

NO. 45223-5-II

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

STEVE KLEIN, INC., d/b/a Klein Honda,

Appellant,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

BRIEF OF RESPONDENT

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I. INTRODUCTION

This case concerns the taxability of “dealer cash” payments automobile dealer Klein Honda receives from the manufacturer, American Honda. Klein Honda earns dealer cash by selling specified Honda models to consumers during a specified window of time and meeting other conditions American Honda imposes for the incentive program. The Board of Tax Appeals correctly applied the law to the evidence in the record, holding that dealer cash payments Klein Honda receives are part of Klein Honda’s taxable gross income and subject to the business and occupation (B&O) tax.

As the Supreme Court has recognized, the Legislature “intended to impose the business and occupation 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)). The applicable B&O tax statutes are clear and unambiguous. There is no dispute that Klein Honda received dealer cash while engaging in the business of an automobile dealership.

During the tax period, Klein Honda earned taxable gross income in several ways. First, and most obviously, Klein Honda earned income from selling vehicles to customers and servicing vehicles. But customers were

not the only source of income to Klein Honda because it also earned taxable income from American Honda. Some of that income was from selling particular vehicle models during a specific time period under a dealer cash incentive program.

Klein Honda argues that dealer cash is not taxable as gross income because Klein Honda did not provide a service to American Honda to earn it other than sell the cars to customers. Klein Honda asserts dealer cash should instead be treated as a reduction in the wholesale selling price of the vehicles from American Honda to Klein Honda, the same as some payments Klein Honda receives automatically from American Honda upon each wholesale purchase of a vehicle. No matter how many times Klein Honda uses the terms “cash back” or “rebate” to describe dealer cash in its arguments, however, the record does not support that claim. The Board correctly 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 a vehicle from American Honda. *See* AR 24-27.

Lacking evidence to support its argument that dealer cash is merely a rebate on the wholesale price Klein Honda paid American Honda for the vehicle, Klein Honda asks this Court to reach that conclusion anyway. Klein Honda offers a statutory argument that ignores much of the definition in RCW 82.04.080 of “gross income of the business.” In the

alternative, Klein Honda argues that the Department of Revenue has been inconsistent in this case with its treatment of dealer cash compared to prior rulings on other payments from auto manufacturers to dealers or its treatment of grocery retailers. The particular facts and circumstances of those other rulings, however, demonstrate no such inconsistency. Even if they did, the statutes and evidence in this case determine taxability, not prior administrative rulings related to other taxpayers or interpretations related to other industries.

Because the Board correctly interpreted and applied the law, this Court should affirm the Board's decision.

II. COUNTERSTATEMENT OF THE ISSUE

Under the definition of "gross income of the business" in RCW 82.04.080 and related B&O tax statutes, did Klein Honda owe B&O tax on payments it received from American Honda as dealer cash, when: (a) Klein Honda earned the payments as part of its business activities, (b) the payments were not connected to Klein Honda's wholesale purchase of vehicles from American Honda, and (c) the payments were conditioned on selling a particular vehicle model during a particular period of time and otherwise complying with the terms of the bulletin outlining the dealer incentive?

III. STATEMENT OF THE CASE

A. Klein Honda's Dealership Operations

Steve Klein, Inc., d/b/a Klein Honda, operates an automobile dealership in Everett, Washington. Klein Honda is an independent franchisee of American Honda Motor Co., Inc. *See* AR 309-63 (Honda Automobile Dealer Sales & Service Agreement) (“Dealer Agreement”). Klein Honda sells new and used vehicles, provides maintenance and repair services, and sells parts and accessories. The Dealer Agreement gives Klein Honda the right to purchase and resell Honda vehicles and other Honda products, to advertise itself as an authorized Honda dealer, and to use Honda trademarks in the advertising, promotion, sale, and servicing of Honda products. AR 314-15, ¶2. The Agreement obligates Klein Honda to maintain a representative mix of Honda vehicles in showroom-ready condition. AR 322, ¶12.1. It also obligates Klein Honda “to effectively promote and sell” Honda vehicles and other products and “to promote and render service to the end user.” *Id.* The Agreement contains a list of models Klein Honda may sell, AR 356, but it does not contain any specific sales goals, whether related to sales figures, specific models, or otherwise. According to owner Steve Klein and Klein Honda’s general manager, Tom Hunt, the Dealer Agreement accurately reflects Klein Honda’s business relationship with American Honda. AR 109-110; AR 154-55.

Klein Honda finances its vehicle inventory through a bank. AR 96. 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; AR 765-770 (sample vehicle invoices and manufacturer certificates).

The vehicle invoice identifies the vehicle by vehicle identification number (VIN), and indicates the wholesale price of the car, the destination and handling charge, and a total invoice price. AR 765, 767, 769 (samples from tax period). The vehicle invoice also states that it "may not reflect dealer's ultimate vehicle cost given any rebates, allowances, collections, discounts, holdback, incentives, etc." AR 765, 767, 769. In fact, the vehicle invoice contains slightly disguised information about "holdbacks" and certain allowances. *Id.* On the same line that the vehicle invoice indicates the manufacturer's suggested retail price (MSRP), the invoice also contains a number, the holdback figure, without identifying what it is. Likewise, the vehicle invoice contains disguised information about expected payments from American Honda for a marketing allowance and

a fuel charge credit, to cover the cost of filling the gas tank when the dealer sells the car to a customer. VTP 83-84.¹

The holdback is a percentage of the MSRP that American Honda will credit Klein Honda in the month following the wholesale purchase. During the tax period, the holdback percentage was 3% of the MSRP. AR 130; VTP 85. Klein Honda finances the total invoice price through the bank, but records a receivable from American Honda for the holdback amount and inputs the difference as the cost of the vehicle. AR 97-98; AR 129, 131; AR 156.

Klein Honda owns the vehicles at the point shipment starts from the factory. AR 97; AR 112. By the time Klein Honda receives a new vehicle from American Honda, the factory has been paid the invoice amount by the bank. AR 97-98; AR 112. Klein Honda pays interest on its line of credit with the bank, and when it sells a vehicle to a customer, it is required to pay the bank in full for that vehicle within three days. AR 98; AR 113-14; AR 147.

When Klein Honda sells a new vehicle to a customer, it communicates that sale to American Honda through an electronic network

¹ Thus, on the first page of Ex. S10, the MSRP for the Honda CR-V Klein Honda purchased in September 2004 was \$25,050.00, and the holdback amount was \$751.50, which American Honda indicated only as “75150” without any dollar sign, decimal point, or description. AR 765; VTP 44. Similarly, the figures “1100/3000” designated that Klein Honda would receive \$110.00 for a marketing allowance and \$30.00 as a fuel charge credit. VTP 83.

using a Retail Delivery Registration form, which contains, among other information, the VIN, the names of Klein Honda personnel associated with the sale, the name and address of the purchaser, and information about the type of financing. AR 772 (Retail Delivery Registration form); AR 106; AR 143. According to Klein Honda's general manager, "This is how American Honda knows who bought what product and also starts the warranty clock." AR 155. However, the form does not include information about the sales price. Under the Dealer Agreement, 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. American Honda collects information from dealerships on overall monthly sales by model, but it does not collect information from dealers on the sale price of any particular vehicle. AR 148-49.

B. American Honda's Payments To Klein Honda

Klein Honda regularly pays American Honda for new vehicles, parts, accessories, and other items or services. Likewise, American Honda regularly makes payments or credits to Klein Honda. These are documented in a monthly balance forward statement. AR 772-78. These payments include reimbursement for services Klein Honda provides, such as service work under a Honda warranty claim or for pre-delivery inspection, the services necessary to get a vehicle ready for retail sale to a

customer. AR 134-45; AR 153; AR 772-78 (sample balance forward statement from American Honda showing various charges and credits). The payments also include a credit for fuel to provide customers a full tank of gas when they purchase a vehicle. AR 134; *see* AR 773 (“fuel charge credit”).

As Steve Klein explained, the purpose of the balance forward statement is to list charges for parts Klein Honda ordered from the factory during the preceding month, charges for promotional materials, subscription fees for online services from Honda, training fees, fees for signage, or “anything that we order from Honda that they’re debiting me.” AR 103; AR 133. Similarly, American Honda uses the balance forward statement to record any credits owing to the dealership for the month, including the credits mentioned above, holdback credits, and payments reflecting other factory-dealer incentive or assistance programs. *Id.*; AR 772-78. If the balance at the end of the month is positive, the dealership owes American Honda that amount, and if the balance is negative, American Honda pays the dealership. AR 104.

With regard to holdback, the balance forward statement shows the total amount credited by American Honda for holdback for vehicles Klein Honda purchased in the preceding month. AR 131-33; *see* AR 778 (showing total holdback credits of \$35,117.10 for represented month).

Other credits American Honda makes on a “per vehicle” or “per model” basis include a marketing allowance credit for Klein Honda’s advertising, and a “floor plan assistance” credit, to offset Klein Honda’s financing costs with the bank for its inventory of cars for sale. AR 116-17; AR 139-40; AR 778. The holdback, marketing allowance, and fuel charge credit are all initially reflected in the vehicle invoice. AR 130; VTP 83-85. The floor plan assistance credit is not shown in the vehicle invoice, but is announced by American Honda in a separate bulletin each year setting forth the amount of floor plan assistance American Honda will pay dealers per vehicle when they purchase vehicles at wholesale. VTP 60-61; VTP 80-83. The amount varies by model. VTP 81.

Klein Honda’s general manager and its office manager, Teresa White, both agreed that American Honda’s payments to Klein Honda of holdback, floor plan assistance, marketing allowance, and the fuel charge credit are “automatic” and are reflected in the next monthly balance forward statement after the vehicle invoice is issued for Klein Honda’s purchase of the vehicle. VTP 59-61, 81-85. Klein Honda does not have to do anything to receive the payments other than purchase the vehicle from American Honda. *Id.*

American Honda also uses the balance forward statement to record credits earned by the dealer under sales incentive award programs, including dealer cash awards, described below. AR 136-38.

C. Dealer Cash Incentive Programs

Throughout the tax period, 2003-2006, and since then, American Honda has created what it calls “incentive programs,” including the “dealer cash” programs. Under a dealer cash incentive program, a dealer is entitled to receive a specified amount of cash for each sale it makes of a particular Honda model during a specified time period. American Honda issues “marketing bulletins” through its electronic network to authorized individuals at dealerships to announce the dealer cash programs. AR 723-64 (sample marketing bulletins from the tax period). For example, a marketing bulletin from 2003 offered \$1,000 in dealer cash for each sale of 2003 Honda Insight models during the period 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.

To earn the dealer cash, it is essential that a sale of the specified model be made to a customer during the time period specified in the marketing bulletin:

Q. The most critical thing that you have to do, though, is to sell the identified model within the specific time period. Right?

A. Definitely.

AR 101. The marketing bulletins 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 conclusion of each dealer cash incentive program and verify by signed affidavit that all listed vehicle sales meet the eligibility requirements for the incentive program. AR 724, 728, 735, 741, 747, 752, 757, 762; AR 100-01.

Owner Steve Klein stressed the need for dealers to comply with each requirement set forth in the marketing bulletins, in order to be eligible to receive the payment:

[B]asically what you want to do is you read these backwards and forwards, because 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.

AR 99-100. Likewise, 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. There have been occasions when American Honda charged back some payments for dealer cash to Klein

Honda when a sale did not meet the requirements of the marketing bulletin. VTP 89, 93-94.

Tom Hunt testified in his deposition that the number of dealer cash incentive programs American Honda offers depends on the market climate:

If the market is a strong market and they have a strong product, you will not see a dealer cash program. If the market becomes challenged and competitive product is viewed as comparable or nearly comparable, there will be a lot more dealer cash because the intent is to keep the product selling.

AR 151. 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. VTP 59. At any given time, American Honda may be running zero to about a dozen dealer cash incentive programs.

VTP 51. Klein Honda's witness, CPA Jeffrey Forsberg, testified about the benefits to an automobile manufacturer in offering dealer cash, in addition to providing holdback and floor plan assistance payments. AR 119-20.

He also 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 121.

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, 479, 755, 760 (marketing bulletins explaining procedure); AR 103-05; AR 136-38; AR 777-78 (balance forward statement). American Honda also posted the payments by vehicle identification number to a "Miscellaneous Billing Invoice" that accompanied the monthly balance forward statement. AR 779 (miscellaneous billing invoice). Neither the balance forward statement nor the miscellaneous billing invoice contain any information about Klein Honda's original invoice cost to purchase the vehicle at wholesale.

Steve Klein confirmed that compensation Klein Honda received under dealer cash incentive programs was "after the fact" of Klein Honda's purchase of vehicles from American Honda. AR 109; *see* AR 765-70 (vehicle invoices). Unlike holdback, marketing allowance and fuel charge credits, no numbers on the vehicle invoices for the wholesale purchase relate to dealer cash. VTP 87-88. Also unlike holdback, floor plan assistance credits, marketing allowance, and fuel charge credits, Klein Honda did not receive a dealer cash award affecting a particular vehicle until after it sold that vehicle to a customer (within the promotion period). AR 141-42; AR 157; VTP 61. Klein Honda kept track of its

entitlement to dealer cash by reference to its vehicle sales, rather than by reference to its original wholesale purchase of a vehicle. VTP 87.

D. Klein Honda's Accounting Of Dealer Cash Incentive Payments

Under the Dealer Agreement, Klein Honda must employ Generally Accepted Accounting Principles in its accounting systems and provide a monthly financial statement to American Honda as set forth in the American Honda Dealer Standard Accounting Manual. AR 329 ¶17.1; AR 364-625 (Accounting Manual). The Accounting Manual provides detailed information about specific accounts to record financial information and a sample financial statement showing where all those accounts fit within a balance sheet, income statement, and gross profit analysis. *See* AR 396-99 (financial statement).

According to office manager Teresa White, in its monthly financial statements Klein Honda recorded dealer cash awards for which it qualified, but had not yet been paid, as a receivable in balance sheet assets in accordance with the Accounting Manual under Account 221, "Factory Receivables – Honda." AR 144-47; *see* AR 396 (balance sheet form), 407 (definition of Account 221, including "incentives earned"). Klein Honda simultaneously recorded dealer cash incentive amounts earned in the variable income account for "Incentives Earned," Account 002A, where the dealer cash was added to amounts from new vehicle sales to arrive at

the gross profit amount for the month. *Id.*; see AR 399 (gross profit analysis, line 16), 559 (definition of Account 002A).² In its federal tax returns, Klein Honda included dealer cash amounts within line 1a, “Gross receipts or sales.” AR 287, 307 (discovery responses); AR 627, 643, 675, 694 (2003-2006 tax returns). Notwithstanding its treatment of dealer cash for accounting and federal tax purposes, however, Klein Honda did not include the amounts as part of its gross income for B&O tax purposes.

E. Department’s Assessment And Procedural Background

In October 2007, the Department assessed Klein Honda \$16,963 in service and other B&O tax 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 represents a discount or reduction in Klein Honda’s cost of purchasing the vehicles from American Honda. AR 784-788. In a final executive level determination issued in August 2010, the Appeals Division upheld the assessment. AR 7, 780-789 (Determination No. 08-0306ER).

² CPA Jeffrey Forsberg explained that if the dealer cash amount was included in the gross profit figure pulled over to line 2 in the income statement for “Gross” (AR 397), then it was properly reported under GAAP. AR 123-25.

Klein Honda appealed to the Board of Tax Appeals, which affirmed the Department's assessment in an initial decision issued on June 6, 2012. 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 paid by Klein Honda when it purchased vehicles from American Honda. CP 98-101. After twenty days the initial decision became final when Klein Honda did not petition the Board for further review. AR 28 (WAC 456-09-930; RCW 34.05.464(1)).

Klein Honda then petitioned the Superior Court for judicial review of the Board's decision. CP 4-6, 81. Thurston County Superior Court Judge Christine Schaller issued a letter ruling on June 27, 2013, and a final order on July 19, 2013, affirming the Board of Tax Appeals decision. CP 84-85. Klein Honda timely appealed the final order. CP 86.

IV. ARGUMENT

Courts review formal decisions of the Board under the Administrative Procedure Act (APA), RCW Ch. 34.05. RCW 82.03.180. The burden of demonstrating the invalidity of the Board's action is on Klein Honda as the party asserting invalidity. 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, Exec. Servs. Dep't, 160 Wn.2d 32, 41, 156 P.3d 185 (2007) (taxpayer has burden to show a B&O tax assessment is incorrect). Under the APA, relief may be granted only if it is determined that Klein Honda has been “substantially prejudiced” by the Board’s decision. RCW 34.05.570(1)(d).

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. Opening Br. at 3; CP 6 (Petition for Judicial Review). 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. *Olympic Tug & Barge*, 163 Wn. App. at 306; *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 what the legislature intended).³ Neither party in this case argues that any applicable statute is ambiguous.

The Board’s findings of fact are reviewed under a substantial evidence standard. RCW 34.05.570(3)(e); *Ferry County v. Concerned*

³ In the case of a statutory ambiguity, courts accord substantial deference to the agency, in this case the Department, which administers the statutes in question and has developed longstanding interpretations. *Verizon NW, Inc. v. Employment Security Dep't*, 164 Wn.2d 909, 915, 194 P.3d 255 (2008); *see also General Motors Corp. v. City of Seattle*, 107 Wn. App. 42, 57, 25 P.3d 1022 (2001).

Friends of Ferry County, 155 Wn.2d 824, 833, 123 P.3d 102 (2005).

Klein Honda has not challenged any of the Board's findings of fact.

Opening Br. at 3; CP 6 (Petition for Judicial Review). Thus, they should be treated as verities on appeal. *Stuewe v. Dep't of Revenue*, 98 Wn. App. 947, 950, 991 P.2d 634 (2000).

Applying the foregoing standards, this Court should affirm the Board's decision in this case.

A. The B&O Tax Applies To Income From All Business Activities.

The Board and the Superior Court correctly upheld the assessments of B&O tax on Klein Honda's dealer cash income during the tax period. AR 14-15. Washington's B&O tax is imposed "for the act or privilege of engaging in business activities" and applies to the gross income of the business. 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).

"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).⁴ 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.”

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. As a result, unless an exception or deduction applies, a taxpayer owes B&O tax on all income received.

⁴ Klein Honda argues that the Board’s decision “ignores the definition of gross income” and fails to address whether dealer cash was a “nontaxable rebate” on the dealer’s wholesale purchase from American Honda, rather than taxable gross income. Opening Br. at 8-9. In fact, the Board quoted the statutory definition of “gross income of the business” in Conclusion of Law No. 4. AR 26-27. Likewise, in the “Analysis” section, the Board explained the difference between dealer cash and payments from the manufacturer that are considered “deductions from the wholesale price,” concluding that dealer cash credits “are taxable as business revenue.” AR 24-25. In Conclusion of Law Nos. 5 and 6, the Board held that Klein Honda was liable to pay B&O tax on dealer cash and that the Department’s assessment was affirmed. AR 27. Klein Honda does not fairly characterize the Board’s decision. The Board decided all issues requiring resolution, even if not in the detail or from the standpoint Klein Honda would prefer.

1. Dealer cash is subject to B&O tax as “gross income of the business.”

Here, the total money Klein Honda received in the course of doing business as a Honda automobile dealership included its income from selling cars to customers. It also included Klein Honda’s income from American Honda for providing predelivery inspection services or warranty services. And as the Board and the Superior Court correctly concluded, it also included dealer cash. Just like those other sources of income, dealer cash constituted “value proceeding or accruing by reason of” the transaction of Klein Honda’s business and was therefore taxable as “gross income of the business.” RCW 82.04.080.

Specific examples of “gross income of the business” in the statutory definition include “gross proceeds of sales” and “compensation for the rendition of services.” *Id.* Klein Honda argues that dealer cash falls within neither of these and cannot be considered taxable gross income “unless it is a payment for services.” Opening Br. at 8, 10, 14-15. But the statutory definition of taxable gross income applies to *any* “value proceeding or accruing by reason of” transacting business, and a number of the examples listed do not involve payments for services (e.g., “interest” and “royalties”). In addition, to clearly express its intent to tax all business income not otherwise exempted, the Legislature’s last

example in the definition is a catch-all, “other emoluments however designated.” RCW 82.04.080. In short, a business can be liable for B&O tax on amounts (including dealer cash) that do not represent compensation for services rendered.⁵

In arguing to the contrary, Klein Honda confuses a *necessary* with a *sufficient* condition. Certainly, receiving income from providing services is *sufficient* to qualify as taxable “gross income of the business,” which includes “compensation for the rendition of services.” RCW 82.04.080. But taxable gross income is not limited to compensation for services; it can include other business fees, perquisites, gains, benefits, advantages, profits, or “other emoluments however designated.” *See Getty Images, Inc. v. City of Seattle*, 163 Wn. App. 590, 601-02, 606, 260 P.3d 926 (2011) (under City’s near-identical definition of “gross income,” funds a corporation received to pay its affiliates’ administrative and managerial service costs fell within definition as “emoluments however designated”), *review denied*, 173 Wn.2d 1014 (2012).

Accordingly, it is not *necessary* for dealer cash to represent compensation for services in order to be taxable. And because dealer cash is a payment Klein Honda receives from American Honda by reason of its

⁵ Contrary to Klein Honda’s statements, the Department did make this argument below. *See* AR 39, VTP 143-45.

business activities, dealer cash is subject to B&O tax as “gross income of the business.”

2. Klein Honda’s income from dealer cash is taxable at the catch-all rate under the “service & other” classification.

Under the B&O tax statutes, the tax rate varies according to the nature of the business the taxpayer is engaging in. For instance, Klein Honda’s gross income from sales of vehicles to customers is subject to the retailing rate in RCW 82.04.250 (currently 0.471 percent). The Department assessed B&O tax on dealer cash under the “service & other” classification in RCW 82.04.290(2). AR 790-93. That classification is not limited to income from providing services. The service & other classification imposes a tax rate of 1.5 percent (during the tax period) on the gross income of “*any business activity other than or in addition to an activity taxed explicitly under another section in this chapter . . .*” RCW 82.04.290(2) (emphasis added).⁶ Klein Honda’s dealer cash receipts are subject to B&O tax under the “service & other” classification regardless of whether they are considered compensation for services rendered or any “other emolument however designated.”

⁶ 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).

a. When Klein Honda earned dealer cash, it was providing a service to American Honda.

The service and 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.”⁷ Earning dealer cash is properly considered a service that does not constitute a “sale at retail” or “sale at wholesale.” 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 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 moving vehicles out of Klein Honda’s inventory and putting Klein Honda in a position to make more wholesale purchases from American Honda).

⁷ 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.

b. Even if dealer cash is not a payment for services, it is properly taxable under the service & other B&O tax classification as an “other emolument.”

Although the service & other classification expressly mentions services not falling within the retailing or wholesaling classifications, it does so “without limiting the scope” of the category to other business activities. RCW 82.04.290(2). In other words, taxpayers can have taxable business income subject to the service & other rate without providing any “services” to earn that income.

One example of a taxable business activity subject to tax under the service & other classification in RCW 82.04.290(2) is interest financial institutions earn on loans or investments. Although banks are allowed to deduct from their taxable gross income amounts received from interest on first mortgages or trust deeds on residential properties under RCW 82.04.4292, other investment or interest income they earn generally is taxable under RCW 82.04.290(2).⁸

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

⁸ This would include the interest Klein Honda’s bank receives from Klein Honda on the line of credit for Klein Honda’s vehicle inventory.

cash to the dealer.⁹ Under the dealer cash incentive, Klein Honda had a source of income in addition to its sales income from customers, which it earned when it sold the specifically identified vehicles during the designated time periods. This was a business activity “in addition to” the retailing activity of transferring possession of new vehicles to customers in return for consideration. RCW 82.04.290(2).

Klein Honda agrees that the measure of the tax turns on the nature business activity, but argues that “[r]eceiving dealer cash—or any other payment—is not a business activity,” unlike “selling cars” and “servicing and repairing vehicles.” Opening Br. at 9. From this premise, Klein Honda appears to argue that because, in its view, it did nothing extra beyond selling cars to obtain dealer cash, and its “gross proceeds of sales” from selling the cars were already subject to retailing B&O tax under RCW 82.04.250(1), the “service & other” rate under RCW 82.04.290(2) is inapplicable. Opening Br. at 9-12. Both the premise and the conclusion are incorrect.

The premise is flawed because dealer cash is not a payment that spontaneously appears in Klein Honda’s accounts without regard to Klein Honda’s business activities. Instead, it is a payment Klein Honda *earns* by

⁹ 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”).

making a sale of a particular Honda model to a customer during a specified time period and fulfilling the reporting requirements. What Klein Honda must do to receive the payment qualifies as “business”: “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.

Klein Honda relies on a case that is readily distinguishable, *Peshastin Lumber & Box, Inc. v. State of Washington*, 61 Wn.2d 413, 378 P.2d 420 (1963). Opening Br. at 14-15. In that case the court held that a lumber manufacturer who was required to build logging roads in order to purchase timber from the United States Forest Service was not subject to B&O tax as a public roads builder merely because the cost of building the roads was considered by the appraiser in setting a fair market bid price for the timber. 61 Wn.2d at 415-17. A material fact in *Peshastin* was that the lumber manufacturer received no payment from the government for building the roads. *Id.* at 415. Instead, building the roads was just one cost of doing business. *Id.* at 417. “There was, in short, no showing that the [taxpayer] received any remuneration, expressible in terms of money, and consequently this was not a taxable activity.” *Id.* The opposite is true here: Klein Honda received remuneration, dealer cash, for selling specified vehicles to customers during specified time periods.

Klein Honda's "no business activity" argument also conflates its retail sales to customers with all "selling" activities. *See* Opening Br. at 12 ("[S]elling cannot be the 'other activity' under the services category. Selling is its own category with its own statutory base"). Contrary to this argument, Klein Honda's retailing activities do not preclude the taxation of dealer cash under the service & other classification. Klein Honda pays B&O tax under the retailing classification for its "sales at retail" of automobiles based on the "gross proceeds of sales." RCW 82.04.250(1) (retailing classification); RCW 82.04.070 (definition of "gross proceeds of sales"). A "sale" is a transfer of the ownership or possession of property for valuable consideration under RCW 82.04.040(1), and "sales" of tangible personal property, including automobiles, are "sales at retail" unless purchased for resale or falling within other specified exclusions. RCW 82.04.050(1)(a). The consumer 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 to or make a "sale at retail" of vehicles to American Honda. Accordingly, Klein Honda's income from dealer cash is not subject to retailing B&O tax under RCW 82.04.250(1). This conclusion, however, does not preclude that income from taxation under the service & other classification as an

“other emolument” merely because dealer cash relates to Klein Honda’s general activity of “selling.” No language in any of the relevant statutes supports that position.

Regardless of whether Klein Honda’s earnings from dealer cash are considered income from providing a service not covered in another B&O tax classification or an “other emolument however designated,” they fall within the service & other classification in RCW 82.04.290(2) and were properly taxed as such at the rate of 1.5 percent.

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

Klein Honda argues that dealer cash should be treated as excluded from taxable “gross income of the business” because it represents a rebate, discount or deduction in the wholesale purchase price of the vehicles for which the award is made, rather than income. Opening Br. at 8-9, 14-15, 21-22. The Board implicitly rejected this theory when it held the dealer cash payments were subject to B&O tax as a separate incident or transaction. AR 26-27. 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, even if the amount of the payment is not yet determined. RCW 82.04.080-

.090 (“value proceeding or accruing,” which comprises “gross income of the business,” is consideration, whether money, credits, rights or other property expressed in terms of money received or accrued); *see also Ford Motor Co.*, 160 Wn.2d at 39-40, 43 (in municipal B&O tax case, court looked to the substance of each transaction to identify its taxable incident).

Here, the Board correctly determined from the record that dealer cash does not represent an adjustment to the wholesale purchase price. Instead, dealer cash is taxable “gross income of the business” that Klein Honda received after its acquisition of vehicles and represents a payment under the manufacturer’s incentive program. *See* AR 26 (Finding of Fact Nos. 4 & 5).

1. Dealer cash is unlike factory to dealer payments tied to the wholesale purchase of the vehicle.

Unlike some other payments Klein Honda receives from American Honda, the dealer cash payments do not reduce the cost of Klein Honda’s vehicle purchases from American Honda. The Department has long recognized that where an automobile manufacturer makes a predetermined credit to a dealer’s open account in the month or quarter immediately following the date the vehicle is invoiced to the dealership, without the payment being contingent on dealer financing or the retail sale of the vehicle, no B&O tax is due on the credit. *See, e.g.*, AR 185-88

(Determination No. 91-263, 11 WTD 263 (1991) (treating a 3% holdback credited to dealer soon after the invoice date as “a revision to the original purchase price of the automobile” that both parties contemplated at the time of the wholesale purchase). Such a payment is “merely an adjustment to the original purchase price of the vehicle.” AR 160 (DOR Auto Dealers Industry Guide (online version))).

Although manufacturer payments or credits to dealers vary by name, the holdback credits Klein Honda regularly receives from American Honda are consistent with the description of holdback amounts the Department treats as a reduction in the dealer’s cost to purchase the vehicle. The holdback, representing 3% of the MSRP, is disclosed on the vehicle invoice documenting Klein Honda’s purchase of a vehicle from American Honda. AR 130, 765. American Honda credits the holdback amount for each vehicle purchase to Klein Honda’s next monthly balance forward statement. AR 131-33, 778. Klein Honda’s receipt of the holdback payment is not contingent upon sale of the vehicle to a customer or any other service or activity by Klein Honda. And as in Determination No. 91-263, when Klein Honda purchases a vehicle from American Honda, “both parties are well aware that the 3% holdback will be returned to the dealer soon after the invoice date.” 11 WTD 263 at 4. Therefore,

receipt of the holdback by Klein Honda is part of the wholesale purchase transaction as contemplated by the parties.

The same is true for the payments Klein Honda receives from American Honda for floor plan assistance, marketing allowance, and the fuel charge credit. Although figures representing the applicable floor plan assistance do not appear on the vehicle invoice when Klein Honda purchases the vehicle at wholesale, all three of these payments are within the contemplation of the parties at the time of that purchase. AR 765, 767, 769 (vehicle invoices); VTP 60-61, 80-83. In addition, they are credited to Klein Honda within days of the wholesale purchase, and apply to all vehicles purchased at all times, without any condition that Klein Honda first sell the vehicle to customers or perform any other action. VTP 59-61, 81-85. As the Board found, these payments are “quantified and contemporaneous with” the wholesale purchase transaction. AR 25 (Finding of Fact No. 3).

Unlike these other payments, the parties do not know at the time of Klein Honda’s vehicle purchases whether Klein Honda will be entitled to receive dealer cash on a particular vehicle. When American Honda announces a dealer cash incentive program, it applies to eligible vehicles in Klein Honda’s inventory, which Klein Honda has already purchased from American Honda. At the time of those wholesale purchases, Klein

Honda would have no way of knowing whether a future dealer cash program would apply to those vehicles, since American Honda does not offer dealer cash incentives for every model of Honda every year and may not have any dealer cash programs in effect at that time. AR 107; VTP 26. Accordingly, a dealer cash credit could not be contemplated by the parties as part of those transactions, and any later payment of dealer cash would not represent a reduction in Klein Honda's original cost to purchase the vehicle.¹⁰

Klein Honda argues that dealer cash reduces the cost of particular vehicles because dealers report sales qualifying for the award by reference to the VIN, and American Honda generates an invoice showing the dealer cash payment for that vehicle. Opening Br. at 16-17, 23. In making this argument Klein Honda disregards the testimony of its own accounting expert, Jeffrey Forsberg. He agreed that the mere fact American Honda makes a payment to Klein Honda by reference to a particular vehicle does not mean the payment is a reduction in the cost of goods sold. VTP 126-27. Instead, he correctly testified that "it depends on what the payment's for and, you know, how it's – all the other facts and circumstances of the money from the factory to the dealership." VTP at 126. Here, the facts

¹⁰ Consistent with this evidence, Klein Honda did not account for dealer cash in its accounting records or federal tax returns as a reduction in its cost of goods sold. Finding of Fact No. 6, AR 26; AR 287, 307 (discovery responses); AR 627, 643, 675, 694 (2003-2006 tax returns).

and circumstances do not support treating dealer cash as a reduction in the wholesale price of the vehicles.

2. The Department's treatment of dealer cash is consistent with its treatment of manufacturer payments to other taxpayers.

Contrary to Klein Honda's arguments, the Department's treatment of dealer cash as taxable gross income in this case is consistent with the Department's treatment of other taxpayers regarding discounts or its published guidance on the subject. *See* Opening Br. at 19-25. Even if there were an inconsistency, the Board properly applied the statutes to the evidence in the record.¹¹ Klein Honda's arguments should be rejected.

Klein Honda's authorities all address application of the Department's rule, WAC 458-20-108 ("Rule 108"), to particular circumstances. Rule 108 provides guidance to taxpayers on computing tax liability when returned goods, allowances, and cash discounts affect the sales transaction. Rule 108(1) provides the general principle: "When a

¹¹ The Department has no authority to create tax immunity beyond what the statutes allow in exemptions, deductions, and credits, whether by administrative rule, excise tax advisories, or determinations in internal appeals. *Department of Revenue v. Nord NW Corp.*, 164 Wn. App. 215, 228, 264 P.3d 259 (2011). In the event of such an inconsistency, the administrative pronouncement would have to give way to the statute. *Activate, Inc. v. Dep't of Revenue*, 150 Wn. App. 807, 816 n.9, 209 P.3d 524 (2009). In addition, whether the Department has been completely consistent in its treatment of allowed and disallowed discounts is not material. As one court said, "the issue on review is not whether the Director has been consistent, but whether the items in question are subject to taxation." *Medic House, Inc. v. Dir. of Revenue*, 799 S.W. 2d 80, 83 (Mo. 1990). The question here is whether the Department properly imposed B&O tax on Klein Honda's dealer cash receipts. The statutes and evidence answer that question, not the Department's actions with regard to another taxpayer or another industry.

contract of sale is made . . . subject to cash or trade discount, the gross proceeds actually derived from the contract and the selling price are determined by the transaction as finally completed.” Under Klein Honda’s theory of the case, rather than being taxed as “gross income of the business,” dealer cash should be treated as a trade discount that reduces the wholesale price at which American Honda sells vehicles to Klein Honda.

A major problem with Klein Honda’s theory is that Klein Honda’s purchases of vehicles at wholesale from American Honda are not made “*subject to cash or trade discount*” for dealer cash as Rule 108 requires. As discussed above, unlike payments for holdback, floor plan assistance, marketing allowance, and fuel charge credits, dealer cash payments are not automatic upon a dealer’s purchase of the vehicle from American Honda. VTP 59-62; 81-85. Unlike those other payments, which qualify as “discounts,” dealer cash is not related to the wholesale purchase transaction in any way. Dealer cash also is not a “cash discount,” because that term relates solely to paying a bill by a specified date. RCW 82.04.160.

Much of the discussion in Department determinations discussing Rule 108 centers on whether the buyer in a transaction has “actually taken” a “bona fide discount.” *See* WAC 458-20-108(5). Klein Honda

relies on a recently-issued Excise Tax Advisory, ETA 3173.2013 (“ETA”),¹² addressing discounts and allowances to grocery stores, and it asserts that “no advance arrangements are necessary” for a payment to qualify as a bona fide discount. Opening Br. at 13. As the Department’s website makes clear, ETAs explain how tax law applies “to a specific issue or specific set of facts.”¹³ Assuming, for the sake without conceding, that tax guidance for grocery stores is relevant here, this argument ignores the requirement in Rule 108(1) that the transaction be “subject to” the discount in order for the selling price to be reduced.

The ETA cites Rule 108 on the first page, and nothing in the ETA purports to change the requirements of Rule 108. In addition, the ETA describes a bona fide discount as “when the distributor grants the grocer either a discount or some form of payment *for doing nothing more than purchasing products from the distributor.*” ETA at 1 (emphasis added).

While this is an accurate characterization of the holdback, floor plan assistance, marketing allowance, and fuel charge credit, which Klein Honda automatically receives on each vehicle shortly after purchasing the

¹² The Department is “encouraged” to use interpretive statements or policy statements like ETAs to advise the public of the agencies’ current opinions, approaches, and likely courses of action. *Simpson Inv. Co. v. Dep’t of Revenue*, 141 Wn.2d 139, 161-62, 3 P.3d 741 (2000); *Association of Wash. Bus. v. Dep’t of Revenue*, 155 Wn.2d 430, 449, 120 P.3d 46 (2005). Such statements are advisory, and not the rule of law. *J.E. Dunn Nw., Inc. v. Dep’t of Labor & Indus.*, 139 Wn. App. 35, 53, 156 P.3d 250 (2007); see also RCW 34.05.230(1)-(2) (advisory unless converted into rule).

¹³ See <http://dor.wa.gov/content/FindALawOrRule/ETA/default.aspx> (last visited 11/27/13).

vehicle from American Honda, the same is not true for dealer cash. Thus, Klein Honda's reliance on the grocery ETA is misplaced.

a. The Department determinations upon which Klein Honda relies are distinguishable and not inconsistent with the assessment in this case.

Klein Honda also relies on two determinations issued by the Department's Appeals Division concerning payments from automobile manufacturers to dealers, one published, and the other unpublished. Opening Br. at 19-21. In both cases, the Department held that the payments were reductions in the dealer's cost to purchase the vehicles from the manufacturer and were not subject to service & other B&O tax. Rather than demonstrating any inconsistency in the Department's rulings, however, these determinations support the Board's decision in this case.

In the unpublished determination, the automobile manufacturer announced to all dealers that it was raising its wholesale prices for the vehicles by 2%, but would return that amount to a dealer when the dealer sold the vehicle to a customer, conditioned upon the dealer achieving an 85% customer satisfaction score as measured by customer surveys. AR 68-74, Determination No. 01-080ER.¹⁴ That 85% satisfaction level was

¹⁴ The Department moved to strike the unpublished determination from the record, primarily based on its statutory requirement to maintain taxpayer confidentiality and relevance. AR 46-51; *see* RCW 82.32.330. During the Board hearing, Klein Honda produced a letter from the auto dealer who was the taxpayer in that case approving

2.6% below the national average at the time. AR 70, 72. Other conditions on return of the 2% were already required by the franchise agreement. The administrative law judge found that the manufacturer was holding back 2% of the wholesale price until it confirmed that the dealer met its contractual obligations regarding customer satisfaction. AR 72-73. In addition, unlike in this case, there was an expectation of a return of the dealer's 2% payment at the time it was made, and the dealer's federal tax returns and financial statements treated the payments as an adjustment to the wholesale price of the vehicle and not as income. AR 72, 74; *contra* AR 287, 307 (discovery responses); AR 627, 643, 675, 694 (2003-2006 tax returns); AR 144-47 (testimony regarding accounting process); AR 396 (balance sheet form), AR 399 (gross profit analysis, line 16), AR 407 (definition of Account 221, including "incentives earned"), AR 559 (definition of Account 002A).

Klein Honda argues that conditions on receiving dealer cash in this case are already contained in the Dealer Agreement, similar to the conditions for receipt of the 2% holdback in the unpublished determination. Opening Br. at 17-18. Klein Honda relies in particular on paragraph 12.9. AR 324. This provision requires dealers to comply with all written directives contained in "bulletins, manuals, or other written or

disclosure of the determination, and the Department subsequently withdrew its motion to strike, though maintaining its relevance objection. VTP 128-29.

electronic communication” when American Honda formulates “new or different marketing strategies, directives, and Policies and Procedures” AR 324. However, nothing in paragraph 12.9 or any other part of the Dealer Agreement requires Klein Honda to sell particular Honda models during a particular time window. In addition, the bulletins in this case describe dealer cash as “incentive programs,” not as “directives” a dealer must comply with (except to earn the cash). *See, e.g.*, AR 724, 728, 731. In short, the record in this case does not support the same conclusion as the Department reached in the unpublished determination, and there is no inconsistency.

In the published determination Klein Honda cites, the Department held that holdback credits of 3% and floor plan interest expense credits of 1.3% were not subject to service & other B&O tax. Determination No. 91-263, 11 WTD 263 (1991) (*see* AR 185-88). The dealer received the holdback automatically at a set time following the wholesale purchase of the vehicle. The dealer had the option of receiving the floor plan credits in one of two ways, either as a credit of 1.3% of the wholesale purchase price to the dealer’s monthly open account statement, or as a credit reflecting the difference in financing rates between 5.5% and the actual financing rate, for up to 120 days, paid upon sale of the vehicle to a customer. *Id.* at 2-3. Under the second option, the floor plan credit amount could vary

based on the actual financing rate the dealer obtained and how quickly it sold the vehicles. All vehicles the dealer purchased from the manufacturer carried a 4.3% surcharge reflected on the invoice. *Id.* at 3.

In this case, as the Department has already noted, the vehicle invoices do reflect a 3% holdback (based on MSRP), which Klein Honda receives in its balance forward statement in the month following Klein Honda's purchase of the vehicle from American Honda. Unlike in 11 WTD 263, however, the vehicle invoices do not reflect any "surcharge" or contain an amount reflecting dealer cash. AR 765-70. Klein Honda's eligibility for dealer cash is not determined by the terms of its wholesale purchases from American Honda. Instead, it is determined by the timing of American Honda's decision to conduct a dealer cash incentive program and the specific terms and conditions of that program.

The variable amount of the floor plan credit in 11 WTD 263 is not a basis for excluding dealer cash from taxation, contrary to Klein Honda's suggestion. Opening Br. at 20. The amount the dealer would receive in that case depended upon the financing rate it obtained from a bank and the number of days the vehicle was in its inventory. The dealer's entitlement to the floor plan credit, however, was certain at the time of the wholesale purchase. Here, in contrast, Klein Honda's entitlement to dealer cash at the time of purchasing any particular vehicle from American Honda is

unknown, depending upon whether and when American Honda chooses to run a dealer cash incentive program on that vehicle model, and whether Klein Honda sells an eligible vehicle during a specified time period and otherwise complies with the requirements of the marketing bulletins.

Klein Honda also compares this case with a determination involving grocery store scan-down allowances and off-invoice purchase allowances. Determination No. 98-172E, 18 WTD 387 (1999) (*see* AR 190-204); Opening Br. at 14, 20-21, 24. The determination held the particular payments were subject to service & other B&O tax. It stated in part: “The Department has been uniform and consistent in its position that bona fide discounts [i.e., reductions in purchase price] never include situations where the purchaser is required *to provide any service or benefit to the seller* in return for the price reduction.” 18 WTD at 396 (emphasis added). The Department concluded the manufacturer’s payments to the grocer were taxable gross income because they “may induce the taxpayer to purchase its products or price them lower for consumers.” *Id.*

In this case, American Honda’s dealer cash payments may induce Klein Honda to price cars in its inventory lower for consumers and are certainly intended to give dealers an incentive to engage in sales activity directed to specific vehicle models. AR 723 (dealer cash marketing bulletin from April 2003: “This program is designed to stimulate 2003

Insight sales”); AR 151-52 (“the intent is to keep the product selling”).

They are similarly taxable.

- b. In any type of sale, payments from a seller to a buyer are not bona fide trade discounts unless the sale is made “subject to” that payment.**

As an alternative to its argument that the Department has acted inconsistently, Klein Honda argues that wholesale relationships are complex and ongoing, with multiple documents reflecting the transactions. Thus, according to Klein Honda, the Department should not require payments from manufacturers to dealers to be “prearranged” in order to qualify as bona fide trade discounts that are treated like a rebated or allowance in reducing the selling price of the item in the wholesale purchase transaction. Opening Br. at 21-25.¹⁵ This argument lacks any statutory support. It also is inconsistent with Rule 108, which requires the sale to be made “subject to” the discount in order to deduct the amount from the selling price and exclude it from taxable gross income. WAC 458-20-108(1), (5).

The alleged complexity of manufacturer/wholesaler/retailer relationships does not justify treating any payments from American Honda as excluded from Klein Honda’s taxable gross income in the absence of

¹⁵ Klein Honda states, without citation to any authority, that Rule 108 “deals with retail, not wholesale transactions.” Opening Br. at 22. However, Rule 108 contains no language limiting its application to retail transactions.

evidence demonstrating that it should be. Under the definition of “gross income of the business” in RCW 82.04.080 and other relevant provisions in the B&O tax statutes, the Department has no authority to merely assume payments to dealers are not taxable, as Klein Honda seems to suggest it should. The opposite is true.

As the Supreme Court instructed nearly 50 years ago in another B&O tax case, “[b]roader language could hardly be devised to convey the idea implicit in the foregoing definitions that the tax applies to everything that is earned, received, paid over to or acquired by” the taxpayer. *Engine Rebuilders, Inc. v. State of Washington*, 66 Wn.2d 147, 150, 401 P.2d 628 (1965); *see also Simpson Inv. Co. v. Dep’t of Revenue*, 141 Wn.2d 139, 149, 3 P.3d 741 (2000); *Time Oil Co. v. State*, 79 Wn.2d 143, 146, 483 P.2d 628 (1971). In addition, the evidence in this case demonstrates that sufficient information exists regarding *this* wholesale relationship to identify with a high degree of certainty which payments from American Honda are within the contemplation and expectation of the parties at the time of a wholesale vehicle purchase and which are not. The wholesale purchases are made “subject to” credits in the next monthly balance forward statement for holdback, marketing allowance, fuel charge credit, and floor plan assistance. AR 765, 767, 769 (vehicle invoices); AR 772-78 (balance forward statement); VTP 60-61, 80-83. The same is not true

for dealer cash, which is unrelated to those wholesale purchases and “after the fact” of those transactions. AR 109, 141-42, 157, 765, 767, 769.

Klein Honda emphasizes the statement contained in dealer invoices that the invoice “*may not reflect* dealer’s ultimate vehicle cost given any rebates, allowances, collections, discounts, holdback, incentives, etc.” AR 765, 767, 769 (emphasis added); Opening Br. at 21, 23. This statement does nothing more than put the reader on notice that there *may* be applicable trade discounts that reduce the wholesale price in the completed transaction. It does not, as Klein Honda claims, “*expressly* make[] the original vehicle sale ‘subject to revision’ by subsequent dealer cash offers.” Opening Br. at 21 (emphasis in original).

Klein Honda also argues that imposing B&O tax on dealer cash is contrary to this Court’s decision in *Discount Tire Co. of Wash., Inc. v. Dep’t of Revenue*, 121 Wn. App. 513, 85 P.3d 400 (2004). Opening Br. at 23-24. That case is not applicable here. It did not concern B&O tax. 121 Wn. App. at 521. The issue was whether the taxpayer, a tire retailer, owed use tax on replacement tires purchased by customers with refunds under an extended warranty. *Id.* at 521. In the process of reaching its holding that no use tax was owed, the Court discussed the portions of Rule 108 concerning returned, defective, or damaged goods. *Id.* at 524-27. This

case concerns alleged adjustments to the wholesale purchase price, or trade discounts, not returned, defective, or damaged goods.

Even if *Discount Tire* were relevant, it is distinguishable. As this Court noted, the extended warranties made the underlying tire sales “subject to cancellation” at the buyer’s option if a damaged or defective tire was not repairable and the customer chose to return the tire for a full refund within the extended warranty period. *Id.* at 527. No evidence in this record makes Klein Honda’s purchase price of vehicles at wholesale “subject to” an adjustment for dealer cash at some later date.

V. CONCLUSION

The Board of Tax Appeals correctly interpreted and applied the law to the evidence in the record. The Department respectfully requests that this Court affirm the decisions below.

RESPECTFULLY SUBMITTED this 27th day of November,
2013.

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PROOF OF SERVICE

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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 27th day of November, 2013, at Tumwater, WA.



Candy Zilinskas, Legal Assistant

WASHINGTON STATE ATTORNEY GENERAL

November 27, 2013 - 2:16 PM

Transmittal Letter

Document Uploaded: 452235-Respondent's Brief.pdf

Case Name: Steve Klein, Inc., d/b/a Klein Honda

Court of Appeals Case Number: 45223-5

Is this a Personal Restraint Petition? Yes No

The document being Filed is:

Designation of Clerk's Papers Supplemental Designation of Clerk's Papers

Statement of Arrangements

Motion: ____

Answer/Reply to Motion: ____

Brief: Respondent's

Statement of Additional Authorities

Cost Bill

Objection to Cost Bill

Affidavit

Letter

Copy of Verbatim Report of Proceedings - No. of Volumes: ____

Hearing Date(s): _____

Personal Restraint Petition (PRP)

Response to Personal Restraint Petition

Reply to Response to Personal Restraint Petition

Petition for Review (PRV)

Other: _____

Comments:

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