.328(5)(c)(iii). See RCW 34.05.328(5)(a)(1) (RCW 34.05.328 applies to "significant legislative rules of the department[] of . . . revenue . . ."). As discussed above, to the extent the Department characterized its 2000 revision of WAC 458-20-346 as an "interpretive rule," it is not entitled to any deference whatsoever, because the Department's revised interpretation conflicts with the statutory mandate. See § B.2, *supra*.

Moreover, the 2000 reinterpretation of the direct seller's exemption cannot be characterized as merely interpretive, both

because it constituted a “significant amendment to . . . policy” and because the Department has treated its new rule as subjecting taxpayers to “a penalty or sanction” for its violation. RCW 34.05.328(5)(c)(iii). In its audit of Dot Foods, the Department stated that its new regulation was a significant legislative rule, asserting that its revised rule “has the same effect as [the] Revenue Act itself (RCW 82.32.300).” (CP 78)<sup>5</sup>

Adopted as part of the Regulatory Reform Act of 1995, RCW 34.05.328 imposes additional notice and comment requirements upon the Department when it adopts a significant legislative rule. RCW 34.05.328(5)(a)(i). The Department disavowed the requirements of RCW 34.05.328 in its notice of proposed rulemaking, stating that it was simply “interpreting” the statute. WSR 99-17-029. (“RCW 34.05.328 does not apply to this rule adoption” because revisions were merely “interpretive.”) See RCW 34.05.320(1)(k) (requiring agency to state “whether RCW 34.05.328 applies to the rule adoption.”). Thus, the Department did not

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<sup>5</sup> RCW 82.32.300 gives the Department authority to “make and publish rules and regulations . . . necessary to enforce” the Revenue Act, “which shall have the same force and effect as if specifically included therein, unless declared by the judgment of a court of record not appealed from.” See *AWB v. Department of Revenue*, 155 Wn.2d at 438-39.

comply with the additional notice required by the Regulatory Reform Act, including most significantly the requirement that in adopting a significant change of past policy, the agency take steps to “inform and educate affected persons about the rule” and “promote and assist voluntary compliance.” RCW 34.05.328(3)(b), (c).

The Department’s failure to give specific notice of its intent to modify its longstanding policy was just one aspect of its failure to comply with the procedural requirements of the APA.<sup>6</sup> Neither its Notice of Proposed Rulemaking, nor its “special notice,” plainly informed affected persons of the Department’s significant policy shift. The Department’s “special notice” stated that “the purpose of the revision is to provide guidance to taxpayers regarding the requirements of the statute” and that the “revised rule is intended to implement RCW 82.04.423 in a comprehensive way, consistent with the terms of the statute.” (CP 73) Although the special notice stated that the direct seller’s exemption is not available to the direct

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<sup>6</sup> The Department similarly failed to engage in the required cost-benefit analysis, or determine whether its proposed rule was “the least burdensome alternative for those required to comply with it that will achieve the general goals and specific objectives” of RCW 82.04.423. RCW 34.05.328(1)(d),(e).

seller “if a consumer product is sold by **anyone** in a permanent retail establishment” (CP 73), the first clause of RCW 82.04.423(2) has always said that with respect to resales by direct seller’s representatives. Nothing in the special notice alerted Dot Foods (or any other taxpayer who received such form notice) to the fact that the Department was reinterpreting the second clause of RCW 82.04.423(2) to rescind the interpretation specifically given to Dot Foods under its private letter ruling that authorized the direct seller exemption where the “remuneration paid to the direct seller . . . will be based on a percentage of net sales of products, i.e., a commission.” (CP 68)

The Department’s newly minted interpretation of RCW 82.04.423 in the 2000 version of WAC 458-20-346 is invalid because it was “adopted without compliance to statutory rule-making procedures.” RCW 34.04.570(2)(c). See ***Simpson Tacoma Kraft Co. v. Department of Ecology***, 119 Wn. 2d 640, 648-49, 835 P.2d 1030 (1992); ***Gasper v. Department of Social and Health Services***, 132 Wn. App. 42, 51, 129 P.3d 849 (2006) (invalidating rules not adopted in compliance with APA). Where the Department has not complied with the requirements of notice or otherwise violated statutorily mandated rulemaking provisions, it is

barred from retroactively assessing taxes. See *Hansen Baking Co.*, 48 Wn.2d at 743-44 (agency may not retroactively assess taxes or impeach its own rules “because of asserted errors of fact, judgment, or discretion on its own part.”); *Group Health Co-op of Puget Sound, Inc. v. Washington State Tax Comm’n*, 72 Wn.2d 422, 428-29, 433 P.2d 201 (1967) (tax commission may not retroactively assess taxes for period prior to amendment of governing statute); *Washington Independent Telephone Ass’n v. Telecommunications Ratepayers Ass’n*, 75 Wn. App. 356, 880 P.2d 50 (1994) (voiding charges imposed pursuant to invalid rule); *Duncan Crane Service, Inc. v. Department of Revenue*, 44 Wn. App. 684, 723 P.2d 480 (1986) (ordering refund of excise taxes paid under tax regulation that exceeded Department’s authority).

Because the Department’s notice failed to meet the requirements of the APA, Dot Foods may continue to rely on the Department’s previous interpretation of RCW 82.04.423. Moreover, Dot Foods is entitled to a refund of all taxes assessed by the Department after January 1, 2000, including the \$707,848 paid after the Department’s audit (CP 76), and all subsequent taxes assessed by the Department and paid by Dot Foods. (See CP 13-

19) This court should reverse the trial court's decision and direct entry of judgment in favor of Dot Foods.

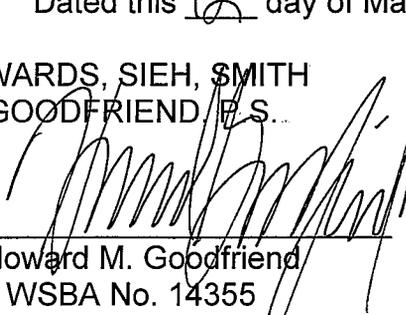
**VI. CONCLUSION**

The Department's revised interpretation of RCW 82.04.423 is both substantively and procedurally flawed. Because Dot Foods continues to be eligible for the direct seller's exemption from B&O tax, this court should reverse and direct entry of judgment in favor of Dot Foods.

Dated this 12<sup>th</sup> day of March, 2007.

EDWARDS, SIEH, SMITH  
& GOODFRIEND, P.S.

KARR TUTTLE CAMPELL

By: 

By: 

Howard M. Goodfriend  
WSBA No. 14355

Jacquelyn A. Beatty  
WSBA No. 17567

Attorneys for Appellant

**DECLARATION OF SERVICE**

The undersigned declares under penalty of perjury, under the laws of the State of Washington, that the following is true and correct:

That on March 12, 2007, I arranged for service of the foregoing *Brief of Appellant* to the court and the parties to this action as follows:

Office of Clerk Court of Appeals - Division II 950 Broadway, Suite 300 Tacoma, WA 98402	<input type="checkbox"/> Facsimile <input type="checkbox"/> Messenger <input checked="" type="checkbox"/> U.S. Mail <input type="checkbox"/> Overnight Mail
Jacquelyn A. Beatty Karr Tuttle Campbell 1201 3rd Ave., Suite 2900 Seattle, WA 98101-3284	<input type="checkbox"/> Facsimile <input type="checkbox"/> Messenger <input checked="" type="checkbox"/> U.S. Mail <input type="checkbox"/> Overnight Mail
Cameron G. Comfort Office of the Attorney General Revenue Division 7141 Cleanwater Dr. SW PO Box 40123 Olympia, WA 98504-0123	<input type="checkbox"/> Facsimile <input type="checkbox"/> Messenger <input checked="" type="checkbox"/> U.S. Mail <input type="checkbox"/> Overnight Mail

**DATED** at Seattle, Washington this 12<sup>th</sup> day of March, 2007.

*Tara M. Holland*  
Tara M. Holland

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 Hearing is Set:  
 Date:  
 Time:  
 Judge Richard D. Hicks/Civil

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 BETTY J. GOULD  
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 KARR TUTTLE CAMPBELL

DEC 26 2006

By D 10:00

**STATE OF WASHINGTON  
 THURSTON COUNTY SUPERIOR COURT**

DOT FOODS, INC.,  
  
 Plaintiff,  
  
 v.  
 DEPARTMENT OF REVENUE,  
 STATE OF WASHINGTON,  
  
 Defendant.

NO. 05-2-00990-7

**ORDER GRANTING SUMMARY  
 JUDGMENT TO DEFENDANT  
 DEPARTMENT OF REVENUE  
 AND DENYING PLAINTIFF DOT  
 FOODS, INC.'S MOTION FOR  
 SUMMARY JUDGMENT**

This matter came on for hearing before the Court on December 6, 2006, upon Plaintiff Dot Foods, Inc.'s Motion for Summary Judgment. Dot Foods's motion sought the benefit of the direct sellers exemption, RCW 82.04.423. Defendant Department of Revenue responded that Dot Foods was not entitled to the direct sellers exemption and asked the Court to grant summary judgment to it as the nonmoving party.

Jacquelyn A. Beatty of Karr Tuttle Campbell and Donald R. Tracy of Brown, Hay & Stephens, LLP represent Dot Foods, Inc. Cameron G. Comfort,

1 Sr. Assistant Attorney General, represents the Department of Revenue. The  
2 Court considered the arguments of counsel and the record, including the  
3 following pleadings, papers, and evidence called to its attention:

4 1. Amended Appeal for Refund of B&O Taxes Exempt Under RCW  
5 82.04.423, filed September 1, 2006 (Docket # 23).

6 2. Plaintiff's Motion for Summary Judgment, filed November 2, 2006  
7 (Docket # 25).

8 3. Plaintiff's Opening Brief in Support of Its Motion for Summary  
9 Judgment, filed November 2, 2006, including attached Exhibits A-E (Docket #  
10 26).

11 4. Parties' Stipulation of Agreed Facts, filed November 20, 2006,  
12 including Attached Exhibits A-E (Docket # 30).

13 5. Declaration of Gary J. Davis, filed November 20, 2006, including  
14 attached Exhibit T (Docket # 31).

15 6. Declaration of Cameron G. Comfort, filed November 20, 2006,  
16 including attached Exhibits F-S (Docket # 32).

17 7. Defendant Department of Revenue's Memorandum in Support of  
18 Summary Judgment, filed November 20, 2006, including attachments 1-4  
19 (Docket # 33).

20 8. Plaintiff's Reply in Support of Its Motion for Summary Judgment,  
21 filed December 1, 2006, including attached Appendices 1-12 (Docket # 40).

22

1 9. Declaration of William S. Clemens, Jr., filed December 1 and  
2 December 7, 2006, with attached Exhibit A (Docket # 41, and Docket # 47).

3 10. Affidavit of Scott Schaeffer, filed December 1, 2006, including  
4 attached Exhibit A (Docket # 42).

5 11. Supplement to Record, filed December 6, 2006 (Docket # 46).

6 Based on the arguments of counsel and the pleadings and evidence  
7 presented, the Court rendered an oral ruling on December 6, 2006, denying Dot  
8 Foods's Motion for Summary Judgment and granting summary judgment to the  
9 Department of Revenue. Now, hereby, it is CONCLUDED:

10 (a) No genuine issues of material fact exist;

11 (b) Dot Foods does not qualify for the direct sellers exemption provided  
12 by RCW 82.04.423; and

13 (c) There being no genuine issues of material fact, the Department of  
14 Revenue is entitled to summary judgment as a matter of law.

15 Based on these conclusions, the Court hereby ORDERS:

16 1. Plaintiff Dot Foods, Inc.'s Motion for Summary Judgment is  
17 DENIED.

18 2. Summary judgment is GRANTED to defendant Department of  
19 Revenue;

20 3. Plaintiff's Amended Appeal for Refund of B&O Taxes Exempt  
21 Under RCW 82.04.423 is DISMISSED WITH PREJUDICE.

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4. Defendant Department of Revenue is awarded statutory attorneys' fee in the amount of \$200.00.

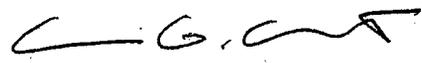
DATED this 22<sup>nd</sup> day of December, 2006.

RICHARD D. HICKS

JUDGE RICHARD D. HICKS

Presented by:

ROB MCKENNA  
Attorney General



CAMERON G. COMFORT, WSBA # 15188  
Sr. Assistant Attorney General  
Attorneys for Defendant Department of Revenue

Approved as to Form; Notice of Presentation Waived:

KARR TUTTLE CAMPBELL



JACQUELYN A. BEATTY, WSBA #17567  
Attorney for Plaintiff Dot Foods, Inc.