NO. 98316-0

SUPREME COURT OF THE STATE OF WASHINGTON

ADVANCED H2O, LLC & TYSON FRESH MEATS, INC.,

Petitioners,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

DEPARTMENT OF REVENUE'S ANSWER TO AMICUS CURIAE BRIEF OF ASSOCIATION OF WASHINGTON BUSINESS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Regulations

Treatises

I. INTRODUCTION

The Court of Appeals' decision below correctly applied the plain meaning of the lease "for the purpose of sublease" sales tax exclusion to the undisputed facts in the record. It does not warrant further review for the reasons set out in the Department of Revenue's Answer to the Petition for Review. Amicus curiae Association of Washington Business (AWB) has offered no valid alternative reason for accepting review.

II. ARGUMENT

A. The Court of Appeals' Decision Correctly Applies the Plain Meaning of the Lease "For the Purpose of Sublease" Exclusion

AWB contends review is warranted because the Court of Appeals failed to apply clear statutory language in concluding the Manufacturers' pallet rentals did not qualify as a lease "for the purpose of sublease" under RCW 82.04.050(4)(b). Specifically, AWB asserts the Court of Appeals' use of a dictionary definition of "sublease" results in "new requirements" for business. AWB Br. at 3. But AWB fails to demonstrate any inconsistency between the dictionary definition and the statutory definition of "lease." There is none.

The retail sales tax applies to "each retail sale." RCW 82.08.020(1). "Retail sale" means "any sale, lease, or rental for any purpose other than for resale, sublease, or subrent." RCW 82.08.010(11).

A "lease or rental" is defined as "any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration." RCW 82.04.040(3)(a). A "retail sale" "includes the renting or leasing of tangible personal property to consumers." RCW 82.04.050(4)(a). A "consumer" includes any business that acquires property for any purpose other than for resale. RCW 82.04.190(1)(a).

The sales and use tax statutes clearly state that a sale or leasing of tangible personal property for *any purpose* other than resale or releasing that property is a retail sale. Under the plain meaning of these statutes, businesses that rent pallets for their own use in delivering products to customers must pay sales or use tax on the rental fees.

The Manufacturers (i.e., petitioners) in this case stipulated that they rented pallets from CHEP USA, Inc. for their own use in delivering their products to customers. The Court of Appeals correctly concluded the Manufacturers' purpose for renting the pallets—to deliver products to customers—counts as a purpose "other than for sublease" within the plain meaning of RCW 82.04.050(4)(b). *Dep't of Revenue v. Advanced H2O, LLC & Tyson Fresh Meats, Inc.*, 11 Wn. App. 2d 384, 402, 404, 453 P.3d 1011 (2019). The Court of Appeals also correctly concluded the pallets could not have been leased "for the purpose of sublease" because the Manufacturers exclusively possessed and controlled the leased pallets for

the entire period of time for which they paid rent. *Id.* at 400. Finally, the Court of Appeals correctly concluded the Manufacturers' "lease for sublease" theory also was refuted by the undisputed fact that their customers had a preexisting rental agreement with CHEP. *Id.* at 400. CHEP is the person that leased the pallets to the Manufacturers' customers.

AWB fails to demonstrate how Court of Appeals' common sense conclusions contradict the plain meaning of the applicable tax statutes.

B. The Court of Appeals' Decision is Consistent with the "Historical Tax Administration" of Packaging Materials

AWB contends review is warranted because the Court of Appeals' decision upsets the settled expectations of the business community regarding the taxation of packaging materials. AWB Br. at 4. To the contrary, the decision below is consistent with the existing tax regulation on packaging materials and multiple published tax determinations specifically addressing how the sales and use taxes apply to pallets. AWB's unsubstantiated assertions to the contrary do not demonstrate a need for this Court to grant review.

According to AWB, "[i]t is commonly understood that when a product is sold the packaging that it comes in is incorporated in the total price of the product." AWB Br. at 6. This is true when the packaging is

actually part of the product sold. For example, the bottles, labels, and caps purchased by Advanced H2O qualified as wholesale purchases because those items became components of the products it manufactured and sold. *See* RCW 82.04.050(1)(a)(ii) (exempting property that becomes an "ingredient or component" of another product for sale to a consumer "without intervening use" by the purchaser); WAC 458-20-115(3)(a) (sales of packing materials to persons who sell tangible personal property contained in the packing materials). Similarly, the Styrofoam trays and plastic wrapping Tyson used in packaging its beef products qualified as wholesale purchases of items acquired for resale. This is because the packaging materials were ultimately consumed by the retail buyer of the manufactured products. Thus, the imposition of the sales or use tax was deferred until that final sale occurred.

In contrast, packaging materials used and consumed by the manufacturer itself, including in delivering products, do not qualify as purchases-for-resale because the packaging will not be resold to the ultimate consumer of its products. *See* WAC 458-20-115(3)(b) (sales of containers that will be used to deliver products but must be returned by customer are retail sales); WAC 458-20-115(5)(c) ("The use tax applies to the use of pallets by a manufacturer or seller where the pallets will not be sold with the product, but are for use in the manufacturing plant or

warehouse."); WAC 458-20-115(6)(c) (same with respect to pallets that must be returned by the customer). The sales or use tax applies to such purchases because the manufacturer itself is the ultimate "consumer" of the packing materials. *See* RCW 82.04.190(1) (defining "consumer" as businesses that acquire items for any purpose other than for resale or another exempt use); *Black v. State*, 67 Wn.2d 97, 103, 406 P.2d 761 (1965) (lessee was the "ultimate consumer" of a leased ship it used as a floating hotel).

The Department has published numerous tax determinations specifically addressing pallets. AR-Tyson 71-76 (Det. No. 01-143, 24 WTD 324 (2005)). Those determinations explain that the retail sales or use tax applies if a manufacturer acquires pallets for use in delivering its products to customers, and does not sell the pallet along with its products.

That is the situation here. The CHEP pallets are never resold to the ultimate consumer of the products manufactured by CHEP's customers; nor are they sold by one CHEP customer to another. CHEP, and CHEP alone, is the person that leases the pallets to each participant in its pallet rental program. The Court of Appeals correctly concluded the retail sales tax applied to the rental fees the Manufacturers paid for their own possession and control of the CHEP pallets.

The Court of Appeals' decision does not come close to disturbing the settled expectations of the business community. The plain meaning of the tax statutes, the tax regulation on packaging materials, and published tax determinations addressing the issue have made it clear that Washington businesses are required to pay sales or use tax on reusable or returnable packaging materials acquired for their own use in delivering products.[1] There is no need for this Court to take review.

C. The Court of Appeals' Decision Does Not Result in the "Double Taxation" of Packaging Materials

According to the AWB, the Court of Appeals' decision threatens the "double taxation" of packaging materials, contrary to legislative intent. AWB Br. at 4-6. It is true that the legislative purpose for exempting wholesale purchases is to avoid pyramiding of the sales tax by deferring the tax until an item of tangible personal property is purchased by the ultimate consumer. But the Court of Appeals' decision does not result in multiple taxation of the pallets; each pallet rental transaction is taxed just once. On the other hand, if the Manufacturers' overly broad interpretation

[1] Moreover, the Department's tax regulation and published tax determinations on packaging materials are consistent with administrative and judicial decisions in jurisdictions with similar sales and use tax statutes. *See* 1 Jerome R. Hellerstein, Walter Hellerstein, & John A. Swain, *State Taxation* ¶ 14.06[1]: Intermediate Transactions in the Economic Process: Exclusion from Sales and Use Tax, "Containers and Packaging" (3d ed. 2016 & Supp. May 2020).

of the lease "for the purpose of sublease" exclusion were correct, the pallets would never be taxed.

To support its argument, AWB claims the decision "could lead to requiring the grocery store to charge a customer sales tax on the shelf price of the soda and also on the value of the carton (packaging) that has already been included in the shelf price of the soda." AWB Br. at 7. AWB is incorrect. The packaging in AWB's hypothetical is part of a single integrated retail sale transaction. The sales tax paid on the retail sales price is a tax on both the soda and the carton. Thus, there would be no basis for taxing the carton separately from the soda. Nothing in the Court of Appeals' decision suggests otherwise.

The rented pallets are not analogous to the carton in AWB's hypothetical. Unlike with the soda carton, the pallets were not sold to the consumer of the Manufacturers' products. Thus, the retail sales tax paid on the purchase price of those products is not a tax on the pallets, and imposing the tax further up the supply chain does not result in multiple taxation of the pallet. The ultimate consumer of a leased pallet is the business that enjoyed possession and control of the pallet during the period for which rent was paid.

The purpose for exempting wholesale sales is to avoid imposing the sales tax on intermediate sales of goods as they pass through the

supply chain. *See* 1 Jerome R. Hellerstein, Walter Hellerstein, & John A. Swain, *State Taxation* ¶ 12.04[4]: Taxation of Intermediate Transactions and Pyramiding of the Sales Tax (3d ed. 2016 & Supp. May 2020). Under AWB's interpretation, however, the sales tax would not apply to the pallets at any step in the supply chain.[2] That is not a reasonable interpretation of the purchase-for-resale or lease-for-sublease exclusion.

The Court of Appeals correctly concluded the Manufacturers were required to pay sales or use tax on their pallet rental payments to CHEP. The Manufacturers were the ultimate consumers of the rented pallets because they were the ones with actual possession and control of the pallets for the period of time covered by their rental payments.

III. CONCLUSION

Neither the Manufacturers nor AWB has asserted any viable reason why the Court of Appeals' decision warrants this Court's review. Accordingly, the Petition should be denied.

[2] CHEP is not required to pay sales or use tax on its own pallet purchases because, unlike its customers, CHEP acquires the pallets for the purpose of reselling or releasing them in the ordinary course of business. *See* RCW 82.04.050(1)(a)(i); WAC 458-20-211(6)(a). Properly applied, the sales and use tax statutes require each CHEP customer to pay tax on their own pallet rental payments.

RESPECTFULLY SUBMITTED this 17th day of June, 2020.

ROBERT W. FERGUSON
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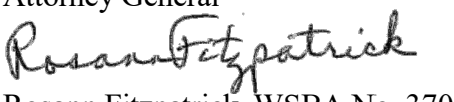

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I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 17th day of June, 2020, at Tumwater, WA.

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