COURT OF APPEALS,
DIVISION I
OF THE STATE OF WASHINGTON

No. 73606-0

UNITED AIRLINES, INC.,

Appellant,

v.

WASHINGTON STATE DEPARTMENT OF REVENUE, *ET AL*,

Respondents.

APPELLANT'S BRIEF

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I. INTRODUCTION

This matter relates to the assessment of possessory interest taxes on property leased by airlines at the SeaTac International Airport, and a temporary assessment methodology adopted by the Washington State Department of Revenue for assessed years 2006 – 2011. This temporary methodology assessed taxes on the Port of Seattle's tax-exempt interest in the property and imposed this tax on airlines, including Appellant, United Airlines, Inc. ("UAL").

UAL filed the underlying action seeking a refund of possessory interest taxes paid under the "manifest error" provisions of RCW 84.69.020, for its leased SeaTac airport properties for assessed years 2009, 2010, and 2011. The Washington State Department of Revenue acting on behalf of it interests and the interests of King County (collectively "DOR") took the position that it: (a) had not assessed taxes against UAL for the tax-exempt interest of the Port of Seattle in the property; and (2) the methodology used by the DOR was a matter of "appraiser judgment", which is exempt from the "manifest error" provisions of RCW 84.69.020 and WAC 458-14-005. UAL presented expert testimony confirming the DOR had assessed taxes against UAL in 2009, 2010 and 2011 for the Port

of Seattle's tax exempt interest – by failing to account for the reversionary interest of the Port of Seattle and the term of the parties' lease agreement. UAL also presented expert testimony confirming that the relief sought by UAL's petition did not require the exercise of appraisal judgment.

The trial court dismissed UAL's action on cross motions for summary judgment (granting dismissal of claims against DOR and King County) without explanation and also denied UAL's request to amend its complaint. This appeal follows.

II. ASSIGNMENTS OF ERROR

No. 1: The lower court erred in entering the May 27, 2015 order granting DOR's motion for summary judgment, and denying UAL's cross-motion for summary judgment.

No. 2: The lower court erred when it denied UAL's motion for leave to file an Amended Complaint on June 9, 2015.

Issues Pertaining to Assignments of Error:

1. Summary Judgment

Whether the trial court erred in granting the DOR's motion for summary judgment and denying UAL's motion for summary judgment on a claim for a refund of possessory interest taxes

assessed by the DOR for 2009, 2010 and 2011, for a "manifest error" in description under RCW 84.69.020 where:

A. There was conflicting expert testimony and evidence offered by the parties which created disputed issues of material fact precluding entry of summary judgment (for either party), specifically with respect to whether or not the DOR's assessment methodology used from 2006-2011 resulted in the value of the Port of Seattle's tax-exempt reversionary interest in the property being assessed and tax against UAL.

B. In the alternative, UAL's motion for summary judgment should have been granted and the DOR's motion should have been denied because:

(i) The DOR utilized a direct capitalization model which assumed a perpetual lease term for UAL's interest in the Airline Properties;

(ii) UAL's actual lease expired in December 2012;

(iii) A "possessory interest" is defined by the right to possess and use the property – as set forth in the lease;

(iv) UAL's lease did not have any renewal or options;

(v) A hypothetical perpetual lease term, as used by the DOR, eliminates any reversionary interest, taxing UAL for the fee interest value of the property – which is exempt from taxation; and

(vi) The error can be corrected by reference to the records alone and valuation methods applied to similarly situated properties, without requiring the exercise of appraisal judgment.

2. Motion to Amend Complaint

Whether UAL's Motion for Leave to File Amended Complaint to reference the April 2014 petition should have been granted where:

(a) Under CR 15(a) leave to amend is to be "freely given";

(b) DOR admitted that allowing the amendment would not result in any prejudice to DOR;

(c) The April 2014 petition referenced in the proposed Amended Complaint expressly related back to the prior December 2012 petition;

(d) The proposed Amended Complaint did not assert any new claims, was based on the same material facts, and arose out of the same occurrence;

(e) The proposed amended complaint would relate back to the filing of the original Complaint pursuant to CR 15(c); and

(f) Even if CR 15(d) applied, and the proposed Amended Complaint were deemed a "supplemental pleading", UAL would nonetheless be entitled to relation back to the original Complaint.

III. STATEMENT OF THE CASE

1. UAL leases property at SeaTac Airport which is subject to a possessory interest property tax.

UAL operates a commercial airline, including operations at SeaTac International Airport in King County, Washington (the "Airline Property"). SeaTac Airport is owned by the Port of Seattle and is exempt from real estate tax. ***RCW 84.40.010(1)***. Leases of Port-owned property are typically subject to a leasehold excise tax, however the possessory interest of centrally assessed utilities (including airlines like UAL) are subject to a "possessory interest" tax in lieu of a leasehold excise tax. A "possessory interest" is not defined by Washington statute or code, but is a term of art recognized in the real estate appraisal industry and is akin to a

"leasehold interest" – though a possessory interest can exist in the absence of a lease (*e.g.*, a license agreement allowing use of property, etc.). It is defined as the right of possession and use of real property owned by a tax exempt public entity for a period of time.

The DOR specifically defines a possessory interest in its own publication, **Property Tax Bulletin #70-14**, as:

> Taxable possessory interests are private interests in property owned by a tax exempt body, usually a public agency.
>
> A taxable possessory interest constitutes a private right to the possession, and use of such property for a period of time. It constitutes the ownership of property for some time less than perpetuity. It is a portion of the bundle of rights that would normally be included in fee simple ownership, and its value therefore is normally something less than the value in perpetuity of the whole bundle.

CP 259. In the context of valuing a "possessory interest", **Property Tax Bulletin #70-14** states consideration must be given to the value of the "reversionary" interest – which is the property interest of the owner of fee title to the property. **CP 259**.

UAL entered into a lease with the Port of Seattle on January 1, 2006 for the use of certain defined airport property (the "Airport Property"). **CP 574-578; CP 579-693.** This was a 6 year lease with no renewal options set to expire on December 21, 2012. **CP 579-**

647. This Airport Property was subject to a possessory use tax, assessed by the DOR.

2. Starting in 2006, the DOR changed its methodology for assessing possessory interests in airline airport properties.

Until 2006, the DOR assessed Airport Properties using an assumed lease term of 7 years. **CP 299-302**. Commencing in assessment year 2006, the DOR decided to change its methodology – by adopting a Direct Capitalization model and assuming a hypothetical perpetual lease term for each property. **CP 228-249; CP 306; CP 309; CP 320-321; CP 452.** This change in methodology increased the assessed value of Airport Properties significantly. **CP 452.**

The DOR performed an assessment of UAL Airline Property in 2009, 2010 and 2011. Within the assessment for each of the years involved, Airport Property leased from the Port of Seattle was valued and assessed using the DOR's new methodology which assumed a perpetual lease term. **CP 452**. UAL paid the assessed taxes, including the portion of the centrally-assessed taxes that were owing for the SeaTac Airport Properties in 2009, 2010 and 2011. CP 453; CP 575.

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3. In 2012, other airlines began to complain about the DOR's new methodology for assessing Airport Properties, and Southwest Airlines filed suit seeking a refund of taxes.

In 2012, certain airlines at SeaTac began to raise concerns about the manner in which the DOR was assessing possessory interests for Airport Property. **CP 312-317**. Alaska Airlines paid certain taxes under protest and initiated a dialogue with the DOR about the methodology implemented by the DOR to value possessory interests since 2006. **CP 304-310**. Southwest Airlines commenced suit against the DOR and King County alleging, *inter alia*, that the DOR had improperly assessed the Airport Property resulting in an increased assessed value for 2009 of over $37,000,000 (including Southwest's Spokane Airport Property). **CP 312-317**. Based on these complaints, and input from other airlines operating in Washington, the DOR began to re-evaluate its process for assessing Airport Properties.

4. DOR's internal documents confirm the DOR was aware its methodology for assessing possessory interests was taxing these properties at their fee simple value.

Kathy Beith, the Assistant director of Property Tax Division at the DOR since 2011, issued a Director's Briefing Document on April 25, 2012 which noted the following:

> The Department assess the property of Alaska Airlines, and other airplane companies, which also includes airport property such as gates, terminals and common areas. The leased airport property are typically subject to a leasehold excise tax (LET) however the possessory leases of centrally assessed airlines are exempt from LET and subject to property tax. The possessory leases of Alaska Airlines are assessed in the same manner as if they owned the property. . . .

CP 304-305. This memo stated the questions presented for the DOR in reviewing its methodology for assessing airline possessory interests were a "legal interpretation and not valuation" questions. **CP 305**. Notwithstanding this admission, DOR has maintained throughout the present lawsuit that UAL's claim is a "valuation" issue. **CP 704-707**; **Transcript of Proceedings (May 22, 2015), p.31**.

5. DOR admits that the process used in 2006-2011 assessed possessory interests at fee interest value.

The DOR acknowledged, in assessing the airline airport properties, it is attempting to assess the possessory interest of the airline company, which is "something less than the fee interest in the property". **CP 319**. It also acknowledged that the methodology used by the DOR from 2006 to 2012 to value possessory interests of airline properties, resulted in an increased assessed value of at least three times the previously assessed value of the same properties. **CP 320-321**.

Facing litigation by Southwest Airlines and likely litigation by Alaska Airlines, the DOR changed its policy for valuing possessory interests starting in 2012 for certain airlines and in 2013 (assessed year 2012) for the entire industry, agreeing to use the actual lease term instead of a hypothetical perpetual lease. **CP 943-944**. Prior to adopting a final revision, the DOR temporarily adopted a methodology using the actual lease term (this temporary methodology was later formally adopted) and in an internal discussion document ("Airline Possessory Lease Appraisal Method Update") the DOR noted:

> **Current temporary method**. Based [on] the risk of potential litigation the Department changed the methodology used between 2006 – 2011 by utilizing the actual lease term, or one-year as a minimum to value only the possessory interest. This insures [sic] that no tax-exempt port property is taxed is being value or taxed.

CP 943-944.

The DOR acknowledged avoiding taxing exempt property was "certainly a part of the reasoning that went into the decision" to change the methodology. **CP 322-323**. This same document, affirmed by Ms. Beith in her deposition testimony provides a compelling admissions by the DOR:

> Because the core issue was based in legal interpretation and not valuation, we requested guidance from the Attorney General's on the following two issues:
>
> - What interest or rights are taxable for possessory interests?
> - Is the length of the taxpayer's actual lease a determining factor when determining the value of the reversionary interest held by the government entity?
>
> Based on their response, considering significant litigation risks, and several court cases that lend support to the pre-2006 method, we changed our appraisal method. . . .

CP 325-326; **CP 310**. The DOR also admitted:

A possessory interest is valued at something less than the entire bundle of rights associated with fee ownership. **CP 328**. A possessory interest is the right of ownership of property for some time less than perpetuity. **CP 328-329**. The methodology used by the DOR from 2006-2011 assumed a zero value for the reversionary interests of the Port. **CP 330-331**. The methodology used by the DOR from 2006 – 2011 valued the possessory interests of the airline airport properties as if they owned the fee interest in the property. **CP 333**.

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6. UAL's Airport Property was assessed and taxed for the years 2009, 2010 and 2011 based on the DOR's methodology assuming a hypothetical perpetual lease term.

The DOR computed the assessed value of the Airline Property for UAL, apportioned the property and equalized the values that were provided to King County for 2009, 2010 and 2011 using a direct capitalization method which presumed a perpetual lease term – notwithstanding the fact that UAL's actual lease term expired on December 31, 2012. **CP 451-453**; **CP 576**; **CP 581**. The assessed value of the Airline Property within King County provided by the State of Washington was then used to compute personal property taxes for UAL that were assessed for 2009, 2010 and 2011. ***Id.*** Personal property taxes assessed to UAL for 2009, 2010 and 2011 were paid by UAL in 2010, 2011 and 2012. ***Id.***

Upon discovering the DOR was utilizing a perpetual lease term, which effectively taxed the Airport Property as if UAL owned the property in fee, Duff & Phelps, acting as UAL's authorized agent, filed a claim under RCW 84.69.020 dated December 31, 2012, requesting a refund of taxes paid as a result of a manifest error in description. **CP 454; CP 581-582; CP 576**. The request for refund is based on a "manifest error in description" of the property taxed. Specifically, the DOR by utilizing a perpetual lease term in its direct

capitalization assessment methodology, effectively assessed and taxed the Port of Seattle's fee interest in the Airport Property (which is exempt from taxation). **CP 228-249**; **CP 446-455**. In a letter dated February 19, 2013, King County denied the refund requests of UAL, asserting that the claim for refund was based on a disagreement with the valuation of operating property as determined by the DOR. **CP 530**.

On April 29, 2014, as an authorized agent acting on behalf of UAL with UAL's express permission and approval, Mr. Perkins presented a property tax refund request to the King County Treasurer seeking refund of the same possessory interest taxes paid by UAL for assessed years 2009, 2010 and 2011. **CP 446-455,544-573**; **CP 576-577**; **CP 582-583.** Bill Gile, Senior Manager of Tax for UAL signed the petition. **CP 455**. In a letter dated May 7, 2014, King County denied the UAL's April 29, 2014 Petition for Property Tax Refund, asserting that the claim did not involve a manifest error in the description of the property. **CP 558-559**.

The total tax refund due to UAL for assessed years 2009, 2010 and 2011 is calculated as follows: 2009 (2010 taxes) $555,906; 2010 (2011 taxes) $473,594; 2011 (2012 taxes) $548,165. **CP 455.**

IV. SUMMARY OF THE ARGUMENT

A. The trial court's rulings on the Cross-Motions for Summary Judgment were in error and should be reversed.

This matter relates to the assessment of possessory interest taxes on UAL-leased property located at the SeaTac Airport, which is owned by the Port of Seattle, and the property is thus tax-exempt. However, under a specific provision in Washington law, UAL's possessory leasehold interest is taxable.

From 2006 to 2011, DOR changed its methodology for assessing airline airport property possessory interests. During this period, the DOR utilized a direct capitalization model which assumed a perpetual lease term for all airline interests in Airline Properties -- instead of using the existing actual lease terms. UAL executed a six (6) year lease for its airline properties in 2006, which was set to expire in December 2012 – with no renewal options. The DOR chose to ignore this lease term and assume a hypothetical perpetual lease term in making its assessments from 2006 - 2011. By doing so, the DOR valued the entire "bundle of rights" owned by the property owner (the tax-exempt interest of the Port of Seattle) in fee simple and assessed this tax on UAL. DOR admitted in its own internal documents that the reversionary interest, the tax exempt interest of

the Port, is "nil" under the model it used from 2006 to 2011. If the reversionary interest is zero, then DOR was taxing the full fee interest of the properties, including the exempt reversionary interest, when it assessed and taxed UAL's airport property in 2009, 2010, and 2010. This is a "manifest error" because it taxed exempt property and imposed this tax on airlines (including UAL); and the error can be cured without resorting to appraisal judgment, as noted by DOR's own internal documents referencing the issued as a "legal" question, not a "value" question.

The trial court's decision on the Cross-Motions for summary judgment should be reversed in light of the disputed material facts presented by the parties, including expert testimony. The DOR's own documents and witness deposition testimony indicate the methodology utilized for valuing airline possessory interests from 2006 – 2012 assumed a "perpetual" lease term, valued the airlines' leased airport properties at or near fee interest value, and assumed a reversionary interest of "nil". The DOR's own witness, Neal Cook, contradicted this position in his declaration offered in support of the DOR's motion, claiming that the DOR methodology was not a "perpetuity model", did not value the possessory interests at fee simple value, and did not include an assessment for the reversionary

interest of the Port of Seattle. To the extent Mr. Cook can be considered an expert qualified to offer opinions, the "opinions" stated in his declaration were expressly contradicted by UAL's expert, David Hunnicutt. Specifically, Mr. Hunnicutt opined that the DOR's methodology failed to account for the reversionary interest of the Port of Seattle, and effectively taxed UAL as if it owned the property in fee simple.

The conflicting positions stated in the DOR's own documents and offered by the DOR's own witnesses, juxtaposed with the expert testimony offered by UAL's expert witness, confirmed that there were disputed issues of material fact which precluded the entry of summary judgment – for either party. The trial court erred in granting DOR's motion, and the matter should be remanded for trial.

In the alternative, the trial court's order granting DOR's motion for summary judgment and denying UAL's motion for summary judgment should be reversed: denying DOR's motion and granting UAL's motion. To correct the manifest error, the DOL can simply use the present value of the existing net lease payment over the remaining period of the lease at, adjusted by a discount rate.

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B. The trial court erred in denying UAL's Motion to Amend its Complaint, and should be reversed.

UAL sought to amend its Complaint to make reference to the supplemental petition presented by UAL to King County in April 2014 – which related to the same claims, same facts, and the same occurrence. King County did not assert any objection or contest the fact that these revised petitions related back to the December 2012 petition. Nor did the DOR claim any prejudice as a result of such proposed amendment. The trial court nonetheless denied the motion

CR 15(c) provides amended pleadings arising out of the same "conduct, transaction or occurrence" relate back to the filing of the original complaint. Here, it is the same conduct, transaction and occurrence that is at issue: the DOR's methodology for assessing UAL's possessory interests of airport property for tax years 2009, 2010 and 2011 and the DOR's denial of the requested refund.

Even if this Court finds CR 15(d) applied to the case at bar, UAL's Amended Complaint still relates back under CR 15(c). CR 15 and FRCP 15 are substantially similar. Federal courts have been clear Rules 15(c) and 15(d) can be considered together and that "supplemental" claims relate back to the initial filing if the claims arise out of the same conduct, transaction or occurrence. Therefore, the

trial court erred when it denied UAL's request for an order allowing the filing of an Amended Complaint.

V. ARGUMENT

A. Faced with disputed issues of material fact, the Trial Court erred when it granted UAL's motion; in the alternative, UAL's motion for summary judgment should have been granted and DOR's motion for summary judgment should have been denied.

1. Rulings on Summary Judgment are reviewed *de novo.*

A trial court's ruling on a party's motion for summary judgment is reviewed by the Court of Appeals *de novo*. *See,* ***Keates v. City of Vancouver***, 73 Wn. App. 257, 263, 869 P.2d 88 (1994). The Court of Appeals engages in the same inquiry as the trial court in determining whether summary judgment is appropriate. ***Lybbert v. Grant County, State of Wash.***, 141 Wn. 2d 29, 34, 1 P.3rd 1124 (2000).

2. This Court should reverse the lower court's ruling on the cross-motions for summary judgment in light of the disputed issues of material fact presented.

The DOR's real estate appraisal expert, Neal Cook, stated in his declaration:

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> The direct capitalization method used by the Department during 2006 through 2011 produce an accurate estimate of the value of the property rights transferred to a lessee, namely the rights to possess and the use of the subject government-owned property. That method did not value the fee simple interest of the subject property, did not value the possessory interest as if those interests are to be held by the lessee into perpetuity, and did not include in the value estimate the lessor's reversionary interest in the subject property.

CP 176.

This contradicts the testimony of DOR witnesses, and various internal DOR documents which were produced in discovery and offered by DOR in support of its motion, which repeatedly indicate the DOR recognized its methodology utilized during this period assumed a perpetual lease term, that it taxed the property equivalent to fee simple ownership and that the reversionary interest of the Port of Seattle under this model was assumed to be "nil". **CP 304-305**; **CP 306-307**; **CP 309**, **CP 330-331**; **CP 333**.

Moreover, Mr. Cook's statements, central to DOR's motion and the material issues presented in both parties' motion, is contradicted in its entirety by UAL's expert, David Hunnicutt's declaration, a duly qualified expert MAI appraiser, who noted that the DOR's methodology for this time period was a perpetuity model, and further stated:

> [I]t is my professional opinion, on a more probable than not bases, that the methodology utilized by the DOR to value and assess UAL leasehold possessory interests at SeaTac for 2009, 2010 and 2011 failed to account for the reversionary interest of the Port of Seattle. As a result, the calculations relied upon by the DOR for value, improperly took into account the value of the tax exempt interest of the Port. Thus, the DOR when assessing taxes for these possessory interests, effectively taxed UAL as if they owned the fee interest for these properties. Therefore, UAL was assessed taxes for exempt Port-owned property.

CP 230.

Hunnicutt's declaration directly contradicts Mr. Cook's statements and the DOR's position with respect to its methodology for valuing airport property possessory interests. Specifically, whether the DOR's methodology from 2006-2011 resulted in taxes being assessed on UAL for the tax-exempt interest of the Port of Seattle. In light of this conflicting evidence, the trial court erred in granting DOR's motion for summary judgment.

In ruling on a motion for summary judgment, the Court is required to consider all material evidence and all reasonable inferences therefrom in favor of the nonmoving party; if reasonable persons might reach different conclusions, the motion must be denied. ***Millikan v. Board of Directors of Everett Sch. Dist. No. 2***, 93 Wn.2d 522, 531, 611 P.2d 414 (1980); ***Fairbanks v. J.B.***

McLoughlin Co., Inc., 131 Wn.2d 96, 102, 929 P.2d 433 (1997)(Court must accept the nonmoving party's evidence as true, and must consider all the facts and all reasonable inferences therefrom in the light most favorable to the nonmoving party). An inference in this context, "is a process of reasoning by which a fact or proposition sought to be established is deduced as logical consequence from other facts, or a state of facts, already proved or admitted." ***Fairbanks v. J.B. McLoughlin Co., Inc.***, 131 Wn.2d at 102 (citations omitted).

Affidavits and other testimonial documents of the party moving for summary judgment must be scrutinized with care, and all reasonable inferences from the evidence must be resolved against him/her, while affidavits of nonmoving party are to be afforded leniency. ***State ex rel. Murray v. Shanks***, 27 Wn. App. 363, 618 P.2d 102 (1980). Even if the basic facts are not in dispute, if the facts are subject to reasonable conflicting inferences, summary judgment is improper. ***Southside Tabernacle v. Pentecostal Church of God, Pacific Northwest District, Inc.***, 32 Wn. App. 814, 821, 650 P.2d 231 (1982). In the context of evaluating the DOR's motion for summary judgment, and UAL's response thereto, the trial court erred in failing to recognize disputes issues of material fact which

precluded the entry of summary judgment – especially when all facts and evidence were considered in the light most favorable to UAL as the non-moving party.

Moreover, conflicting expert testimony (Cook vs. Hunnicutt) on a material issue also created disputed issues of material fact precluding the entry of summary judgment. "In general, an affidavit containing admissible expert opinion on an ultimate issue of fact is sufficient to create a genuine issue as to that fact, precluding summary judgment." ***J.N. v. Bellingham Sch. Dist. No. 501***, 74 Wn. App. 49, 60-61, 871 P.2d 1106 (1994) (reversing summary judgment where the trial court "discounted the sworn testimony of J.N.'s experts"). *See also* ***Lamon v. McDonnell Douglas Corp.***, 91 Wn.2d 345, 351-53, 588 P.2d 1346 (1979) (reversing summary judgment where the expert affidavit presented by the plaintiff created at least one genuine issue of material fact); ***Morton v. McFall***, 128 Wn. App. 245, 254-55, 115 P.3d 1023 (2005) (reversing summary judgment where the declaration of plaintiff's medical expert contradicted the declaration of defendant's expert as to the necessity of certain medical tests, thus raising an issue of material fact).

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3. In the alternative, this court should reverse the trial court's ruling on the DOR's motion, but grant UAL's motion for summary judgment for the following reasons.

(a) Taxable possessory interests are not defined under Washington law.

This case involves a fairly narrow category of properties – centrally assessed utilities that are leasing property on publicly owned land. A basic primer for the context of this appeal is appropriate. We start with the basic proposition that "[a]ll properties belonging to the United States, state, or any county or municipal corporation . . . [are] exempt from taxation." ***RCW 84.40.010(1).*** For government owned properties that are leased by private parties, there is a "leasehold excise tax" imposed in lieu of a property tax. ***RCW 82.29A.030.*** However, centrally assessed operating properties of utilities and transportation companies (which includes airlines) are exempt from the leasehold excise tax. ***RCW 82.29A.130.*** Instead, they are subject to a "possessory use" tax, which is not defined by Washington law.

(b) RCW 84.69.020(2) requires a refund of property taxes for taxes paid as a result of a "manifest error in description".

RCW 84.69.020(2) provides that on the order of the county treasurer, ad valorem taxes paid before or after delinquency shall be refunded if the taxes were paid as a result of "manifest error in description." WAC 458-14-005(14) defines "manifest error" as "an error

in listing or assessment, which does not involve a revaluation of property." WAC 458-14-005(14) also provides a list of items that constitute a "manifest error" as follows:

> (a) An error in the legal description;
> (b) A clerical or posting error;
> (c) Double assessments;
> (d) Misapplication of statistical data;
> (e) Incorrect characteristic data;
> (f) Incorrect placement of improvements;
> (g) Erroneous measurements;
> (h) The assessment of property exempted by law from taxation;
> (i) The failure to deduct the exemption allowed by law to the head of a family; or
> (j) Any other error which can be corrected by reference to the records and valuation methods applied to similarly situated properties, without exercising appraisal judgment.

WAC 458-14-005(emphasis added). The present case falls under parts (h) and (j) of this code provision. First, as more fully set forth herein, the assessments in question effectively taxed exempt property (tax exempt property owned by the Port of Seattle). The direct capitalization methodology utilized from 2006-2011 by the DOR assumed a lease term for the airlines (including UAL) into perpetuity (instead of the actual lease term). Using this method eliminated the reversionary interest of the owner of the property (tax-exempt Port of Seattle) and completely ignored the terms of the parties' actual lease. For UAL, its lease expired in December 2012 (not perpetuity). Second, the correction can be made based upon information the DOR already

has and such correction does not require any appraisal judgment – as all the DOR needs to do is utilize the existing lease term instead of a hypothetical perpetual lease term to recalculate the amount of taxes that should have been assessed – in order to determine UAL's refund.

(c) Using the wrong methodology to compute the value of the leasehold possessory interests was a manifest error in description under WAC 458-14-005.

In order to understand this issue, it is helpful to review one of the basic real property concepts relating to ownership and the rights of an owner, as compared to a "bundle of sticks":

> Rights in real property are often compared to a bundle of sticks, with each stick representing a different right or interest. The entire bundle of sticks represents the complete set of rights, which is called the fee simple interest. The bundle of rights can be divided in almost innumerable ways. In a possessory interest, the ownership of the possessory rights in real property is separated from the ownership of the fee interest. Generally, a possessory interest consists of a right to the possession of real property for a period less than perpetuity by one party, the holder of the possessory interest, while another party, the fee simple owner, retains the right to regain possession of the real property at a future date.

Assessor's Handbook, California State Board of Equalization, Section 510, The Assessment of Taxable Possessory Interests, December 2002. This definition is echoed by the DOR's own **Property Tax Bulletin #70-14**. **CP 259.** (Possessory interest defined as a "portion of the bundle of rights that would normally be included in a fee

ownership, and its value therefore is normally something less than the value in perpetuity of the whole bundle".)

UAL, as the lessee of property from the Port of Seattle, is considered to own a possessory interest in that leased property. This leasehold possessory interest is distinct from the interest held by the Port of Seattle to regain possession of the real property at a future date, also known as a leasehold reversionary interest. Together, these interests, the possessory interest and the reversionary interest, make up the fee interest in the real property owned by the Port of Seattle – in other words, the complete bundle of rights. **CP 228-249; CP 446-455**.

The Port of Seattle is exempt from real property taxes in Washington pursuant to RCW 84.36.451. However, as noted, this exemption does not apply to "leasehold interests which are part of the operating properties of public utilities subject to assessment under chapter 84.12 RCW." ***RCW 84.36.451(2)***. Accordingly, the properly determined value of the leasehold possessory interest in the real property leased by UAL from the Port of Seattle is included in the assessed value of property to UAL.

Washington has previously addressed the value of leasehold possessory interests. In ***Pier 67 II, Inc. v. King County***, 78 Wash 2d 48, 469 P2d 902 (1970), the Supreme Court of Washington provided guidance for valuing leasehold possessory interest. In ***Pier 67***, a

taxpayer challenged the validity of valuations for a leasehold interest and improvements on state owned land. ***Id., at 48-48.*** The Court found that in determining the taxable value of a leasehold interest "the value to be taxed is the value of the right to use the property over the period of the lease." ***Id., at 56-57 (emphasis added)***. The Washington Supreme Court went on to note the market "value of a leasehold is to be measured by considering both benefits to be garnered from the use of the property over the term of the lease and the burdens placed upon it." ***Id., at 56.***

The seminal case concerning taxing of possessory interests in Washington is ***Duwamish Warehouse v. Hoppe***, 102 Wn. 2d 249, 684 P.2d 703 (1984), where Duwamish Warehouse appealed the valuation of its leasehold interest on lands owned by the Port of Seattle. The Washington Supreme Court laid out the parameters for what can be taxed when assessing leasehold interests in publicly owned land as follows:

> Ordinarily, full and fair value means the amount a willing buyer would pay a seller who is willing but not obligated to sell. *See, e.g.*, ***Carkonen v. Williams***, 76 Wash.2d 617, 458 P.2d 280 (1969). Where private land is leased, the willing buyer is contemplated to be purchasing the entire fee, including leasehold and improvements...In the circumstances of state-owned interests in the land, however, the State's ownership interest cannot be purchased. Thus, a willing buyer would not logically pay a price for the entire fee....

Id., at 254. The ***Duwamish*** court went on to evaluate the accepted standard for assessing leased public property, concluding that the reversionary interest of the public must be considered in determining the leasehold interest value, noting:

> The Washington Legislature has provided that noncontract rent improvements on public property are to be assessed in accordance with RCW Title 84. RCW 84.40.030 requires that the improvements be valued at their true and fair value. To disregard the fact that this building reverts to the Port at the end of the lease term, long before its useful life is up, would be to disregard a factor which plainly would affect the price negotiations between a willing buyer and a willing seller.

Id., at 256.

Thus under ***Pier 67***, the lease term must be considered when calculating a possessory interests, and under ***Duwamish***, the reversion of the property back to the public must also be considered. The DOR did neither in this instance. The DOR chose a perpetual model (ignoring the actual term of the lease) and decided that the reversionary interests was zero. This is a manifest error. **CP 228-249; CP 446-455**

The formula used in 2009, 2010 and 2011 to value the leasehold possessory interest was to compute the income stream from the lease and then divide that income stream by a capitalization rate. Dividing the lease income stream of a property by a capitalization rate, also known as the income capitalization approach, is one approach used to determine the value of property. **CP 232-235**. This method determines

a value for the entire fee interest of the property, which includes both the leasehold possessory interest and the leasehold reversionary interest. ***Id.***; **CP 230**.

The income capitalization formula involves discounting the expected cash flow over the term of the lease. Each expected cash flow in the future is discounted using a capitalization rate to discount that cash flow to its current value. The sum of the current values of the various discounted cash flows are summed to determine the value of the leasehold possessory interest over the remaining life of the lease. **CP 228-249**.

When the cash flows are expected to remain the same into the future and are discounted back to the present based on the assumption that the cash flows will continue into perpetuity, it is only necessary to divide the cash flows by the capitalization rate. This essentially assumes that the property will never revert to the lessor and the value of the reversionary interest is zero. Accordingly, the entire value of the property is equal to the leasehold possessory interest and no value is assigned to the reversionary interest. If there is a value in the reversionary interest, capitalizing the leasehold income into perpetuity results in the inclusion of that reversionary interest in the leasehold possessory interest. **CP 228-249; CP 446-455; CP 813-821**.

When the DOR failed to take into account the remaining life of UAL's SeaTac airport lease, the DOR valued and assessed the entire fee interest in the property, which includes the leasehold possessory interest and leasehold reversionary interest. **CP 230**. RCW 84.36.451(2) exempts from taxation property owned by the Port of Seattle. Accordingly, this error in assessment by the DOR caused the assessment of property exempted by law from taxation, which is a manifest error in assessment per WAC 458-14-005(14)(h). This is an error that could be corrected by reference "to the records and valuation methods applied to similarly situated properties, without exercising appraisal judgment." ***WAC 458-14-005(14)***. All that is necessary is to determine the remaining life of the lease and capitalize the lease income over the remaining life of the lease. No appraisal judgment is required in order to correctly calculate the value of the leasehold possessory interest.

(d) The American Airlines case is directly on point and provides persuasive authority.

California courts have faced a very similar fact pattern and resolved this matter in favor of the taxpayer. ***American Airlines, Inc. v. County of Los Angeles***, 65 Cal.App.3d 325 (1976).

In ***American Airlines***, two airline companies sought refund of property taxes paid on their respective leasehold interests at a

municipal airport. The Los Angeles County Assessor had assessed the possessory interests of the airlines upon the 'reasonably anticipated term of possession' – and disregarding the actual terms of the existing leases. The procedural history of the American Airlines case is strikingly similar to the case at hand:

> Each airline leases at LAX various parcels of real property generally described as passenger terminal facilities. The leases, far from uniform in content, were entered into separately by each airline, as lessee, and the City of Los Angeles, a tax-exempt entity . . . as lessor. Many of the leases were entered into in 1962 and 1963 for 28 year terms . . . None of the leases contains any option to renew, and the airlines assert that there are no understandings or agreements relating to renewal.
>
> Until 1973 the Assessor assessed the possessory interests of each airline in its leases by capitalizing the annual fair market rental rate of the leases over the actual remaining terms thereof. In 1973, instead of using the 18-year remaining term of the leases, the assessor based his assessments upon a 25-year period which in his opinion was the 'reasonably anticipated term of possession' of the leased property.

American Airlines, at 327-328.

The court went on to note:

> Undeniably the leaseholds of the airlines are possessory interests in the tax-exempt property of defendant City and as such are properly taxable as real property. However, the obvious question remains—<u>what do the airlines have following termination of their leases that the assessor purported to assess</u>?

Id., at 329 (emphasis added).

This is the same question posed to the court by UAL in this action. Concluding that "there is no indication here that the airlines have anything more than their leases and, perhaps, the hope that renewal of the leases will be possible. . . ." the ***American Airlines*** court concluded the airlines' possessory interest must be defined by the existing lease terms. 65 Cal. App., 3rd, 331-332. Assessing tax on any interest in excess of the actual lease term, effectively imposes a tax on the taxpayer for the exempt interest of the fee owner (in this case, the Port of Seattle).

(e) UAL's Administrative Refund Claims Were Properly "Verified" As Required Under RCW 84.69.030(1)(a).

The administrative refund claimed filed on behalf of UAL complied with all statutory requirements. RCW 84.69.030(1)(a) provides, in full:

> Except as provided in this section, no orders for a refund under this chapter may be made except on a claim verified by the person who paid the tax, the person's guardian, executor or administrator.

(emphasis added). The term "verified" is not defined in the statute.

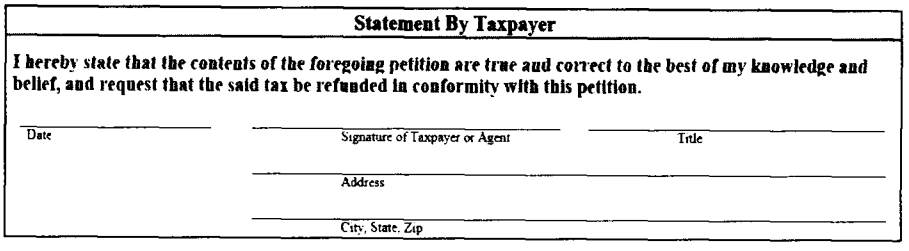
DOR would ask the court to construe the definition of "verify" narrowly—alleging that it means to swear to the truth of the facts asserted. Black's Law Dictionary's complete definition of "verify" states:

> 1. To prove to be true; to confirm or establish the truth or truthfulness of; to authenticate. 2. To confirm or substantiate by oath or affidavit; to swear to the truth of.

Black's Law Dictionary (10th ed. 2014). If the Legislature intended "verify" to mean oath or swear, it would have, as shown by the statute defining the terms "oath" and "swear": "'Oath' may be held to mean affirmation, and the word 'swear' may be held to mean affirm." ***RCW 84.04.070***. However, the Legislature chose to not use the terms "oath" or "swear" but instead "verify", suggesting a different requirement than one signed under oath or penalty of perjury. Adopting DOR's proposed narrow definition of "verify" in this context would suggest that the Legislature meant to impose a different requirement than the statute's plain language. The term "verify" should be interpreted to mean to prove to be true, to confirm, or to authenticate.

The DOR's own form does not require taxpayers to swear, affirm or even "verify" the matters set forth in a petition for a refund.

The form which the DOR would have taxpayers fill out to petition for a tax refund under RCW 84.60.060 or 84.69.050, provides:



Statement By Taxpayer

I hereby state that the contents of the foregoing petition are true and correct to the best of my knowledge and belief, and request that the said tax be refunded in conformity with this petition.

Date | Signature of Taxpayer or Agent | Title

Address

City, State, Zip

CP 545-546.

The language provided by the DOR's form does not purport to have the signature of the taxpayer or agent to "swear", "affirm" or "declare under penalty of perjury" any of the facts set forth in the petition. It also provides that it may be signed by the "taxpayer or agent". For the DOR to now claim that "verified" means to swear to the truth is inconsistent with its own form. As such, David Perkins, an authorized agent acting on behalf of UAL, complied with the statutory requirements of RCW 84.69.030(1)(a) when he submitted the original petitions for refund in December 2012. **CP 454**; **CP 576**; **CP 581-582**. Perkins reviewed the underlying data, including UAL's payment of taxes and the calculations for the amount of tax refunds UAL believed to be due. **CP 454**. The data was all verified as true and correct by UAL officers in their tax department and Perkins. **CP 454**; **CP 581-582**.

Moreover, if there is any doubt as to meaning of a tax statute, it must be construed against the taxing power. ***Mac Amusement Co. v. DOR***, 95 Wn. 2d 963, 966, 633 P.2d 68 (1981). If a tax statute is ambiguous, it must be construed 425 most strongly against the taxing authority. ***Grp. Health of Puget Sound v. DOR***, 106 Wash.2d 391, 401, 722 P.2d 787 (1986). ***City of Wenatchee v. Chelan Cnty.*** Pub. Util. Dist. No. 1, 181 Wash. App. 326, 337, 325 P.3d 419, 424-25 (2014).

B. <u>The Lower Court Erred in Denying UAL's Motion for Leave to Amend its Complaint.</u>

1. Leave to amend under CR 15(a) is to be "freely given"

Rules governing amendment to pleadings serve to facilitate proper decisions on the merits, to provide parties with adequate notice of the basis for claims and defenses asserted against them, and to allow amendment except where prejudice to the opposing party would result. ***Wilson v. Horsley***, 137 Wash. 2d 500, 974 P.2d 316 (1999). The purpose of pleadings is to facilitate proper decision on the merits, and not to erect formal and burdensome impediments to litigation process - CR 15 was designed to facilitate amendment except where prejudice to opposing party would result. ***Caruso v. Local Union No. 690***, 100 Wash. 2d 343, 670 P.2d 240, (1983). The

touchstone for denial of a motion to amend a pleading is whether such amendment will prejudice the nonmoving party. ***Wilson***, at 505. Absent prejudice to defendant, the motion should be granted.

2. The April 2014 petition for refund was an amendment to the December 2012 petition and the proposed Amended Complaint relates back to plaintiff's initial Complaint.

The April 2014 petition by its terms expressly related back to the prior petition for refund. Specifically, it stated:

> Please find the enclosed revised petitions for property tax refund originally filed by letter dated December 31, 2012 on behalf of the above-referenced taxpayer for tax years 2010, 2011, and 2012. The enclosed revised petitions for property tax refund are intended to relate back to and amend the originally filed petitions.
>
> Please note that the original petitions filed for property tax refund have already been denied or no action was taken within six months of the filing. As such, actions have been commenced in Superior Court on the original petitions as provided for under RCW 84.69.120.
>
> Should there be any action taken by the Superior Court dismissing the suits commenced on the original petitions for refund of property tax for lack of jurisdiction, the enclosed revised petitions filed will become original petitions for refund of property tax.

CP 544. In a letter dated May 7, 2014, King County denied the UAL's April 29, 2014 request, asserting:

> Based on the following three reasons we are denying your claims: (1) the claim does not involve a manifest error in the description of the property (RCW 84.69.020(2), (2) claims for refund of amounts due in 2010 were not filed within the three year period required by RCW 84.69.030(2), and (3) virtually identical claims were previously denied and are currently the subject of judicial review in Thurston County Superior Court.

King County failed to assert any objection or contest the fact that these revised petitions related back to the December 2012 petition. **CP 558-559**.

The material facts, parties and claims did not change. Although the dollar amount calculated for UAL's damages was slightly revised, this is not a material change to UAL's claim.

In addition to the express language of the April 2014 petition (and the fact that King County never raised an objection to this language), CR 15(c) provides amended pleadings arising out of the same "conduct, transaction or occurrence" relate back to the filing of the original complaint. CR 15(c). Here, it is the same conduct, transaction and occurrence that is at issue: the DOR's methodology for assessing UAL's possessory interests of airport property for tax years 2009, 2010 and 2011 and the DOR's denial of the requested refund.

Relation back of amendments is proper even when the case presents a new cause of action or legal theory, as long as the cause of action arose out of the same "conduct, transaction or occurrence" and defendant receives adequate notice of the amendment. See ***Olson v. Roberts & Schaeffer Co.***, 25 Wash. App. 225, 227, 607 P.2d 319 (1980). Interpreting CR 15(c) and the relation back doctrine, Washington Courts have affirmed the rule:

///

> [I]s to be liberally construed on the side of allowance of relation back of the amendment where the opposing party will be put to no disadvantage. Modern rules of procedure are intended to allow the court to reach the merits, as opposed to disposition on technical niceties.

Lind v. Frick, 15 Wash. App. 614, 550 P.2d 709 (Div. 3 1976)(citations omitted). Applying this liberal standard, and the complete lack of prejudice to DOR, UAL's motion should have been be granted.

3. To the extent CR 15(d) arguably applies, UAL is entitled to amendment and relation back under that provision as well.

DOR contends that UAL's proposed amended complaint should be reviewed under the provisions of CR 15(d) as a "supplemental pleading". This is incorrect. Although the proposed amended complaint does reference facts that occurred after the filing of this lawsuit (presentation of the April 2014 petition and the county's denial), this is a mere procedural formality. On the grounds and bases previously set forth, the April 2014 petition was merely an amendment to the prior petition and not a "new" claim per se – as it deal with the same conduct, transaction and occurrence involved in the above-captioned lawsuit.

Even if this Court finds CR 15(d) applies in the case at bar, Plaintiff's Amended Complaint still relates back under CR 15(c). CR 15 and FRCP 15 are substantially similar. Federal courts have been clear Rules 15(c) and 15(d) can be considered together. The Ninth Circuit in ***William Inglis & Sons Baking Co. v. ITT Continental Baking Co., Inc.*** held "refusal to allow the supplemental complaint to 'relate back' to the date of the original complaint was erroneous." 688 F.2d 1014, 1056, 668 F.2d 1014 (9th Cir. 1981). In ***Security Ins. Co. v. United States ex rel. Haydis***, the Ninth Circuit cited both Rule 15(c) and 15(d) and held the supplemental pleading could relate back to the original complaint. 388 F.2d 444 (9th Cir. 1964) (finding both complaints arose out of the same transaction and allowed a supplemental pleading filed after the expiration of the one-year statute of limitations to relate back to a previously filed complaint).

4. UAL's amendment would not be "futile" and this is not the appropriate standard under CR 15.

The DOR's allegation that the Amended Complaint would be "futile" because the facts are not "material to the issue at hand" is misplaced. The DOR argues the amended pleading is futile based on its own legal conclusion that UAL is not entitled to a tax refund from King County as a matter of law. However, this very issue has

yet to be decided by this Court. If this Court finds UAL to be entitled to a tax refund on summary judgment, then the amendment is clearly not futile. If, however, the Court is unable to make a determination at the summary judgment stage whether UAL is entitled to a tax refund, this also undermines the DOR's allegation because these revised facts supports the amount of tax refund owed if a factfinder later finds UAL to be entitled to a tax refund.

VI. CONCLUSION

DOR admitted in its own internal documents that the reversionary interest, the tax exempt interests of the Port, is "nil" under the model they used from 2006 to 2011. If the reversionary interest is zero, then DOR was taxing the full fee interest of the properties – including the tax-exempt reversionary interest of the Port of Seattle – when it assessed and taxed UAL's Airline Properties in 2009, 2010, and 2011. This is a "manifest error".

Given the huge disparity of the assessed values of the differing methods used by DOR, and the fact that it changed its methodology when faced with litigation by other airlines, and after consulting with the Attorney General's office, it is apparent the DOR is aware the methodology employed during this time was flawed and in error.

DOR's Motion for Summary Judgment should have b denied in its entirety. By arbitrarily assuming a perpetual lease term in its methodology for valuing possessory interests, even though UAL only had a 6 year lease, which expired in 2012 (with no renewal options) – the DOR effectively valued the entire bundle of rights owned by the owner of the property (the tax-exempt Port) in fee simple. The DOR admitted in its own internal documents that the reversionary interest, the tax exempt interests of the Port, is "nil" under the model they used from 2006 – 2011. If the reversionary interest is zero, then the DOR was taxing the full fee interest of the properties – including the exempt reversionary interest – when it assessed and taxed UAL's Airline Properties in 2009, 2010 and 2011. This is a "manifest error" because it effectively taxed exempt property and the error can be cured without resorting to appraisal judgment – as noted by the DOR's own internal documents (referencing the issue as a "legal" question not a "value" question). Accordingly, UAL respectfully requests this Court overturn the lower court's ruling on summary judgment in its entirety: denying DOR's motion and granting UAL's motion.

In the alternative, faced with inconsistent internal documents from DOR and sworn testimony offered by its own witnesses as well

as the directly conflicting expert testimony offered by UAL, the trial court erred when it granted the DOR's motion. In light of the disputed issues of material fact presented it was an error for the court below to grant summary judgment (for either party).

Furthermore, the undersigned respectfully submits the trial court erred when it denied UAL's motion for leave to file an Amended Complaint. The proposed Amended Complaint would not result in any prejudice to UAL, did not raise any new claims, and related to the same conduct, transaction and occurrence, and therefore related back to the initial Complaint – to the extent such relation back would even be necessary.

Respectfully submitted this 26th day of October, 2015.

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CERTIFICATE OF SERVICE

The undersigned certifies under penalty of perjury under the laws of the State of Washington, that on the below date, delivered a true copy of this document to counsel of record for the Respondent, via regular mail.

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Dated this 26th day of October, 2015, at Seattle, Washington.

Tara L. Peterson