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SUPREME COURT OF THE STATE OF WASHINGTON

STEVEN KLEIN, INC., d/b/a KLEIN HONDA,

Petitioner,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

DEPARTMENT OF REVENUE'S SUPPLEMENTAL BRIEF

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I. INTRODUCTION

The Legislature's intent with the business and occupation (B&O) tax is to impose the tax "upon virtually all business activities carried on within the state." *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn.2d 139, 149, 3 P.3d 741, (2000) (quoting *Time Oil Co. v. State*, 79 Wn.2d 143, 146, 483 P.2d 628 (1971)). All receipts from engaging in business activities in Washington are taxable, in the absence of an applicable statutory exemption or deduction.

The question in this case is whether Klein Honda owes B&O tax on "dealer cash" payments it receives from automobile manufacturer American Honda. This is a question of statutory interpretation and involves an inquiry into the Legislature's intent. The answer is revealed in the plain meaning of the overall B&O tax statutory scheme, including the taxing statute, related definitions, and the rate structure.

Because Klein Honda earned dealer cash in the course of its business operations as an automobile dealer, those receipts are subject to tax. The Board of Tax Appeals and the courts below correctly upheld the assessments of B&O tax on Klein Honda's dealer cash income during the tax period. The measure and rate of the B&O tax varies by the nature of the business activity, and all of these decisions hold that the dealer cash income is properly taxable under the catchall "service & other" classification under RCW 82.04.290(2).

Under Klein Honda's interpretation, and that of the dissenting Court of Appeals judge, the catchall "service & other" classification does

not catch all, but only some, of the remaining sources of business income when the specific classifications are inapplicable. Klein Honda effectively asks this Court to conclude the Legislature intended to create a gap in the B&O tax scheme, exempting income earned from one party that is conditioned upon the taxpayer's successful transaction with another party. This Court should reject Klein Honda's interpretation, as the tribunals below did, because it is without support in the statutory language and contrary to legislative intent as set forth in the B&O tax scheme.

II. STATEMENT OF THE ISSUE

Under the applicable B&O tax statutes, are the dealer cash incentive payments Klein Honda receives from American Honda subject to B&O tax where Klein Honda receives the payments as part of its dealership business?

III. STATEMENT OF THE CASE

A. Klein Honda's Automobile Dealership

Steve Klein, Inc., d/b/a Klein Honda, operates an automobile dealership in Everett, Washington. Klein Honda sells new and used Honda vehicles, parts and accessories, and provides maintenance and repair services. VTP 31. Klein Honda is an independent franchisee of American Honda Motor Co., Inc.

When Klein Honda purchases a vehicle at wholesale, American Honda generates a vehicle invoice and a manufacturer's certificate of origin, documenting transfer of each new vehicle Klein Honda purchases, just before the factory ships the vehicle. AR 108. Klein Honda then sells

the Honda vehicles to its customers. The retail sales price is a matter entirely left to the discretion of the dealer, although American Honda does provide a manufacturer's suggested retail price. AR 330, ¶ 17.6. Klein Honda pays B&O tax on the gross income received from the customer at the retailing rate and collects retail sales tax from the transaction. AR 23.

B. Dealer Cash Payments

American Honda created what it calls "incentive programs," including "dealer cash" programs. Under a dealer cash program, a dealer is entitled to receive a specified amount of cash for each sale it makes of a particular Honda model to a retail customer during a specified time period. AR 99-101, VTP 61-62.

To announce a dealer cash program, American Honda issues "marketing bulletins" through its electronic network to authorized individuals at dealerships. AR 723-64. For example, a marketing bulletin from 2003 offered \$1,000 in dealer cash to Honda dealers for each sale of a 2003 Honda Insight model during April through June 2003. AR 723. According to the marketing bulletins, the dealer cash programs are designed to stimulate sales of the identified models. AR 723, 727.

The marketing bulletins also provide substantial detail about which vehicles and vehicle sales qualify the dealer for the incentive payment, and what records dealers must keep and actions they must take to receive the incentive payment. For instance, dealers must conduct a self-audit at the end of each dealer cash incentive program and verify by signed affidavit

that all listed vehicle sales meet the eligibility requirements for the award. AR 724, 728, 735, 741, 747, 752, 757, 762; AR 100-01.

Klein Honda's general manager, Tom Hunt, described the marketing bulletin as a "conditional offer," agreeing that marketing bulletins contain all the requirements that dealers must fulfill to receive the dealer cash. AR 152; VTP 61-62. According to Mr. Hunt, dealer cash is a way for American Honda to put more momentum behind a particular vehicle model when, for instance, a competitor is offering customer rebates. VTP 50. The money is paid to dealers for the purpose of increasing the sales of a particular vehicle model. Similarly, Klein Honda's accounting expert recognized that dealer cash can help the dealer move the inventory by allowing the dealer to sell the vehicle for a price lower than it otherwise might have. AR 119-20. Owner Steve Klein confirmed that compensation received under dealer cash incentive programs was "after the fact" of Klein Honda's purchase of vehicles from American Honda. AR 109.

American Honda compensates dealers for making sales qualified for dealer cash by issuing a credit to the dealer's monthly balance forward statement. AR 724, 728, 731, 737, 744, 749, 755, 760, AR 103-05; AR 136-38; AR 777-78. The balance forward statement is a list of charges (e.g., purchased promotional materials, parts, and fees) and payments (e.g., holdbacks, sales awards, warranty service payments, and dealer cash) between Klein Honda and American Honda. AR 103, 133, 136-38. If the balance on the statement at the end of the month is positive,

American Honda pays the dealership. AR 104. Klein Honda included dealer cash amounts in its federal tax returns, line 1a, "Gross receipts or sales." AR 287; *see, e.g.*, AR 643.

C. Procedural History

In October 2007, the Department assessed Klein Honda \$16,963 in B&O taxes and interest on dealer cash credits Klein Honda received during the audit period, January 1, 2003, through December 31, 2006: AR 790-96. During that period, Klein Honda had received \$1,037,450 in dealer cash from American Honda. AR 795. Klein Honda paid the assessment and petitioned the Department's Appeals Division for a refund. AR 4, 7, 780-81. Klein Honda argued that dealer cash represented a discount or reduction in Klein Honda's cost of purchasing the vehicles from American Honda, rather than income subject to B&O tax. AR 784-788. The Appeals Division upheld the assessment. AR 7, 780-789.

Klein Honda appealed to the Board of Tax Appeals, which affirmed the assessment. CP 92-101. The Board reasoned that dealer cash was an additional source of taxable gross income to Klein Honda and was not properly treated as a reduction in the wholesale price Klein Honda paid when it purchased vehicles from American Honda. CP 98-101.

Klein Honda sought judicial review of the Board's decision. CP 4-6, 81. Thurston County Superior Court Judge Christine Schaller affirmed the Board of Tax Appeals decision. CP 84-85. Klein Honda timely appealed the final order to Court of Appeals, Division Two, which subsequently transferred the case to Division One. CP 86.

On appeal, Klein Honda argued there is no separate business activity from selling the vehicle or that dealer cash is a bona fide discount on the wholesale price. The Court of Appeals disagreed, holding dealer cash was received in the course of doing business and did not reflect a discount on the wholesale price. *Steven Klein, Inc. v. Dep't of Revenue*, 184 Wn. App. 344, 352-55, 336 P.3d 663 (2014). Further, the Court held earning dealer cash was a discrete business activity beyond the mere retail sale of a vehicle. *Id.* at 353. Accordingly, the income was properly taxable under the catchall classification for business activities not otherwise identified explicitly in another section. *Id.* Judge Mary Kay Becker dissented, expressing the view that to earn dealer cash, Klein Honda did not engage in a business activity other than selling cars at retail. *Id.* at 359 (Becker, J., dissenting in part). This Court granted Klein Honda's petition for review on April 2, 2015.

IV. ARGUMENT

The Board of Tax Appeals correctly held that Klein Honda owes B&O tax on its dealer cash income, and the Superior Court and Court of Appeals correctly affirmed that decision. The Board and the courts below also correctly rejected Klein Honda's argument that dealer cash represents a reduction in the wholesale selling price of vehicles from American Honda to Klein Honda, in the form of "cash back" or a "rebate." The Board found dealer cash to be unrelated to wholesale vehicle purchases and not a discount off the wholesale price that Klein Honda receives

merely for purchasing those vehicles. *See* AR 24-27. This Court should affirm the Board's decision.

Courts review decisions of the Board under the Administrative Procedure Act (APA), RCW 34.05. RCW 82.03.180. The burden of demonstrating the invalidity of the Board's action is on Klein Honda. RCW 34.05.570(1)(a); *Olympic Tug & Barge, Inc. v. Dep't of Revenue*, 163 Wn. App. 298, 306, 259 P.3d 338 (2011), *review denied*, 173 Wn.2d 1021 (2012); *see also Ford Motor Co. v. City of Seattle*, 160 Wn.2d 32, 41, 156 P.3d 185 (2007) (taxpayer has burden to show a B&O tax assessment is incorrect).

Klein Honda claims the Board committed legal error in holding that Klein Honda owed B&O tax on dealer cash payments it received from American Honda. CP 6. A court may grant relief from an agency order when the agency has "erroneously interpreted or applied the law." RCW 34.05.570(3)(d). The Board's interpretations of statutes and other legal conclusions are reviewed de novo.¹ *Olympic Tug & Barge, Inc. v. Dep't of Revenue*, 163 Wn. App. 298, 306, 259 P.3d 338 (2011), *review denied*, 173 Wn.2d 1021 (2012); *see also Campbell v. Dep't of Social & Health Servs.*, 150 Wn.2d 881, 894 n.4, 83 P.3d 999 (2004) (If a statute's meaning is plain, then the court must give effect to the plain meaning as expressing

¹ The Board's findings of fact are reviewed under a substantial evidence standard. RCW 34.05.570(3)(e). Because Klein Honda did not challenge any of the Board's findings of fact, they are verities on appeal. CP 6; *see Stuewe v. Dep't of Revenue*, 98 Wn. App. 947, 950, 991 P.2d 634 (2000).

what the legislature intended). Neither party in this case argues that any applicable statute is ambiguous.

Because the Board's decision was correct, Klein Honda cannot demonstrate any error of law.

A. Under The B&O Tax Scheme, The Tax Applies To Income From All Business Activities, Including Earning Dealer Cash.

Washington's B&O tax is imposed "for the act or privilege of engaging in business activities" in Washington. RCW 82.04.220. "Business" includes "*all* activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly." RCW 82.04.140 (emphasis added). The B&O tax rate varies by the nature of the business activity. *See* RCW 82.04.220(1) ("The tax is measured by the application of rates against the value of products, gross proceeds of sales, or gross income of the business, as the case may be"); *Time Oil*, 79 Wn.2d at 146 (the statute classifies various business activities "for purposes of applying and measuring the tax").

Unlike the federal income tax, the B&O tax is not a tax on profit, net gain, capital gain, or sales "but a tax on the total money or money's worth received in the course of doing business." *Budget Rent-A-Car of Wash.-Oregon v. Dep't of Revenue*, 81 Wn.2d 171, 173, 500 P.2d 764 (1972). The B&O tax provisions "leave practically no business and commerce free of the business and occupation tax." *Id.*, 81 Wn.2d at 175.

During the tax period, Klein Honda was "engaging in the business" of conducting a Honda automobile dealership. Its "business" included all

those activities with the object of gain, benefit or advantage, for either itself or third parties. The dealer cash programs benefited both Klein Honda and American Honda. AR 285, 727; VTP 50. Accordingly, the Court of Appeals properly held Klein Honda was subject to the B&O tax by engaging in business activities and that dealer cash was “connected to a business activity.” *Steven Klein*, 184 Wn. App. at 353-54; *see Ford Motor Co.*, 160 Wn.2d at 39-40 (noting that the taxable incident of a B&O tax is the “general privilege of engaging in business”).

1. The catchall classification in RCW 82.04.290(2) provides the measure and rate of tax applicable to Klein Honda’s income from dealer cash.

If the B&O tax had only a single rate applied to the gross receipts of a taxable business, there would be nothing left to discuss. However, the Legislature chose to identify certain specific business activities and assign rates accordingly. *See, e.g.*, RCW 82.04.240 (manufacturing), RCW 82.04.250 (retailing), RCW 82.04.286 (conducting horse races), RCW 82.04.2905 (providing day care). If a taxpayer’s business activities do not fall within one of the specific classifications, the applicable rate is found in the “general” or “catchall” classification in RCW 82.04.290(2). *Bowie v. Dep’t of Revenue*, 171 Wn.2d 1, 5-6, 248 P.3d 504 (2011). This classification imposes a tax rate of 1.5 percent on the gross income of the business of “*any business activity other than or in addition to an activity taxed explicitly*” under another section. RCW 82.04.290(2)(a) (emphasis

supplied).² This catchall classification includes, without limitation, “persons engaged in the business of rendering any type of service which does not constitute a ‘sale at retail’ or a ‘sale at wholesale.’” RCW 82.04.290(2)(b). The classification is commonly referred to as the “service & other” classification.

Likewise, the privilege of earning dealer cash is an unspecified business activity that is “other than or in addition to” an explicitly taxed activity. It does not fall within any of the tax classifications addressed to specific business activities. Thus, the privilege of earning dealer cash is taxable under the catchall rate in RCW 82.04.290(2).

2. Dealer cash is subject to the rate in RCW 82.04.290(2) regardless of whether Klein Honda provides a service to American Honda to earn it.

When this litigation started in the Board of Tax Appeals, Klein Honda argued that dealer cash was not taxable because Klein provided no service to American Honda in order to receive it. *See* AR 166-170. Klein Honda complains to this Court that the Board and the Court of Appeals

² The measure of the tax, “gross income of the business,” is broadly defined as:

[T]he *value proceeding or accruing by reason of the transaction of the business engaged in* and includes gross proceeds of sales, compensation for the rendition of services, . . . interest, discount, rents, royalties, fees, commissions, dividends, *and other emoluments however designated*, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

RCW 82.04.080(1) (emphasis added). Likewise, RCW 82.04.090 defines “value proceeding or accruing” in pertinent part as “the consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued.”

“substantially changed the thrust of the case by holding that no services were actually necessary.” Petition for Review at 12, n.3; *see* AR 14-15, *Steven Klein*, 184 Wn. App. at 352-53 (dealer cash need not represent compensation for services to be taxable under RCW 82.04.290(2)).

Rather than changing the thrust of the case, the Board and the Court of Appeals recognized that Klein Honda was confusing a sufficient condition with a necessary condition in applying RCW 82.04.290(2). Receiving compensation for providing a service not otherwise covered by other B&O classifications is sufficient to apply the service & other rate in RCW 82.04.290(2). However, the service & other classification applies to “*any*” business activity “other than or in addition to” activities taxed under other classifications. RCW 82.04.290(2)(a) (emphasis added). It is not necessary that a service be provided.

Many businesses that fall under the service & other classification do, in fact, provide services. *See, e.g., Simpson Investment*, 141 Wn.2d at 143-46 (taxpayer received taxable income, subject to the service & other B&O tax classification, from providing cash management and other administrative services to its timber industry subsidiaries); *Activate, Inc. v. Dep't of Revenue*, 150 Wn. App. 807, 209 P.3d 524 (2009) (a sales agent for a wireless service provider received commission income subject to the service & other B&O tax classification).

Businesses also can earn income subject to the service & other classification without providing a service in exchange for that income. For instance, when banks invest their own funds, the interest they receive

on those investments is subject to B&O tax under the service & other classification, unless the investment qualifies for a specific statutory deduction. WAC 458-20-146 (taxation of financial institutions); *see* RCW 82.04.4292 (allowing deduction for interest received on certain mortgage-related investments). This business activity of earning income on investments, which does not involve providing services, is an activity “other than or in addition to” activities explicitly taxed in other sections. Hence, it is taxable as provided in RCW 82.04.290(2)(a).

The Board and the Court of Appeals correctly gave effect to all the applicable language in RCW 82.04.290(2) .

3. Whether considered a service or not, earning dealer cash is a business activity “other than or in addition to” Klein Honda’s retail sales of cars to customers.

The service & other classification includes activities of persons engaged in the business of rendering “any type of service” that does not constitute a “sale at retail” or “sale at wholesale.” RCW 82.04.290(2)(b). Earning dealer cash is properly considered a service that does not constitute a “sale at retail” or “sale at wholesale.”³ The terms of the marketing bulletins create an offer accepted by the performance of services. American Honda conditions payment to dealers on (a) selling the identified model of a vehicle within the specified time period, (b) properly documenting the sale to American Honda, and (c) performing a

³ Examples of services constituting “sales at retail” include cleaning, repairing, or constructing property for consumers, automobile towing services, and furnishing lodging. RCW 82.04.050(2)(a), (b), (e), (f). Services constituting “sales at wholesale” are described in RCW 82.04.060.

self-audit of the list of qualifying vehicle sales. AR 723-64; *see also* AR 100 (the bulletin “is our contract. ... If we don’t do everything to the letter of these bulletins they can say, we’re not going to give you the dealer cash”). This service benefited both Klein Honda (with direct income from the sale and additional income from the dealer cash) and American Honda (by reducing Klein Honda’s inventory and putting Klein Honda in a position to make more wholesale purchases from American Honda).

Although Klein Honda must sell a vehicle to earn dealer cash, dealer cash is not subject to the “retailing” B&O tax classification because Klein Honda does not make a retail sale of the vehicle to American Honda. A “sale” is a transfer of the ownership or possession of property for valuable consideration under RCW 82.04.040, and “sales” of tangible personal property are “sales at retail” unless purchased for resale or falling within other specified exclusions. RCW 82.04.050(1)(a). The purchaser owes retail sales tax on each retail sale, and the seller pays retailing B&O tax on its income from those sales. RCW 82.08.020(1); RCW 82.04.250(1). To earn dealer cash, Klein Honda does not transfer possession or ownership of vehicles *to* American Honda for consideration. Thus, Klein’s transaction with American Honda is not a “sale at retail” subject to the retailing B&O tax rate. *See Steven Klein*, 184 Wn. App. at 353 & n.1.

Regardless of whether Klein Honda performed any “service” to earn dealer cash, the requirements for taxation of any other business activity under RCW 82.04.290(2) are certainly met by the *quid pro quo* of

the marketing bulletins: if the dealer sells a particular model of vehicle within a particular time period, American Honda will pay a particular amount of cash to the dealer. *See* AR 99-100 (“this is our contract with the factory to get our money, and if we don’t do everything to the letter of these bulletins they can say, we’re not going to give you the dealer cash”). Under these programs, Klein Honda had a source of income in addition to its sales income from customers, which it earned when it sold the identified vehicles during the designated time periods. This was a business activity “other than or in addition to” the retailing activity of transferring possession of new vehicles to customers in return for consideration. RCW 82.04.290(2)(a).

4. The Legislature did not exempt dealer cash income from taxation, and treating it as exempt is contrary to the B&O tax scheme.

Judge Becker dissented from the Court of Appeals decision, concluding that Klein Honda was not taxable because neither subsections (a) or (b) of RCW 82.04.290(2) applied. *Steven Klein*, 184 Wn. App. at 356-59 (Becker, J., dissenting). The gist of her analysis was that the only business activity Klein Honda engaged in to earn dealer cash was selling cars at retail. *Id.* at 358-59. She considered subsection (2)(b) inapplicable because it applies to services that are *not* sales at retail. *Id.* at 358. And she considered subsection (2)(a) inapplicable because she viewed Klein Honda’s activities to earn dealer cash as no more than making sales at retail and documenting those sales. These, she concluded, were not separately taxable “other” business activities. *Id.* at 359. Similarly, Klein

Honda argues that its dealer cash earnings do not fall within RCW 82.04.290(2) and are not taxable because earning dealer cash is the “exact same activity” as retailing and not a “discrete” or separate activity. Petition for Review at 10-11. These arguments are incorrect.

As the Department has previously illustrated, as a factual matter, the transactions regarding sales of vehicles and earning dealer cash are quite distinct. Answer to Petition at 14-15. The retail sales of vehicles are separate from dealer cash transactions, under separate contracts, and between different parties. Accordingly, earning dealer cash is an “other activity” subject to the service & other B&O tax rate.

The flaw in Klein Honda’s argument is exposed when one considers the effect of the position: Receipts generated in the course of business activities in Washington would be treated as exempt from B&O tax, without a statutory deduction or exemption. Thus, this could occur whenever a taxpayer received income from one party that was conditioned on the occurrence of a business transaction with another party.

Contrary to statutory interpretation principles, this approach disregards the entire B&O tax scheme, which is to tax all business activities, however described, unless a deduction or exemption applies. *Budget Rent-A-Car*, 81 Wn.2d at 175; *Simpson*, 141 Wn.2d at 149 (quoting *Time Oil Co.*, 79 Wn.2d at 146). And businesses may owe B&O tax under multiple tax classifications for portions of their gross income if they engage in multiple business activities. RCW 82.04.440(1); *Air-Mac, Inc. v. State*, 78 Wn.2d 319, 323, 474 P.2d 261 (1970) (each business

activity is subject to the B&O tax, not just the principal business). The same activity may be taxable under separate but overlapping B&O tax classifications. See *Drury the Tailor v. Jenner*, 12 Wn.2d 508, 510, 515, 122 P.2d 493 (1942) (before exemption enacted, custom tailor owed B&O taxes under both retailing and manufacturing classifications).

The Court's goal in interpreting statutes is to ascertain and carry out the Legislature's intent. *Lake v. Woodcreek Homeowners Ass'n*, 169 Wn.2d 516, 526, 243 P.3d 1283 (2010). The plain meaning of a statute is discerned from "the ordinary meaning of the language at issue, the context of the statute in which that provision is found, related provisions, and the statutory scheme as a whole." *Id.*; *Department of Ecology v. Campbell & Gwinn, LLC*, 146 Wn.2d 1, 11, 43 P.3d 4 (2002) (consider "all that the Legislature has said in the statute and related statutes which disclose legislative intent about the provision in question"). The Legislature chose a structure for the B&O tax that provided specific rate classifications, based on the nature of the business activities, and a catchall classification in RCW 82.04.290(2) to provide the tax rate for "any business activity other than or in addition to an activity taxed explicitly" in one of the specific classifications. (Emphasis added). In spite of this, Klein Honda's interpretation would leave a gap in the B&O tax statutes, such that income from dealer cash is somehow exempt from the tax. But this cannot be the Legislature's intent – the Legislature's broadly-worded catchall classification for "any business activity" not otherwise specified would have little meaning if that were true.

In interpreting RCW 82.04.290(2) to conclude that Klein Honda's dealer cash income is not taxable, Klein Honda also confuses the incident of the B&O tax (taxability) with the measure and rate of the tax. The statute that governs whether dealer cash is *taxable* is RCW 82.04.220, and the identified taxable activity is "the act or privilege of engaging in business activities." Klein Honda earns dealer cash in the course of operating a car dealership, and thus that income is taxable. In contrast, RCW 82.04.290(2) merely establishes the measure (gross income of the business) and rate (1.5%) for business activities that fall outside the specific statutory classifications.

Klein Honda has offered no explanation for why the Legislature might have intended to exempt dealer cash or other income generated under similar circumstances from the B&O tax. Statutes should be interpreted in a manner that avoids unlikely, absurd, or strained consequences. *Bowie*, 171 Wn.2d at 14. Interpreting RCW 82.04 and RCW 82.04.290(2) to create a gap in the tax scheme, such that Klein Honda's income from dealer cash is excluded from the reach of the B&O tax, results in such an unlikely, absurd, or strained consequence. The Board and the Court of Appeals correctly rejected that interpretation.

B. Dealer Cash Is Not An Adjustment In The Wholesale Purchase Transaction.

Klein Honda's alternative theory for why its dealer cash income should not be subject to B&O tax is that the payments represent nothing more than a discount or adjustment to the price Klein Honda paid to

purchase the vehicles at wholesale from American Honda. The Board rejected this theory by implication when it held the dealer cash payments were subject to B&O tax as a separate incident or transaction. AR 26-27. The Court of Appeals addressed the argument and rejected it. *Steven Klein*, 184 Wn. App. at 354-56. In its petition for review, Klein Honda did not discuss this issue, but it may raise the point again.

The question of whether an auto manufacturer payment to a dealer represents an adjustment to the wholesale purchase price of a vehicle is one that turns on evidence regarding the specific transaction.⁴ Such payments are common in the industry, and the Department has allowed payments that truly adjust the wholesale purchase price to be treated as such, and not as income subject to the B&O tax. *See, e.g.*, AR 185-88 (published tax decision); AR 160 (DOR Auto Dealers Industry Guide).

For a payment from an auto manufacturer to a dealer to constitute an adjustment to the dealer's wholesale purchase of a vehicle, the parties must contemplate the payment at the time of the transaction, and the dealer's entitlement to the payment must be certain. *See* WAC 458-20-108(1) ("selling price" for determining retail sales tax and B&O tax will be reduced when contract is made "subject to" a trade discount).

The holdback credits Klein Honda regularly receives from American Honda are discounts on the dealer's cost to purchase the vehicle. The holdback, representing 3% of the MSRP, is disclosed on the

⁴ The Department's brief in the Court of Appeals contains a full analysis of Klein Honda's wholesale discount argument. *See* Brief of Respondent at 28-44.

vehicle invoice documenting Klein Honda's wholesale purchase, and Klein Honda receives the credit within the next month. AR 130-33, 765, 778. Klein Honda's receipt of the holdback payment is not contingent upon sale of the vehicle to a customer or any other activity by Klein Honda, and both parties are aware that the holdback amount will be credited to the dealer soon after the invoice date. Thus, the holdback is part of the wholesale transaction.

The same is true for the payments Klein Honda receives from American Honda for floor plan assistance, marketing allowance, and the fuel charge credit. All three of these payments are within the contemplation of the parties at the time of that purchase, credited to Klein Honda within days, applied to all vehicles, and paid without any condition that Klein Honda first sell the vehicles. AR 765, 767, 769 (vehicle invoices); VTP 59-61, 80-85. As the Board found, these payments are "quantified and contemporaneous with" the wholesale purchase transaction. AR 25 (Finding of Fact No. 3).

Dealer cash is unlike these other payments, because the parties do not know at the time of the wholesale purchase whether Klein Honda will be entitled to receive dealer cash on a particular vehicle. When American Honda announces a dealer cash incentive, it applies to eligible vehicles in Klein Honda's inventory, previously purchased from American Honda. At the time of those purchases, Klein Honda would not know whether a future dealer cash program would apply to those vehicles. AR 107; VTP 26. Accordingly, a dealer cash credit could not be contemplated by the

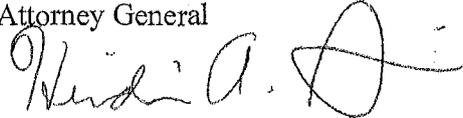
parties in those transactions, and any later payment of dealer cash would not represent a reduction in Klein Honda's cost to purchase the vehicle. In sum, Klein Honda failed to establish that dealer cash payments represent an adjustment to the wholesale purchase price of vehicles.

V. CONCLUSION

The Legislature intended to subject all business activity in Washington to the B&O tax, and Klein Honda earned dealer cash in the course of its business activities. Klein Honda's income from dealer cash is taxable under RCW 82.04.220(1), and because no specific rate classification covers dealer cash, it is subject to the catchall service & other rate in RCW 82.04.290(2). For the foregoing reasons, and those set forth in the Department's prior briefing, the Board and the courts below correctly held that Klein Honda is subject to B&O tax on its dealer cash income. The Board's decision should be affirmed.

RESPECTFULLY SUBMITTED this 4th day of May, 2015.

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

DATED this 4th day of May, 2015, at Tumwater, WA.


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Importance: High

Attached for filing is the Department of Revenue's Supplemental Brief.

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