No. 98316-0

SUPREME COURT
OF THE STATE OF WASHINGTON

ADVANCED H20, LLC & TYSON FRESH MEATS, INC.,

Petitioners

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent

ON PETITION FOR REVIEW FROM
COURT OF APPEALS, DIVISION II
No. 51468-1-II
(Consolidated with No. 51313-0-II)

CORRECTED PETITION FOR REVIEW

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I. INTRODUCTION

Advanced H2O, LLC ("Advanced H20") and Tyson Fresh Meats, Inc. ("Tyson") (collectively "Appellants") leased pallets from CHEP USA ("CHEP") for the sole purpose of transferring the pallets to their customers, along with a corresponding sale of their respective products. The Court of Appeals nevertheless concluded that Appellants' lease transactions are not exempt from retail sales and use tax under RCW 82.04.050(4)(b) as a "lease-for-sublease" or, alternatively, under WAC 458–20–115 ("Rule 115") as a resale of packing materials. In so holding, the Court of Appeals violated Washington courts' well-established principles of statutory construction and fundamentally altered the plain meaning of these exemptions.

First, the requirements for sales-for-resale in RCW 82.04.050(1)(a) are not applicable to leases-for-sublease transactions in RCW 82.05.050(4)(b). For the Court of Appeals to conclude otherwise conflicts with this Court's established plain meaning analysis from cases such as *State v. Evergreen Freedom Foundation*, 192 Wn.2d 782, 789-90, 432 P.3d 805 (2019) and many others, and renders section (4)(b) superfluous and without meaning.

Second, it is an "axiom of statutory interpretation that where a term is defined" courts must use that definition. *U.S. v. Hoffman*, 154 Wn.2d 730,

741, 116 P.3d 999 (2005). The Legislature has required that a specialized definition of "lease" be used for all sales and use tax purposes. RCW 82.04.040(3)(a). Using Black's Law Dictionary to impart a "common meaning" into RCW 82.040.050(4)(b), as the Court of Appeals did, alters the plain meaning of the statute and is contrary to the Legislature's intent.

Finally, no evidence supports the Court of Appeals' conclusion that Appellants' pallet transactions do not meet the plain meaning of RCW 82.04.050(4)(b) or, alternatively, Rule 115. Appellants received valid consideration from their customers in exchange for indefinitely transferring possession and control of the leased pallets along with the sale of specific goods. Under either the ordinary application of either authority, Appellants' pallet leases are exempt from retail sales and use tax.

This Court should grant review under RAP 13.4(b)(1), (2) and (4) to correct the Court of Appeals' errors and reinstate the exemptions as set forth by the Legislature.

II. ISSUES PRESENTED FOR REVIEW

1. RCW 82.04.050(4)(b) exempts from tax leasing of tangible property where the lease is for the purpose of sublease. Did the Court of Appeals err when it incorporated unrelated statutory provisions into the statute in contravention of this Court's plain meaning rule?

2. The Legislature established a special, statutory definition for "lease"

that applies to all uses of the term in the State's retail sales and use tax laws. Did the Court of Appeals err when it substituted a common dictionary definition for the statutory definition in the lease-for-sublease exemption found in RCW 82.04.050(4)(b)?

3. Does substantial evidence support the Board of Tax Appeal's conclusion that Appellants' received valid consideration from their customers in exchange for indefinitely transferring possession and control of the leased pallets?

III. STATEMENT OF THE CASE

A. Appellants' Lease Pallets For the Purpose of Transferring the Pallets to their Customers

Advanced H2O manufactures and sells bottled water and other beverages in Washington. AR-H2O 91 ¶ 4.[1] Tyson processes and sells meat products in Washington. AR-Tyson 88 ¶ 3. Both companies leased pallets for the purpose of transferring their products with the pallets to their customers. Specifically, they place their products onto the pallets and deliver both the pallets and the products to the customer. AR-H2O 91 ¶ 6; AR-Tyson 88 ¶ 4.

Both Appellants acquire the pallets by signing "Hire Agreements" with CHEP USA ("CHEP"). AR-H2O 91 ¶ 7; AR-Tyson 88 ¶ 5. CHEP

[1] This brief refers to the respective administrative records of Taxpayers as "AR-H2O" and "AR-Tyson."

charges a flat "Issue Fee" for each pallet based on the anticipated amount of time that Appellants will have possession of the pallets. AR-H2O 122, 123 ¶ 3; AR-Tyson 102, 115. In exchange for the flat Issue Fee, Taxpayers have the right to possess the pallet indefinitely; the Hire Agreement is an ongoing agreement with no fixed term. *See* AR-H2O 113, 118 ¶ 12(b) (CHEP can only require the return of pallets from Appellants upon termination of the Hire Agreement).

Appellants also receive pallets from other CHEP participants. If the pallets from other participants are empty, CHEP assesses an "Inbound Movement Fee" in lieu of the Issue Fee. *See* AR-H2O 123 ¶ 4, 138-39 (separating CHEP-issued pallets and empty pallets Advanced H2O received from other CHEP participants). If Appellants receive the pallets as part of a shipment of goods from another CHEP participant, CHEP assesses no fee. AR-H2O 122-23; AR-Tyson 104 ¶ 5. Nothing in the Hire Agreement prohibits CHEP participants from charging each other when transferring possession of pallets. AR-H2O 113–25; AR-Tyson 111–14. Both Advanced H20 and Tyson factor the Issue Fee and Inbound Movement Fee into the amounts they charge their customers for their products. AR-H2O 91 ¶ 8; AR-Tyson 88 ¶ 6.

B. The Board of Tax Appeals Correctly Found that Appellants' Lease-for-Sublease Transactions were Exempt from Tax

Advanced H2O filed a refund request with the Department for the sales taxes it paid on CHEP rental fees for the January 1, 2008 to December 31, 2011, tax periods. AR-H2O 91 ¶ 3. The Department denied the refund request and Advanced H2O appealed the denial to the Department's Appeals Division. AR-H2O 92. The Appeals Division affirmed the denial and Advanced H2O appealed to the Board of Tax Appeals. *Id.*

The Department audited Tyson for the January 1, 2007 to December 31, 2010, tax periods. AR-Tyson 147. The Department assessed Tyson for unpaid use tax on the payments Tyson made to CHEP for the pallets. AR-Tyson 152. Tyson appealed the assessment to the Department's Appeals Division. AR 89 ¶ 9. The Appeals Division affirmed the assessment and Tyson appealed to the Board. *Id.*

In separate proceedings, the Board granted summary judgment to both Advanced H2O and Tyson. AR-H2O 22-31; AR-Tyson 10-19. The Board held that Appellants' lease of pallets from CHEP were exempt from sales tax because (1) each transferred possession of the pallets to their customers in satisfaction of the definition of "lease" in RCW 82.04.040(3)(a) and the "lease-for-sublease" exemption under RCW 82.04.050(4)(b); and (2) each leased pallets from CHEP as leases of

"packing materials" for sublease to its customers under WAC 458-20-115(2), (3)(a), and (6)(c). AR-H2O 22-31; AR-Tyson 10-19.

The Department of Revenue sought judicial review. AR-H2O 3-5; AR-Tyson 3-7. The Thurston County Superior Court reversed the Board of Tax Appeals in both cases. Advanced H20 and Tyson each timely appealed and the matters were consolidated. The Court of Appeals reversed the Board of Tax Appeals.[2] *Department of Revenue v. Advanced H20, LLC*, 11 Wn. App. 2d 384, 405, 453 P.3d 1011 (2019) (Appendix A). Appellants asked the Court of Appeals to reconsider. The Court of Appeals denied the request on February 21, 2020. Order Denying Motion for Reconsideration, No. 51468-1-II (Appendix B). Appellants now seek review to correct the Court of Appeals' revisions to the State's tax law and reinstate the plain meaning of the applicable exemptions.

IV. REASONS WHY REVIEW SHOULD BE GRANTED

The Court of Appeals' statutory analysis is not consistent with this Court's well-settled instructions for how to derive the plain meaning of statutes. Specifically, the Court of Appeals failed to give meaning to the words set explicitly by the Legislature for lease-for-sublease transactions

[2] This is matter is a judicial review under the Administrative Procedure Act, RCW 34.05, thus the Court of Appeals reviewed the Board of Tax Appeals' orders de novo. *See Teamsters Local Union No. 117 v. Dep't of Corrections*, 179 Wn. App. 110, 117 n. 5, 317 P.3d 111 (2014) (citing *Postema v. Pollution Control Hearings Bd.*, 142 Wn.2d 68, 77, 11 P.3d 726 (2000)).

and adopted a more narrow interpretation that is not consistent with the plain meaning of the law.

This case concerns two distinct issues. First, whether Appellants' pallet leases are exempt from taxation under RCW 82.04.050(4)(b) when Appellants leased the pallets for the purpose of transferring possession of the pallets to their customers in exchange for consideration. Second and alternatively, whether the leases are exempt from taxation under Rule 115 because Appellants acquired the pallets for inclusion as packing materials with the sale of their respective products. The Court of Appeals' analysis failed to carry out the Legislature's intent to exempt lease-for-sublease transactions from retail sales tax. Advanced H20 and Tyson respectfully ask this Court to grant review to set the proper analysis for these provisions.

C. Appellants' Pallet Transactions Satisfy the Lease-for-Sublease Exemption in RCW 82.04.050(4)(b)

A court's fundamental objective when construing a statute is to ascertain and carry out the Legislature's intent. *Evergreen Freedom Found.*, 192 Wn.2d at 789. The court must look at the "entire context of the statute in which the provision is found, as well as related provisions, amendments to the provision, and the statutory scheme as a whole." *Id.* (internal quotations and alternations omitted). Further, "no part of a statute should be deemed inoperative or superfluous unless it is the result of obvious mistake

or error." *Filo Foods, LLC v. City of SeaTac*, 183 Wn.2d 770, 787, 357 P.3d 1040 (2015) (quoting *In re Det. of Strand*, 167 Wn.2d 180, 189, 217 P.3d 1159 (2009). The Court of Appeals failed to adhere to these instructions when it adopted an overly restricted reading of the test for the lease-for-sublease exemption in RCW 82.04.050 that is not supported by the plain text of the relevant statutes and effectively writes the exemption out of the tax code. This Court should grant review and reinstate the Board of Tax Appeals' correct decisions below.

1. The Court of Appeals Applied the Wrong Test for Lease-for-Sublease Transactions

Retail sales tax is imposed on "each retail sale" of tangible personal property, unless the sale is "explicitly excluded" in RCW 82.04.050. *See* RCW 82.08.020(1). "Retail sales" means "any sale, *lease* or rental for any purpose *other than for resale, sublease, or subrent.*" RCW 82.08.010(11) (emphasis added). Further, under RCW 82.04.050(4)(b), the "leasing of tangible personal property where the lease . . . is for the purpose of sublease" is explicitly excluded from the definition of "retail sales." A lease constitutes "any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration." RCW 82.04.040(3)(a). Thus, under a plain reading of these statutes, any person who obtains a lease "for the purpose" of transferring "possession or control"

of the leased property to another lessee for "a fixed or indeterminate term" for "consideration" is not required to pay retail sales tax on the original lease transaction. RCW 82.04.040(3)(a), .050(4)(b); RCW 82.08.010(11).

The Court of Appeals, however, adopted a different standard that is not supported by the plain text of these statutes. Specifically, the Court of Appeals incorporated the terms of RCW 82.04.050(1)(a)(i) into the analysis of RCW 82.04.050(4)(b). The Court of Appeals thus concluded that, to qualify for the exception, a taxpayer has to show they (1) leased the pallets for sublease, (2) subleased the pallets in their regular course of business, and (3) did not make intervening use of the pallets before sublease. *See Advanced H20*, 11 Wn. App. 2d at 397-98. *See id*. However, the statutory requirements for the resale of tangible property exception found in RCW 82.04.050(1)(a)(i) simply are not applicable to the lease-for-sublease exemption found in RCW 82.04.050(4)(b).[3]

Even though both sales and leases can constitute a "retail sale," the tax statutes treat them as different transactions for purposes of the retail sales tax exception. *See, e.g.*, RCW 82.08.010(11) ("Retail sale" means

[3] The Court of Appeals also relied on *Dep't of Revenue v. Sprint Spectrum, LP*, 174 Wn. App. 645, 302 P.3d 1280 (2013) to require Appellants to show "they purchased the [pallets] for resale or sublease" and "have not made *intervening use* of the purchased items." *Advanced H20*, 11 Wn. App. 2d at 402 (emphasis in original). *Sprint Spectrum* concerned only sales-for-resales under RCW 82.04.050(1)(a), and thus is also not applicable to the lease transactions here. *See Sprint Spectrum*, 174 Wn. App. at 662–63.

"any sale, lease, *or* rental for any purpose *other than* resale, sublease, *or* subrent" (emphases added)). This separate treatment is evident by the structure and language used in RCW 82.04.050. Subsection (1)(a)(i) addresses a retail sales exception for "sale[s] to a person who . . . purchases for the purpose of resale." It also requires that the purchase be made "in the regular course of business without intervening use" for the exception to apply. *See* RCW 82.04.050(1)(a)(i). In contrast, subsection (4)(b) addresses the exception for "leasing . . . for the purpose of sublease" and does not contain any language similar to an "intervening use" requirement. RCW 82.04.050(4)(b).

If the Court of Appeals were correct that the terms of section (1)(a)(i) extend to lease-for-sublease transactions simply because both sales and leases fall under the definition of "retail sales," then section (4)(b) would be entirely unnecessary. Alternatively, for the "intervening use" test in (1)(a)(i) to apply to lease-for-sublease transactions, the Court of Appeals had to add language to section (4)(b) that the Legislature did not specifically include. Both assumptions are incorrect as a matter of statutory interpretation. The Court of Appeals violated this Court's repeated instruction "to not add words where the legislature has chosen not to include them." *See, e.g.*, *Lake v. Woodcreek Homeowners Ass'n*, 169 Wn.2d 516, 527, 243 P.3d 1283 (2010).

The Court of Appeals should have "presume[d] the Legislature means exactly what it says," *Wright v. Lyft, Inc.*, 189 Wn.2d 718, 727, 406 P.3d 1149 (2017), and construed the statues so that "all the language used is given effect, *with no portion* rendered meaningless or superfluous," *Assoc. Press v. Washington State Leg*., 194 Wn.2d 915, 920, 454 P.3d 93 (2019) (emphasis added). By using different language in sections (1)(a)(i) and (4) of RCW 82.04.050, the Legislature intended different requirements to apply to the sales-for-resale and leases-for-sublease exceptions. *See United Parcel Service, Inc. v. Dep't of Revenue*, 102 Wn.2d 355, 362, 687 P.2d 186 (1984) (noting that it is an "elementary rule" that the presence of term in one provision and the absence in another means a "difference in legislative intent"). This Court should grant review to reinstate the plain meaning of these statutes.

2. The Court Misapprehended Both RCW 82.04.050(4)(b) and Appellants' Lease Transactions

The Court also erred in its construction of RCW 82.04.050(4)(b) and misapprehended the nature of Appellants' lease transactions with their customers.

a. A lease-for-sublease transaction does not require transferring ownership rights

As a threshold issue requiring this Court's review, the Court of should not have imported a common dictionary definition into RCW

82.04.050(4)(b) instead of using the Legislature's explicitly defined terms. By doing so, the Court of Appeals violated the axiom of statutory construction that where a term is defined the court must use that definition. *Hoffman*, 154 Wn.2d at at 741. More importantly, it fundamentally altered the plain meaning of the statute.

When interpreting RCW 82.04.050(4)(b), the Court of Appeals should have followed other courts and evaluated the language only in context with the defined terms. *See Solvay Chemicals, Inc. v. Dep't of Revenue*, 4 Wn. App. 2d 918, 926 n.6, 424 P.3d 1238 (2018) (declining to apply dictionary definition to statutorily defined term, noting that "[o]nly where a term is undefined will it be given its plain and ordinary definition"). The Legislature crafted a definition for "lease" that must be used for all "sales and use tax purposes." *See* RCW 82.04.040(3)(a) ("The definition . . . must be used for sales and use tax purposes regardless if a transaction is characterized as a lease or rental under generally accepted accounting principles, the United States internal revenue code, Washington state's commercial code, or other provisions of federal, state, or local law"). RCW 82.040.050(4)(b) uses both "lease" and "sublease." It does not make sense for the Legislature to require a specialized definition for one and not the other, especially when the latter transaction (sublease) can only follow from the former (lease).

Moreover, the Court of Appeals fundamentally changed the meaning of RCW 82.04.050(4)(b) by incorporating a "common" dictionary definition into the statute. *Compare* RCW 82.04.040(3)(a) (defining "lease or rental") *with Lease*, Black's Law Dictionary (11th ed. 2019). Black's Law Dictionary defines a "lease" in terms of conveying "the *right* to use" property in exchange of consideration. *Lease*, Black's Law Dictionary (11th ed. 2019); *accord Sublease*, Black's Law Dictionary (11th ed. 2019) ("A lease by a lessee to a third party, transferring *the right to possession* to some or all of the leased property for a term shorter than that of the lessee, who retains a right of reversion"). In contrast, the tax code definition encompasses "*any* transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration." RCW 82.04.040(3)(a) (emphasis added).[4] Thus, applying the definition to that of sublease for purposes of the retail sales tax exception in RCW 82.04.050(4)(b), requires one lessee to obtain a lease for the purpose of transferring possession or control of the leased property to another lessee for a fixed or indeterminate term in exchange for consideration.

The Court of Appeals thus added requirements that are not found in the plain meaning of RCW 82.04.050(4)(b). If left to stand, the Court of

[4] While it would not be appropriate under RCW 82.040.040(3)(a) to use an alternate definition, the tax code is more in line with the definition of "assignment," which is the "transfer of rights or property." *Assignment*, Black's Law Dictionary (11th ed. 2019).

Appeals' opinion mandates that, rather than looking to whether a taxpayer has transferred possession or control of personal property, courts and the Board of Tax Appeals must look to whether the taxpayer transferred legal *rights* to the property akin to ownership. *See, e.g.*, *Advanced H20*, 11 Wn. App. 2d at 399 (describing a lease as an exchange "for the *right* to possess or control" property); *id*. at 400 (noting that Appellants' *right* to possess or control ended upon transferring the pallets to their customers). Such an analysis is inconsistent with plain meaning of RCW 82.04.050(4)(b) and mandates this Court's correction.

b. Appellants' Transactions Constitute a Lease-for Sublease

Applying the correct statutory language, the Court of Appeals should have concluded that Appellants' pallet transactions with their customers fall under the plain terms of a lease-for-sublease under RCW 82.04.050(4)(b).

The Court of Appeals found it relevant that, once Appellants transferred pallets to a customer, Appellants' own right to possess and control the pallets ended. *See Advanced H20*, 11 Wn. App. 2d at 400. From this, the Court of Appeals jumped to the tautological conclusion that Appellants could not sublease the pallets "when they no longer lease the pallet[s] themselves." *Id.* But such a conclusion misconstrues the nature and

legal effect of a sublease. For each transfer to take place, the original lessee *must* release possession and control of the property at issue. And there is nothing in the tax code that requires these transactions to be ongoing, as the Court of Appeals held.

Accordingly, there was no basis for the Court of Appeals to adopt the Department's overly narrow argument that Appellants did not receive valid consideration for transferring the pallets to their customers' possession and control. *Advanced H20*, 11 Wn. App. 2d at 399-400. "Consideration is a bargained-for exchange of promises." *Lokan & Assocs. v. Am. Beef Processing, LLC*, 177 Wn. App. 490, 496, 311 P.3d 1285 (2013). Further, it is "a basic principle of contract law" that "consideration sufficient to support one promise is sufficient to support any number of promises, and each written term of a contract need not be bargained for." *Millican of Washington, Inc. v. Wienker Carpet Serv., Inc.*, 44 Wn. App. 409, 413, 722 P.2d 861 (1986) (citing multiple authority). Here, Appellants entered into agreements with their customers whereby the customers would pay Appellants for *both* possession of the CHEP pallets *and* legal title to the goods. If this were not so, there would have been no basis for either Advanced H20 or Tyson to transfer possession and control of the pallets to their respective customers, or for the customers to have accepted "responsibility" for the pallets if the pallets were not part of the bargained-

for exchange.[5] In other words, Appellants factored consideration into their invoice for transferring the pallets into their customers' possession and their customers accepted. The Court of Appeals should have found valid consideration in this bargained-for exchange.

The Court of Appeals should have also concluded that Appellants received the consideration for a "fixed or indeterminate" term. Advanced H20, 11 Wn. App. 2d at 400-01. *Citing Gandy v. State*, 57 Wn.2d 690, 359 P.2d 302 (1961), the Court of Appeals focused on a purported lack of consideration from Appellants' customers in exchange of "period[s] of possession." *See Advanced H20,* 11 Wn. App. 2d at 401. But reliance on Gandy is misplaced as this Court in Gandy analyzed entirely different versions of the statutes than exist today. See Gandy, 57 Wn.2d at 693. Specifically, neither the statutory definition of "lease" nor the exception for leases-for-subleases had been codified. See id.; accord 1959 Ex.S Ch. 5 § 1. This Court, therefore, had no need to construe either provision. Instead, the Court applied the "usual" definition of lease "whereby one party gives to

[5] The Court of Appeal's opinion also suggests a misapprehension of the CHEP pallet pooling system. The entire CHEP system is designed to transfer leases of the pallets from one party to another such that possession and control of the pallets is acquired by the subleasing party for an indeterminate term. *See, e.g.*, AR-H2O 117 (allowing Appellants to transfer "responsibility" for the pallets to "another customer" who has agreed to "use the equipment"). If the customers had not agreed to pay Appellants' for transference of the pallets, they would have had to pay CHEP issuance fees for each new delivery of pallets. AR-H2O 122, 123 ¶ 3; AR-Tyson 102. However, CHEP does not charge a fee if a participant receives a loaded pallet from another participant. AR-H2O 122-23; AR-Tyson 104 ¶ 5.

another the right to the use and possession of property for a specified time and, ordinarily, for fixed payments." Gandy, 57 Wn.2d at 694. Because all of the Court's analysis was based on this definition and different tax provisions than at issue here, Gandy simply does not apply to Appellants' lease transactions.

Moreover, the Court of Appeals' focus on *Gandy's* discussion of "periods of possession" misses the fact that Appellants' transfer of the pallets to their customers were for undefined, indefinite periods of time—the very meaning of "indeterminate" in RCW 82.40.040. *See* Indeterminate, Merriam-Webster's Online Dictionary, available at https://www.merriam-webster.com/dictionary/indeterminate (last visited March 21, 2020).

Finally, as previously discussed, the Court of Appeals' incorporation of a "without intervening use" or "some use" requirement is not supported by the plain language of RCW 82.04.050(4)(b). *See Advanced H20,* 11 Wn. App. 2d at 403-04. Instead, the Court of Appeals should have looked only to whether Appellants leased the CHEP pallets "for the purpose of" transferring possession or control of the pallets to their customers. And all of the evidence in the record shows that Appellants did.

Indeed, the very points the Court of Appeals relied on to find the contrary support this conclusion. *Id.* Appellants' agreements with CHEP dictated that Appellants could only use the pallets "for shipment to

[customers].” *Id.* at 403 (citing AR 98). Further, Appellants’ stated that they leased the pallets “for the sole purpose” of placing their products onto the pallets and shipping them to their customers. *Id.* If Appellants had intended to use the pallets for other purposes, Appellants would have entered into a different agreement with CHEP and retained the pallets for their own use. Appellants leased pallets from CHEP for the sole purpose of transferring the pallets to their customers’ possession and control.

In sum, both the law and the facts support the Board of Tax Appeals’ conclusions that Appellants’ lease transactions satisfy the lease-for-sublease exception in RCW 82.04.050(4)(b). This Court should grant review to reinstate the correct application of the law.

D. Appellants’ Pallet Transactions Constitute a Sale of Packing Materials under Rule 115

The Board of Tax Appeals alternatively held that Appellants’ pallet transfers fell under the exception in WAC 458–20–115 for sales of packing materials. The Court of Appeals did not engage with that exception, having erroneously concluded that Appellants’ “did not sublease the pallets to their customers.” *Advanced H20*, 11 Wn. App. 2d at 405. The Court of Appeals also ignored the text of Rule 115, which is directly on point to the facts here.

As previously discussed, a “sale” is “any transfer of the ownership of, title to, *or possession* of property for a valuable consideration.” RCW

82.04.040(1) (emphasis added). In turn, a retail sale does not include "purchases for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person." RCW 82.04.050(l)(a)(i). With respect to this exception, the Department has drawn a distinction between sales of containers in which the containers are to be returned and those which are non-returnable. *See* Rule 115(2)(b). Where the containers are returnable, the customer receiving the container is merely a bailee, having temporary possession under a bailment arrangement. See Wash. Tax Det. No. 01–143, 24 WTD 324, 326 (2005) (Appendix C). Because a bailment does not involve granting consideration for the transfer of possession, a bailment does not constitute a sale under RCW 82.04.040(1). *See Id*. In this case, there was no bailment arrangement between Appellants and their customers in which the customers were responsible for returning the pallets to Appellants. Therefore, the pallets were not returnable under Rule 115.

Explicitly relevant here, the Department has also recognized that nonreturnable pallets sold along with tangible products may be purchased without the payment of retails sales or use tax as a sale-for-resale. Rule 115(6)(c); *accord* Wash. Tax Det. No. 01–143, 24 WTD at 327 ("If the manufacturer uses the pallets as part of its packaging of goods and does not retain title to the pallets, the pallets are purchased for resale, and retail sales

or use tax would not be due") (Appendix D).[6] The key inquiry thus should have been whether Appellants obtained the pallets solely for inclusion with the sales of their respective products and did not expect them to be returned. As previously discussed, they did. Appellants leased the pallets for the purpose of shrink-wrapping goods to the pallets for transfer of the entire package to their customers' possession and control. *See, e.g.*, AR AR-H2O 91; AR-Tyson 88. In fact, the Department has even held that a charge for non-returnable pallets is part of the selling price of a manufacturer's products because the taxpayer had to palletize the products to be saleable to its customers, just as it had to put the beer it manufactured into a container. *See* Wash. Tax Det. No. 00-119, 20 WTD 117 at 120. There should have been no dispute that here the pallets were necessary to sell the products to Appellant's customers. Accordingly, the Appellant's transfer of possession of the pallets to customers as part of the sale of their products clearly constitute sales under the text of Rule 115 and the Department's own past treatment of this issue. The Court of Appeals should have affirmed the Board of Tax Appeals on this issue too.

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[6] While the determination does reference title and ownership, this is in context where the taxpayer had purchased the pallets. *See* Wash. Tax Det. No. 01–143, 24 WTD 324 at 1. Nothing in the language of Rule 115 defines "sale" in a manner that is different from the definition established in RCW 82.04.040(1), which includes transfers of possession for consideration. Therefore, a transfer of possession for consideration should be treated the same as the transfer of title and ownership for consideration.

V. CONCLUSION

For these reasons, Appellants respectfully ask this Court to grant review and reinstate the Board of Tax Appeals' orders.

RESPECTFULLY SUBMITTED this 23rd day of March, 2020.

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APPENDIX A

Filed
Washington State
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IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

STATE OF WASHINGTON, DEPARTMENT OF REVENUE Respondent, v. ADVANCED H2O, LLC, Appellant.	No. 51468-1-II PUBLISHED OPINION (Consolidated with No. 51513-0-II)
STATE OF WASHINGTON, DEPARTMENT OF REVENUE Respondent, v. TYSON FRESH MEATS INC., Appellant.	

CRUSER, J. — The Department of Revenue (DOR) appeals the Board of Tax Appeals' (Board) orders granting summary judgment to Tyson Fresh Meats Inc. (Tyson) and Advanced H2O LLC (H2O); Tyson and H2O appeal the superior court's reversal of the Board's orders.[1] DOR

[1] General Order 2010–1 of Division II, *In Re: Modified Procedures For Appeals Under The Administrative Procedures Act, Chapter 34.05, and Appeals Under the Land Use Petition Act, Chapter 36.70C RCW* (Wash. Ct. App.), available at http://www.courts.wa.gov/ appellate—trial—courts/, requires that the party filing an appeal in superior court, here DOR, shall have the responsibility for the opening and reply briefs before our court and shall be entitled to open and conclude oral argument, whether designated as the appellant or respondent on appeal to this court.

contends that the Board erred when ruling that Tyson's and H2O's rental payments for the use of pallets are exempt from the retail sales or use tax under RCW 82.04.050(4)(b) because Tyson and H2O did not sublease the pallets to their customers or lease the pallets for the purpose of sublease to their customers and because the leases of pallets were not a lease of "packing materials" under WAC 458-20-115(3)(a) (Rule 115). Tyson and H2O contend that the Board did not err when ruling that their lease transactions are exempt from the retail sales tax under RCW 82.04.050(4)(b) because they leased the pallets for the purpose of subleasing the pallets to their customers and their leases of the pallets were leases of "packing materials" within the meaning of Rule 115(3)(a).

We agree with DOR and hold that Tyson's and H2O's lease transactions are not exempt from the retail sales and the use tax under RCW 82.04.050(4)(b) and are therefore subject to the retail sales and use tax. Accordingly, we reverse the Board and affirm the superior court.

FACTS

I. BACKGROUND FACTS

The following facts are undisputed. Tyson is a beef manufacturing corporation that processes and sells meat in Washington. H2O is a corporation that manufactures and sells bottled water and other beverages in Washington. During the years at issue, Tyson and H2O packed their products onto wooden pallets—portable platforms for transporting freight—to facilitate the delivery of their products to their customers.

Tyson and H2O leased wooden pallets from CHEP USA (CHEP), a company that operates a pallet pooling service. CHEP issues, collects, conditions, and reissues pallets, which help companies like Tyson and H2O streamline distribution and transportation of their products to

others. Each CHEP pallet is identifiable by a CHEP logo and the words "Property of CHEP" or "Owned by CHEP." H2O Clerk's Papers (CP) at 28.

Tyson and H2O signed a "Hire Agreement" with CHEP to enter into CHEP's pallet pooling service. The agreement states that CHEP retains ownership and legal title of the pallets at all times:

> **6. OWNERSHIP OF EQUIPMENT**
> (a) CHEP never sells or transfers ownership of its Equipment. Customer acknowledges and agrees that each item of Equipment has a special value to CHEP and that CHEP repairs, maintains, handles, and otherwise administers the circulation of all Equipment as part of a pool.
> (b) Customer acknowledges and agrees that despite any other clause in the Agreement, CHEP remains the owner of the Equipment at all times. Neither customer nor any other person is entitled to purchase or sell the Equipment, or use, dispose, or otherwise deal with Equipment in any way that is inconsistent with CHEP's ownership of the Equipment or the terms of this Agreement. Payment of the Lost Equipment Fee or any other circumstance or event does not constitute or result in any transfer of any property right or other interest in the Equipment by or from CHEP.

H2O Administrative Record (AR) at 121. The agreement also states that customers may not "assign" their rights under the agreement without CHEP's written consent. Tyson AR at 113. Invoices to CHEP customers repeat the Hire Agreement, stating that CHEP is the exclusive owner and that the payment of any fee does not result in "any transfer of any property right or other interest in any CHEP Equipment by or from CHEP." *Id.* at 134.

As part of the Hire Agreement, CHEP customers agree to accept transfers from other CHEP customers. When customers ship their products on pallets to distributors or retailers who were also customers of CHEP, the receiving party is required to notify CHEP as to the quantity received and the location of the pallets. Once a customer accepts a transfer of pallets, the pallets become subject to the receiving customer's contract with CHEP. CHEP then deducts the transferred pallets

from the delivering customer's quantity of pallets "on Hire" or quantity of pallets in its possession.[2] H2O AR at 120.

The Hire Agreement strictly prohibits transfers of pallets to "unauthorized locations," which include transfers to nonparticipating parties or parties that did not have a separate agreement with CHEP. Tyson AR at 99. Customers may transfer pallets to only "authorized locations," which include CHEP's distribution centers or other CHEP customers. *Id*. If a customer transfers pallets to a nonparticipating party, CHEP charges the customer with a "Lost" fee and a "Surcharge." H2O AR at 121, 127. However, if the customer obtains written consent from CHEP to make a transfer to an unauthorized party, CHEP only charges a surcharge and not the lost fee.[3] Conversely, if a customer ships their products using CHEP pallets to another CHEP customer, the customer does not incur a surcharge upon delivery.

[2] The relevant contract language is as follows:

> Definition of "QUANTITY OF EQUIPMENT ON RENTAL." For any given day, the Quantity of Equipment on Rental will be calculated by subtracting the quantity of pallets returned to CHEP, or transferred to an authorized location, from the quantity of Equipment shipped to the Customer before that day.
>
> . . . .
>
> 5.6 As of the date of transfer of Equipment, the Quantity of Equipment on Rental will increase at the authorized location and will decrease the Quantity of Equipment on Rental at the Customer by the quantity transferred.

Tyson AR at 99.

[3] Both H2O and Tyson's Hire Agreements contain these terms. However, Tyson's agreement states that CHEP will waive the surcharge and provide discounts on Tyson's pallet rental fees if the nonparticipating party signs an agreement with CHEP to enter the pooling service. The lost fee still applied to Tyson in the event that more than .5 percent of the total quantity of CHEP pallets issued to Tyson are unaccounted for upon completion of a periodic inventory check.

On a weekly basis, CHEP charges each customer for use of the pallets by multiplying the number of pallets used by the number of rental days the pallets were in the customer's possession during the billing cycle. CHEP also charges an "Issue Fee" for each pallet the customer receives from CHEP. Tyson CP at 49. Once the customer pays the issue fee, it has the right to keep the pallet in its possession as long as the Hire Agreement is in place.

Tyson and H2O did not provide its customers with an itemized bill charge related to the CHEP pallets when the customers received deliveries of their products. Instead, Tyson "pass[ed] the cost of the pallet rental to the customer in either the freight charge or in the product cost." Tyson AR at 155. H2O's pallet costs are "factored into the amounts it charges customers" for its products. H2O AR at 24.

II. PROCEDURAL HISTORY: TYSON

DOR audited Tyson for the period of January 1, 2007 through December 31, 2010. DOR assessed Tyson with a $142,691.01 use tax on the pallets Tyson leased from CHEP. Tyson unsuccessfully appealed the tax to DOR's Appeals Division.

Tyson appealed to the Board. Tyson and DOR filed cross motions for summary judgment. Tyson argued that its lease of pallets from CHEP are excluded from the definition of "retail sale" in RCW 82.04.050(1)(a)(i) because Tyson leased the pallets from CHEP for the purpose of subleasing the pallets to its customers and that Tyson's lease of the pallets was a lease of "packing materials" within Rule 115.

The Board granted Tyson's motion for summary judgment. The Board concluded that the rental fees Tyson paid to CHEP were exempt from the retail sales or use taxes as a lease for sublease under RCW 82.04.050(4)(b). The Board further concluded that Tyson's lease of the

pallets qualified as a "lease of 'packing materials' for sublease to its customers" under Rule 115(2), (3)(a), and (6)(c). Tyson AR at 28.

DOR petitioned for judicial review of the Board's decision. The superior court reversed the Board, ruling that Tyson's pallet lease did not qualify as a "'rental for the purpose of sublease or subrent'" within RCW 82.04.050(4)(b) and the lease transactions were not exempt from the sales or use taxes as "'packing materials'" under Rule 115. Tyson CP at 91.

Tyson appeals the superior court's reversal of the Board's decision.

III. PROCEDURAL HISTORY: H2O

DOR assessed H2O with $327,720 in retail sales tax on pallet rental fees from January 1, 2008 through December 31, 2011. H2O requested a refund, arguing that its lease transactions are exempt from the retail sales or use tax because the pallets qualified as nonreturnable "packing materials" under Rule 115.

DOR denied H2O's request. H2O moved for reconsideration, arguing that its lease qualifies as a lease for sublease and is exempt from the retail sales and use tax under RCW 82.04.050(4)(b). DOR denied H2O's motion for reconsideration.

After unsuccessfully appealing to DOR's Appeals Division, H2O appealed the assessment to the Board. At the Board, both parties filed cross motions for summary judgment. H2O argued that the lease payments are exempt from the retail sales and use tax as a lease transaction under RCW 82.04.040(3), and as a lease-for-sublease of packing materials under Rule 115. The Board agreed and ruled that H2O's transaction was a lease under RCW 82.04.040(3) for the use of pallets and qualified for the lease-for-sublease exception under RCW 82.04.050(4)(b) and as a lease of packing materials under Rule 115(2), (3)(a), and (6)(c).

DOR petitioned for judicial review of the Board's decision. The superior court reversed the Board, concluding that the Board erred when it determined that the pallet rentals were exempt from the retail sales and use tax under RCW 82.04.050(4)(b) and Rule 115 as sales of nonreturnable "'packing materials.'" H2O CP at 97.

H2O appeals the superior court's reversal of the Board's decision.

ANALYSIS

DOR contends that the Board erred in ruling that Tyson's and H2O's (the Manufacturers) lease of CHEP pallets qualifies as a sale-for-resale exemption or lease-for-sublease exemption from the retail sales and use tax under RCW 82.04.050(4)(b) because the Manufacturers did not lease the pallets from CHEP for the purpose of a sublease nor did they sublease the pallets to their customers. DOR also argues that the Board erred in ruling that the Manufacturers' lease transactions are exempt from the retail sales tax under RCW 82.04.050(4)(b) as a lease of "packing materials" pursuant to Rule 115. The Manufacturers counter that their lease transactions are exempt from the retail sales tax under RCW 82.04.050(4)(b) because they leased the pallets for the purpose of a sublease and subleased the pallets to their customers. Furthermore, the Manufacturers argue that their lease transactions are tax exempt as leases or sales of "packing materials" within the meaning of Rule 115. We agree with DOR.

I. STANDARD OF REVIEW

This case presents a review of an order for summary judgment involving statutory interpretation. Washington's Administrative Procedure Act, ch. 34.05 RCW, governs our review of the Board's order for summary judgment. *Steven Klein, Inc. v. Dep't of Revenue*, 183 Wn.2d 889, 895, 357 P.3d 59 (2015). "On appeal, we review the Board's decision, not the superior court,

and our review of the Board's decision is limited to the record before the Board." *Sprint Spectrum, LP v. Dep't of Revenue*, 174 Wn. App. 645, 657, 302 P.3d 1280 (2013). As the party asserting that the Board erred, DOR bears the burden of demonstrating the invalidity of the Board's actions. *Id*. We review the Board's order de novo. *Id.* at 657-58.

On review of an order for summary judgment, we perform the same inquiry as the trial court. *Activate, Inc. v. Dep't of Revenue*, 150 Wn. App. 807, 812, 209 P.3d 524 (2009). A court must grant summary judgment if there is "no genuine issue as to any material fact and . . . the moving party is entitled to a judgment as a matter of law." CR 56(c). "We grant summary judgment only if reasonable persons could reach but one conclusion from all the evidence." *Activate*, 150 Wn. App. at 812.

We review questions of law, including statutory construction, de novo. *Id.* "'The court's fundamental objective in construing a statute is to ascertain and carry out the legislature's intent.'" *Lake v. Woodcreek Homeowners Ass'n*, 169 Wn.2d 516, 526, 243 P.3d 1283 (2010) (quoting *Arborwood Idaho, L.L.C. v. City of Kennewick*, 151 Wn.2d 359, 367, 89 P.3d 217 (2004)).

Statutory interpretation begins with the statute's plain meaning. *Sprint*, 174 Wn. App. at 658. We discern the plain meaning from the ordinary meaning of the language at issue, the statute's context, related provisions, and the statutory scheme as a whole. *Lake*, 169 Wn.2d at 526. If the statute is unambiguous, we derive the legislature's intent from the plain language and ordinary meaning alone. *Activate*, 150 Wn. App. at 812.

A statute or regulation is ambiguous if it is susceptible to more than one reasonable interpretation. *Seattle FilmWorks, Inc. v. Dep't of Revenue*, 106 Wn. App. 448, 453, 24 P.3d 460 (2001). Generally, a reviewing court construes an ambiguous taxing statute or regulation in the

taxpayer's favor. *Id.* But when the court is interpreting a regulation or statute granting a tax exemption or deduction, the court must construe it "'strictly, though fairly and in keeping with the ordinary meaning of their language, against the taxpayer.'" *Id.* (quoting *Group Health Coop. of Puget Sound, Inc. v. Dep't of Revenue*, 106 Wn.2d 391, 401-02, 722 P.2d 787 (1986)). As taxation is the "'rule'" and "'exemption is the exception,'" the taxpayer who "'claims an exemption carries the burden of proving [it] qualifies for it.'" *TracFone Wireless, Inc. v. Dep't of Revenue*, 170 Wn.2d 273, 296-97, 242 P.3d 810 (2010); *Activate*, 150 Wn. App. at 813 (alteration in original) (quoting *Glen Park Assocs., LLC v. Dep't of Revenue*, 119 Wn. App. 481, 486, 82 P.3d 664 (2003)).

DOR may prescribe regulations to enforce the tax code. Former RCW 82.32.300 (1997). "The rules of statutory construction apply to agency regulations as well as statutes." *Tesoro Ref. & Mktg. Co. v. Dep't of Revenue*, 164 Wn.2d 310, 322, 189 P.3d 28 (2008). We give great deference to the DOR's interpretation of its own regulations; however, DOR's interpretation is not binding on this court. *Dep't of Revenue v. GameStop, Inc.*, 8 Wn. App. 2d 74, 82, 436 P.3d 435, *review denied*, 193 Wn.2d 1026 (2019). We presume that the regulation is valid if it is reasonably consistent with the statute it implements. *Id.*

II. LEGAL PRINCIPLES

Washington imposes an excise tax known as the "retail sales" tax on the selling price of each retail transaction of tangible goods in the state. RCW 82.08.020(1)(a). The retail sales tax is calculated based on the sales price of the item sold. RCW 82.08.010(1)(a)(i). Under Washington excise tax laws, the term "sale" is any "transfer of the ownership of, title to, or possession of property for a valuable consideration." Former RCW 82.04.040(1) (2004).

The retail sales tax is not imposed on a transaction if the transaction is specifically excluded from the definition of a "retail sale" under RCW 82.04.050(1)(a). The statutory definition of a retail sale excludes purchases "for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person." *Id.* This exclusion is commonly referred to as the sale-for-resale exception or the wholesale exception. WAC 458-20- 115(3)(a).

The definition of "retail sale" includes a lease or rental of personal tangible property. RCW 82.04.050(4)(a). The term "lease or rental" is defined as "any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration." Former RCW 82.04.040(3)(a) (2004). Because a retail sale includes a retail lease, the sale-for-resale exception from the statutory definition of "retail sale" is extended to a lease for sublease. Therefore, the retail sales tax is not imposed on leases "for the purpose of [sublease] as tangible personal property in the regular course of business without intervening use by such person." RCW 82.04.050(1)(a)(i); RCW 82.08.010(11). Additionally, our legislature expressly extended the definition of a retail sale to exclude "renting or leasing tangible personal property where the lease or rental is for the purpose of sublease or subrent." RCW 82.04.050(4)(b).

WAC 458-20-211(1) (Rule 211), DOR's administrative interpretation of RCW 82.04.050, "explains how persons are taxable who rent or lease tangible personal property" under the retail sales tax. Rule 211[4] states,

> (6) **Retail sales tax.** Persons who rent or lease tangible personal property to users or consumers are required to collect from their lessees the retail sales tax measured by gross income from rentals as of the time the rental payments fall due.
>
> (a) RCW 82.04.050 excludes from the definition of the term "retail sale," purchases for resale "as tangible personal property." Thus the retail sales tax does not apply upon sales of tangible personal property to persons who purchase the

[4] Rule 211 uses the terms "leasing" and "renting" interchangeably. WAC 458-20-211(2)(a).

> same *solely for the purpose of renting or leasing such property*. . . . However, the retail sales tax *applies* upon sales to persons who . . . *intend to make some use of the property other than or in addition to renting or leasing*.

WAC 458-20-211(6) (emphasis added).[5]

Within the sale-for-resale exception is the sale of "packing materials." Rule 115(3)(a). DOR's administrative Rule 115 explains that a sale of packing materials is not subject to the retail sales tax if the buyer of the materials "sell[s] tangible personal property contained in or protected by packing materials." Thus, the retail sales tax is not imposed on the initial sale of packing materials because the purpose of that sale is for the resale of the packing materials, which are sold *with* the product. Because a retail sale includes a lease or rental of personal tangible property, the exception under Rule 115 also applies to a lease for sublease. RCW 82.08.010(11); RCW 82.04.050(4)(a).

Washington also imposes a use tax, which is a "companion tax" that applies when a seller has not collected the retail sales tax. RCW 82.12.020(1)(a), (2); *Glen Park*, 119 Wn. App. at 484 n.1. "The use tax's purpose is 'to tax the privilege of using all tangible property within the state on which [the retail] sales tax has not been paid.'" *Activate*, 150 Wn. App. at 814 (quoting *Sacred Heart Med. Ctr. v. Dep't of Revenue*, 88 Wn. App. 632, 638, 946 P.2d 409 (1997)). The use tax statute incorporates by reference chapters 82.04 and 82.08 RCW. RCW 82.12.010(1); *Activate*,

[5] The Manufacturers argue that Rule 211 does not apply in this case because the rule interprets only the sale-for-resale exception under RCW 82.04.050(1)(a) and not the lease-for-sublease exception. What the Manufacturers ignore is that a retail lease is included within the definition of a "retail sale." RCW 82.08.010(11); RCW 82.04.050(4)(a). Because a lease qualifies as a "sale" under RCW 82.08.010(11), a lease is extended to the sale-for-resale exception from the term "retail sale." RCW 82.04.050(1)(a)(i). Therefore, Rule 211 applies to both the sale-for-resale exception and the lease-for-sublease exception.

150 Wn. App. at 814. Thus, the same exceptions that apply to the retail sales tax also apply to the use tax "because those exemptions are embedded within the definition of 'retail sale' under RCW 82.04.050(1)." *Activate*, 150 Wn. App. at 814.

There is no dispute that the Manufacturers leased pallets from CHEP and their leases constitute a retail transaction subject to the retail sales or use tax. However, the Manufacturers claim that they are exempt from paying either the retail sales tax or the use tax on their lease transactions with CHEP (1) under RCW 82.04.050(4)(b) as a lease for sublease or (2) as a wholesale sale of nonreturnable "packing material" under Rule 115.

III. ANALYSIS

A. LEASE FOR THE PURPOSE OF SUBLEASE EXCEPTION TO THE RETAIL SALES OR USE TAX

DOR assigns error to the Board's conclusion that the Manufacturers' lease of pallets from CHEP was within the "retail sale" exception of RCW 82.04.050(1)(a)(i) and (4)(b) as a lease for sublease. DOR argues that the Manufacturers' lease of the pallets from CHEP does not qualify for the exemption because the Manufacturers did not (1) sublease the pallets as they did not receive consideration from their customers for the customers' own use of the pallets or (2) acquire the pallets from CHEP for the purpose of subleasing the pallets to their customers. The Manufacturers argue that the Board correctly determined that their lease of pallets from CHEP is within the plain meaning of a lease-for-sublease exemption because it (1) "sub-transferred possession" of CHEP pallets to their customers, (2) received consideration for the pallets from their customers, and (3) used the pallets "for the purpose of shipping product to their customers." Appellant's Resp. Br. at 12-13. We agree with DOR.

To qualify for the lease-for-sublease exception, the Manufacturers must show that they (1) leased the pallets for sublease, (2) subleased the pallets in its regular course of business, and (3) did not make an intervening use of the pallets before sublease.[6] *See Sprint*, 174 Wn. App. at 663; RCW 82.08.010(11); RCW 82.04.050(1)(a)(i). 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." Former RCW 82.04.040(3)(a). As the legislature does not specifically define "sublease" as used in chapter 82.04 RCW, we apply its common meaning, which may be determined by referring to a dictionary. *Quadrant Corp. v. Cent. Puget Sound Growth Mgmt. Hr'gs Bd.*, 154 Wn.2d 224, 239, 110 P.3d 1132 (2005). *Black's Law Dictionary* defines "sublease" as a "lease by a lessee to a third party, transferring the right to possession to some or all of the leased property for a term shorter than that of the lessee." BLACK'S LAW DICTIONARY 1724 (11th ed. 2019).

1. NO CONSIDERATION

To establish that they subleased the pallets, the Manufacturers have to show that they transferred possession or control of the pallets *for consideration*. The Manufacturers contend that they leased the pallets to their customers for consideration because the pallet costs are factored into the amounts they charge customers for their products. DOR responds that regardless of whether the Manufacturers "factored" the pallet costs into the selling price of the products sold, the amount the Manufacturers charged for the products "was *not* consideration for their customers'

[6] We do not interpret the meaning of "regular course of business" within the sale-for-resale exception as DOR does not argue that the Manufacturers did not sublease the pallets in its "regular course of business."

own possession or use of the pallets for any period of time."[7] Reply Br. of Resp't at 12. Therefore, the Manufacturers did not receive consideration in exchange for the possession or control of the pallets by their customers as required by the definition of a lease or rental under former RCW 82.04.040(3)(a). We agree with DOR.

A lease is the *exchange* of consideration (1) for the right to possess or control the property (2) for a fixed or indeterminate term. Former RCW 82.04.040(3)(a). The Manufacturers stipulated below that they "recoup[ ]" the pallet rental costs by factoring the costs into the amount customers pay for each product. H2O AR at 86. H2O stated that "one of the costs of the bottled water and beverage products are the rental payments [H2O] made to CHEP, which the parties stipulated, [H2O] recouped as part of the selling price of its products." *Id*. Tyson submitted to the Board that its *own* pallet costs were "factored into the amounts it charges customers" for its products. Tyson AR at 88. "Factual stipulations generally bind the parties and the court." *Glen Park*, 119 Wn. App. at 487.

The Manufacturers were free to recover costs, including pallet rental expenses, through the amount they charged customers for their products. However, the Manufacturers' ability to recover *past* costs did not convert its product sale into a "sublease" of the CHEP pallets. Each customer's consideration was not given in exchange for the customer's own right to possess or control the *CHEP pallets* in the future; rather, the consideration was given in exchange for the customer's own right to possess or control the products sold by Tyson or H2O.

[7] In DOR's opening brief, DOR argues that Tyson did not charge their customers for the transferred pallets. However, in DOR's reply brief, DOR somewhat acknowledges its stipulation.

On appeal, the Manufacturers take a somewhat different stance. The Manufacturers now argue that they factored consideration into the selling price of their products for each customer's *own use* of the pallets and not just in exchange for the customer's right to possess or control the products sold by Tyson and H2O. Therefore, the Manufacturers contend that their customers paid the Manufacturers for the customers' own future use of the pallets, making the transaction a sublease.

Assuming, arguendo, that the Manufacturers' stipulations to the Board are not binding, the outcome does not change. A "sublease" is a "lease by a lessee to a third party, transferring the right to possession to some or all of the *leased property* for a term shorter than that of the lessee." BLACK'S 1724. However, once the Manufacturers transferred a pallet to a customer, the Manufacturers' own right to possess or control the pallet under the Hire Agreement with CHEP ended. Upon transfer, CHEP deducted the pallet from the quantity of pallets in the Manufacturers' possession, and the pallet became subject to the customer's Hire Agreement with CHEP. Therefore, the Manufacturers' own lease of a pallet ended upon transfer to the customer. The Manufacturers cannot sublease a pallet when they no longer lease the pallet themselves. Thus, the Manufacturers' claim that it subleased the pallets to their customers is simply not possible within the plain meaning of a sublease and the framework of their own pallet leases with CHEP.

We hold that the Manufacturers did not receive consideration in exchange for their customers' own right to possess or control the pallets within the definition of a lease or rental under former RCW 82.04.040(3)(a) because the customers gave consideration only for the right to possess the Manufacturer's products, and the Manufacturers' right to possess or control the pallets ended upon transfer to their customers under their Hire Agreement with CHEP.

2. FOR A FIXED OR INDETERMINATE TERM

The Manufacturers do not argue that their alleged sublease of pallets to their customers is for a fixed or indeterminate term, a required element of a lease under former RCW 82.04.040(3)(a). Instead, the Manufacturers contend that their transaction with their customers is within the plain language of a lease because they "sub-transferred possession of [CHEP] pallets to purchasers of their products" upon delivery of their product "for consideration." Appellant's Resp. Br. at 12.

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." Former RCW 82.04.040(3)(a). Therefore, a taxable lease differs from a sale because consideration is paid in exchange for the right to possess and control the tangible personal property *for a period of time*. Former RCW 82.04.040(3)(a). Even if the Manufacturers' customers exchanged consideration for their own right to possess or control the pallets, and the Manufacturers' lease of the pallets did not terminate upon transfer of the pallets, the Manufacturers did not receive consideration for their customers' possession of the pallets for a fixed or indeterminate term. Former RCW 82.04.040(3)(a).

DOR cites to *Gandy v. State* to support its assertion that a transaction may be characterized as a lease under the tax code only if the transfer of possession or control is for a fixed or indeterminate term. 57 Wn.2d 690, 692, 359 P.2d 302 (1961); former RCW 82.04.040(3)(a). In *Gandy*, the taxpayer owned a business leasing vehicles. 57 Wn.2d at 692. The issue before the court was whether the retail sales tax attached only to the amount paid by the lessee at the execution of the lease or if the tax also attached to each lease payment when it became due. *Id.* at 695.

To determine when the retail sales tax attached to a lease, the *Gandy* court engaged in a discussion of a lease under the "Retail Sales Tax Act," ch. 82.08 RCW. *Id.* at 694. The court

reasoned that the lessee's obligation depends upon his right to possession and "[e]ach rental payment relates to a *period of possession*." *Id.* at 695 (emphasis added). The court held that the lessee must pay taxes on the selling price when the lease is executed and all rental payments because each rental payment is for his continued enjoyment and right to possess the vehicle. *Id.*

The Manufacturers pay consideration to CHEP in exchange for their own continued enjoyment and right to possess the pallets for the past fixed or indeterminate term. *Gandy*, 57 Wn.2d at 695; former RCW 82.04.040(3)(a). However, the Manufacturers' customers do not contract with or give consideration to the Manufacturers in exchange for their own "period of possession" of the pallets for a fixed or indeterminate term. *Gandy*, 57 Wn.2d at 695. As noted above, the Manufacturers do not argue, nor does the record state, that the Manufacturers' transfer of pallets to its customers was for only a fixed or indeterminate term or that the selling price related to a corresponding "period of possession." *Id.*

The Manufacturers contend that by referencing *Gandy*, DOR "attempts to distract [this] Court by reading non-existant and irrelevant requirements into the statutory language." Appellant's Resp. Br. at 12. But *Gandy* does not expand the definition of a lease under former RCW 82.04.040(3)(a). The fact that the leases at issue in *Gandy* involved a series of rental payments does not change the definition of a lease under the Retail Sales Tax Act; it changes the number of taxable events only if the transaction involves multiple payments. 57 Wn.2d at 694.

The Manufacturers do not argue that their transactions with their customers involving CHEP pallets included an exchange of pallets for a fixed or indeterminate term, an essential element of a lease. Former RCW 82.04.040(3)(a). Thus, we again agree with DOR.

3. MANUFACTURERS DID NOT LEASE THE PALLETS FOR THE PURPOSE OF SUBLEASE

DOR argues that the Manufacturers do not qualify for the lease-for-sublease exception because the Manufacturers purchased the pallets for their own use in shipping operations and not for the purpose of "resale, sublease, or subrent" within the definition of RCW 82.08.010(11). The Manufacturers argue that DOR "is wrong: [DOR] stipulated that [the Manufacturers] acquired the pallets for the purpose of shipping product to their customers." Appellant's Resp. Br. at 13. We agree with DOR.

To qualify for the lease-for-sublease exception, the Manufacturers must show that they purchased the property for resale or sublease and the Manufacturers have not made *intervening use* of the purchased items. *Sprint*, 174 Wn. App. at 663 (emphasis added). The terms "use," "used," "using," or "put to use," with respect to tangible personal property,

> have their ordinary meaning, and mean:
>
> (a) . . . the first act within this state by which the taxpayer takes or assumes dominion or control over the article of tangible personal property (as a consumer), and include installation, storage, withdrawal from storage, distribution, or any other act preparatory to subsequent actual use or consumption within this state.

RCW 82.12.010(6).

Rule 211 explains that the retail sales tax does not apply to sales of tangible goods when

> persons who purchase the [tangible goods] solely for the purpose of renting or leasing such property. . . . However, the retail sales tax *applies* upon sales to persons who . . . intend to make some use of the property other than or in addition to renting or leasing.

WAC 458-20-211(6)(a) (emphasis added).

Here, in the Hire Agreement, CHEP made clear that the ordinary use of its pallets is for use in shipping products: "'[c]ustomer will use Equipment *only for shipments to [customers]*,'" Tyson AR at 98; and the Manufacturers' acknowledge that they used the pallets "for the sole

purpose of placing their products onto the pallets and transferring possession of those product-loaded pallets via shipment." Appellant's Resp. Br. at 1. The Manufacturers stipulated that they leased the pallets from CHEP and "*only* use[d] the pallets in shipping products to their customers." Appellant's Resp. Br. at 20 (emphasis added). The Manufacturers leased the pallets for the purpose of using the pallets for their intended use—to facilitate the delivery of their products to their customers.

The crux of the Manufacturers' argument is that their use of the pallets to distribute their products to their customers is not an intervening use. However, using the pallets to transport and distribute their products to their customers plainly constitutes making use of the pallets for a purpose other than merely renting or leasing the pallets. The undisputed material facts show that the Manufacturers not only intended but made "some use of the [pallets] other than or in addition to renting or leasing." WAC 458-20-211(6)(a). They assumed dominion or control over the pallets for the sole purpose of using the pallets to facilitate transportation and distribution of their products to their customers, well within the ordinary and expected use of a pallet. RCW 82.12.010(6)(a).

The burden of showing that the terms of a tax exemption are met lies with the taxpayer. *Activate*, 150 Wn. App. at 813 (quoting *Glen Park*, 119 Wn. App. at 486). Under the facts presented, the requirements of the lease-for-sublease exemption have not been satisfied. The Manufacturers have not shown that they subleased the pallet to their customers or that they leased the pallets from CHEP for the purpose of subleasing the pallets to their customers. Accordingly, we hold that the lease transactions at issue do not qualify for the sale-for-resale exemption as a lease for sublease under RCW 82.04.050(4)(b).

B. PACKAGING MATERIALS EXCEPTION TO THE RETAIL SALES TAX

DOR contends that the Board erred in ruling that the Manufacturers' leases of pallets qualified as a lease for sublease of packing materials under Rule 115. The Manufacturers contend that their lease transactions are exempt from the retail sales tax as wholesale sales of packing material. We agree with DOR.

Under Rule 115, the sale or lease of packing materials is not subject to the retail sales tax if the buyer of the materials "sell[s] tangible personal property contained in or protected by packing materials." The retail sales tax is not imposed if the purpose of the initial sale or lease of the packing materials is for the resale or sublease of the packing materials *with* the product.

In ruling that the Manufacturers were entitled to the sale-for-resale exemption (or lease-for-sublease exception) under Rule 115, the Board concluded that the Manufacturers' leases of pallets were a lease of "'packing materials'" and the Manufacturers subleased the pallets as part of the sale of their products. H2O AR at 28. However, as discussed above, the Manufacturers' did not sublease the pallets to their customers. The Manufacturers sold the products contained only on the pallets for shipment purposes and transferred possession of only the pallets. And any interest that the Manufacturers had in the pallets terminated upon transfer of the pallets to the customer. Therefore, we hold that the Manufacturers' lease transactions are not exempt from the retail sales tax as a resale or sublease of "packing materials" under Rule 115.

CONCLUSION

We hold that the Manufacturers' lease transactions are not entitled to the "lease-for-sublease" exception to the retail sales or use tax under RCW 82.04.050(4)(b) or as a lease or sale of "packing materials" within the meaning of Rule 115. The Manufacturers did not lease pallets

from CHEP for the purpose of subleasing the pallets to their customers nor did the Manufacturers sublease the pallets to their customers. We reverse the Board and affirm the superior court's decision to deny the Manufacturers' refund requests.

CRUSER, J.

We concur:

MAXA, C.J.

LEE, J.

APPENDIX B

Filed
Washington State
Court of Appeals
Division Two

February 21, 2020

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

STATE OF WASHINGTON, DEPARTMENT OF REVENUE Respondent, v. ADVANCED H2O, LLC, Appellant.	No. 51468-1-II ORDER DENYING MOTION FOR CONSIDERATION (Consolidated with No. 51513-0-II)
STATE OF WASHINGTON, DEPARTMENT OF REVENUE Respondent, v. TYSON FRESH MEATS INC., Appellant.	

APPELLANTS move for reconsideration of the Court's December 10, 2019 published opinion. Upon consideration, the Court denies the motion. Accordingly, it is

SO ORDERED.

PANEL: Jj. Maxa, Lee, Cruser

FOR THE COURT:

CRUSER, J.

APPENDIX C

Cite as Det. No. 01-143, 24 WTD 324 (2005)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of:	)	D E T E R M I N A T I O N
	)	
	)	No. 01-143
	)	
. . .	)	Registration No. . . .
	)	FY . . . /Audit No. . . .
	)	Docket No. . . .
	)	
	)	
	)	

RULE 115; RULE 211; RCW 82.08.020: RETAIL SALES TAX -- CONSUMER -- BAILMENT -- PALLETS. If a manufacturer uses pallets to transport goods to buyers, who temporarily possess the pallets under a bailment arrangement, the manufacturer is a consumer of the pallets and owes retail sales tax or use tax. If a manufacturer uses the pallets as part of its packaging of goods and does not retain title to the pallets, the pallets are purchased for resale, and it does not owe retail sales or use tax. When a taxpayer has the right to have the pallets returned and by agreement accepts like-kind pallets the transaction involves a bailment, rather than a series of sales and repurchases of like-kind pallets.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Mahan, A.L.J. – Manufacturer seeks a refund of retail sales tax paid on the purchase of pallets.[1]

ISSUE

Whether the taxpayer purchased pallets for resale or for its own use. . . .

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

FACTS

The taxpayer . . . . manufactures and distributes a variety of canned and bottled food products.

The Department of Revenue (Department) audited the taxpayer's records for the 1993 through 1996 period. One issue in the audit was a possible refund of retail sales tax the taxpayer had paid on its purchase of pallets. The taxpayer based its refund claim on the manufacturing machinery and equipment (M&E) exemption under RCW 82.08.02565. On appeal, the taxpayer also asserted, in the alternative, that the pallets were purchased for resale. At the hearing, the taxpayer withdrew its original claim based on the M&E exemption.

The taxpayer purchases heavy-duty pallets from third-party vendors. The pallets must meet the Grocery Management Association standards for strength and size. According to the taxpayer, such pallets last one to two years with repeated use and, after five uses, typically require some repair. Also, according to the taxpayer, the pallets it uses are "generic" and its name or logo is not imprinted onto the pallets. Its products are placed into cardboard boxes, which are shrink-wrapped to the pallets for storage and ultimate delivery to the taxpayer's customers. Customers are not charged a pallet deposit and are not separately invoiced for the pallets.

[In] 1992, the taxpayer entered into a written [Agreement] with six of its customers, which together accounted for 22% of the taxpayer's annual sales. Under these agreements, its customers are obligated to return the taxpayer's pallets or a "like pallet" for every pallet delivered to the customer. The agreement contains a detailed description of the type and condition of the pallets to be returned to the taxpayer.

In the early part of the audit, taxpayer's prior representative addressed the pallet issue in a letter to the Department. . . . [T]he taxpayer's prior representative stated:

> Recall also that the Company's practices with respect to pallets changed in . . . 1992. As a result, we concluded that the Company was no longer reselling its pallets after . . . 1992 . . . the Company has been paying use tax on all pallets under its new operating practices.

Consistent with this statement and its understanding of its written agreements, the taxpayer treated the pallet purchases as not being for resale during the audit period.

Although the taxpayer does not have written return or exchange agreements with its other customers, the taxpayer endeavors to have its pallets or like-kind pallets returned by its customers. The taxpayer maintains a record of all pallets that are delivered to its customers. It sends out monthly statements to its customers reporting the number of pallets delivered to them and the number of pallets that were returned to the taxpayer. Carriers are also encouraged to pickup one pallet from customers for each pallet they deliver to the customers and return the pallets to the taxpayer.

When customers have failed to return pallets to the taxpayer, the taxpayer has on occasion billed its customers for pallets. During a four year period, the taxpayer billed its customers $ . . . for pallets. The taxpayer also may raise prices or deny discounts to customers who do not return pallets. The taxpayer's program to get pallets returned to it has been successful. The taxpayer reports that 97% of its pallet-related expenses are for repairs, rather than for the purchasing of new pallets.

ANALYSIS

All sales of tangible personal property to consumers in the state of Washington are subject to retail sales tax unless the sales are otherwise exempt from taxation. RCW 82.08.020; RCW 82.04.050. The term "retail sale" is defined, through RCW 82.08.010(4), at RCW 82.04.050(1). There, the statute provides that a retail sale does not include "purchases for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person." RCW 82.04.050(l)(a). The term "consumer" is defined, through RCW 82.12.010(5), at RCW 82.04.190. There, a consumer is any "person who purchases, acquires, owns, holds or uses any article of tangible personal property irrespective of the nature of the person's business . . . other than for the purpose resale in the regular course of business . . . ."

Under RCW 82.04.040, a "sale" means a transfer "of the ownership, title to, or possession" of property for "valuable consideration." In contrast, the temporary transfer of possession without consideration is considered a bailment for tax purposes. *See* WAC 458-20-211(2)(b); Excise Tax Advisory 314 (ETA 314).[2] The taxpayer contends the pallets were packaging material purchased for resale and that it repurchased pallets from its customers. At issue is whether the transfers of pallets between the taxpayer and its customers constituted a series of sales and repurchases of the same or like-kind pallets or a bailment of the pallets.

In general, a manufacturer's purchase or use of pallets is taxed in one of three ways. If the manufacturer uses the pallets in warehousing goods and for other non-sale purposes, the manufacturer would be a consumer, and retail sales tax or use tax would be due, unless the goods

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[2] Under the common law, a bailment "arises generally when personalty is delivered to another for some particular purpose with an express or implied contract to redeliver when the purpose has been fulfilled." *Gingrich v. Unigard Sec. Ins. Co.*, 57 Wn. App. 424, 431-32, 788 P.2d 1096 (1990) (quoting *Freeman v. Metro Transmission, Inc.*, 12 Wn. App. 930, 932, 533 P.2d 130 (1975)). Bailments commonly involve a mutual benefit to the bailor and bailee. A bailment for mutual benefit arises

> when both parties to the contract receive a benefit flowing from the bailment. 8 C.J.S. *Bailments* § 16 (1988). The benefit to the bailee need not be in the form of cash. Rather, the benefit may derive from
>
> > a bailment [which] is a mere incident to the performance of services for which the bailee receives compensation or to the conduct of business from which the bailee derives profit, or where the bailment is motivated by the bailor's desire to promote a sale . . . .

American Nursery Products, Inc. v. Indian Wells Orchards, 115 Wn.2d 217, 232, 797 P.2d 477 (quoting 8 C.J.S. *Bailments* § 16, at 239 (1988)); *see also White v. Burke*, 31 Wn.2d 573, 583, 197 P.2d 1008 (1948). A mutual benefit running between the bailor and bailee is not consideration for purposes of Rule 211.

are otherwise exempt from taxation.[3] If the manufacturer uses the pallets to transport goods to buyers, who temporarily possess the pallets under a bailment arrangement, the manufacturer would also be a consumer of the pallets, and retail sales tax or use tax would be due. If the manufacturer uses the pallets as part of its packaging of goods and does not retain title to the pallets, the pallets are purchased for resale, and retail sales or use tax would not be due. *See* WAC 458-20-115 (Rule 115).[4]

Rule 115 provides that retail sales tax is not imposed on the sale of the packaging materials to a manufacturer because such materials are purchased for resale. Rule 115 also provides that containers are not purchased for resale and are subject to tax when title does not pass to the purchaser and the containers are customarily returned to the seller:

> Sales of containers to persons who sell tangible personal property therein, but who retain title to such containers which are to be returned, are sales for consumption and subject to tax under the retailing classification. This class includes wooden or metal bottle cases, barrels, gas tanks, carboys, drums, bags and other items, when title thereto remains in the seller of the tangible personal property contained therein, and even though a deposit is not made for the containers, and when such articles are customarily returned to the seller.

(Emphasis added.)

The taxpayer contends that its pallets should be treated the same as other packaging materials that remain with products sold to consumers. It relies on Det. No. 90-302, 10 WTD 101 (1990), and Det. No. 91-019, 10 WTD 385 (1990), for the proposition that generic or fungible pallets included with goods being sold are purchases for resale and are not subject to retail sales tax.

In Det. No. 91-019, 10 WTD 385 (1990), a manufacturer used wooden pallets imprinted with its name to transport beer and wine products to its wholesale distributor. The manufacturer billed an amount to the distributor for the pallets, which amount was refunded upon the return of the pallets. The Audit Division assessed the distributor with use tax on the pallets because it considered the distribution of the pallets to be a sale of the pallets. We reversed and held that there was no sale of the pallets to the distributor because title did not pass. After examining Rule 115, we concluded that title did not pass because the parties had an "oral agreement" that the

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[3] *See generally* WAC 458-20-13601(9)(b).

[4] Subsection (6)(c) of Rule 115 further provides a specific example of how pallets may be taxed:

> XY uses three types of pallets in its manufacturing operation. One type of pallet is used strictly for storing paper which is in the manufacturing process. A second type of pallet is returnable and the customer is charged a deposit which is refunded at the time the pallet is returned. The third type of pallet is nonreturnable and is sold with the product. XY is required to pay retail sales or use tax on the first two types of pallets. The third type of pallets may be purchased by XY without the payment of retail sales or use tax since these pallets are sold with the paper products.

customers would return the pallets to the distributor and, upon return, the amount originally charged for the pallets was refunded or credited to the distributor's account.

In Det. No. 90-302, 10 WTD 101 (1990), a manufacturer included a separate pallet charge on invoices to some of its customers, at the request of those customers. The Audit Division assessed use tax or deferred sales tax on all purchases of pallets by the manufacturer. It concluded that the manufacturer did not purchase the pallets for resale, because it considered the pallet charges to be part of a deposit-return program rather than a sale of the pallets. However, the evidence showed that the taxpayer's customers were "under no obligation whatsoever to return the pallet to the taxpayer." Further, the pallets used by the manufacturer were "generic," and were not imprinted with the manufacturer's name, and the manufacturer would grant credit even for pallets that did not originate with the manufacturer. Under the facts of that case, we concluded that title to the pallets had passed to the manufacturer's customers and, accordingly, the manufacturer did not owe use tax or deferred sales tax.

Whether customers were required, through the use of a deposit arrangement or by an agreement, to return the pallets was an underlying factual issue in both cases. To the extent a party retains the right to control the use or return of an item provides evidence on whether title passes. In one case, we found that, by oral agreement and by the use of a deposit, the manufacturer retained the right to have the pallets redelivered and title did not pass. In the other case, the manufacturer was found not to have retained the right to require the pallets to be redelivered, either through a deposit arrangement or by agreement, and we found title to have passed.

In the later case, the generic or fungible nature of the pallets and the fact that the same pallets were commonly not returned supported the conclusion that the parties intended to transfer title, rather than only temporary possession under a bailment arrangement. In this regard, it is usually necessary for a bailee to return the identical property to the bailor in a bailment arrangement:

> With the exception of securities such as stock certificates, the bailee generally can discharge his or her duty to redeliver the bailed property to the bailor only by returning the identical item of property that he or she received in it original or an altered form, according to the terms of the bailment. In the absence of an agreement to do so, a bailor ordinarily cannot be compelled to accept other property of the same kind and of equal value in lieu of that which was given to the bailee.

8A Am. Jur. 2d, *Bailments* § 143 (2000).

However, when the commingling of fungible goods is required by the needs of the trade and is done with the consent of the parties, a bailment is established if that is the intent of the parties. For example, warehousemen are generally permitted to commingle fungible goods and to return goods of like quality and amount. *Id.* It may also occur in the transportation of fungible goods. *See, e.g., Public Service Elec. & Gas Co. v. Federal Power Commission*, 371 F.2d 1 (3rd Cir. 1967), *cert. denied*, 389 U.S. 849 (1967) (where the court examined the economic and legal substance of a transportation agreement involving commingling, and concluded that it was really

a bailment of a fungible commodity (gas) rather than a sale and repurchase). It may also occur with respect to the return of fungible items sent to a processor. *See, e.g., In re Bristol Industries Corp.*, 690 F.2d 26, 30-31 (2nd Cir. 1982) (concurring opinion); Det. No. 98-157, 19 WTD 753 (2000).

Accordingly, to the extent we find the taxpayer had the right to have the pallets returned, the fact that by agreement it accepted like-kind pallets would not preclude us from finding the transaction involved a bailment, rather than a series of sales and repurchases of like-kind pallets. Here, the pallets at issue meet specific industry standards and had a useful life, value, and utility to the taxpayer beyond the initial delivery of the packaged goods being transported on the pallets. Consistent with this value and utility to the taxpayer, the taxpayer had a written agreement with some of its customers requiring the return of either the same pallets or like-kind pallets. The evidence points to similar oral agreements with its other customers. The taxpayer carefully kept an accounting of the transfers of pallets to its other customers, and it exercised the right to charge or penalize customers who do not return either the same pallets or like-kind pallets. Consistent with its prior statements, the evidence shows that the taxpayer was the consumer of the pallets, and the pallets were not purchased for resale.

The taxpayer has not sustained the burden, essential to its case, of proving that title to and ownership of the pallets passed to its customers, as opposed to possession being transferred under a bailment arrangement. Accordingly, the Department's denial of a refund is sustained.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 26th day of September, 2001.

APPENDIX D

Cite as Det. No. 00-119, 20 WTD 117 (2001)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	D E T E R M I N A T I O N
	)	
	)	No. 00-119
	)	
. . .	)	Registration No. . . .
	)	Petition for Refund

RCW 82.04.240; RCW 82.04.450: B&O TAX -- PACKING MATERIALS -- PALLETS -- VALUE OF PRODUCTS MANUFACTURED. A manufacturer's separately-itemized charges for shipping pallets on which the manufacturer's product is held for sale, where title to the pallets passes to the customer upon delivery, are part of the value of the products manufactured, and therefore are part of the measure of the manufacturing B&O tax.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

Beer manufacturer petitions for refund of manufacturing business and occupation (B&O) tax it paid on its separately-stated charges to wholesale customers for shipping pallets on which it delivered the packaged beer.[1]

FACTS:

Prusia, A.L.J. -- The taxpayer, . . ., owned and operated the . . . [Brewing Company] located in . . ., Washington. The taxpayer, through its . . . Division, was in the business of manufacturing and wholesaling beer.

The taxpayer's wholesale business consisted of the sale of packaged beer to distributors throughout the United States. After brewing the beer, the taxpayer packaged the beer in cans, bottles, kegs, cartons, and cases. For some wholesale sales, the taxpayer loaded the cases onto pallets for shipping. Pallets used for shipping were shrink-wrapped together with the packaged beer. The taxpayer then sold the entire shrink-wrapped package, consisting of cans, cartons,

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

cases, pallets, and shrink-wrap, to distributors who picked up the packages at the . . . brewery. The sales price included all associated packaging, but on the invoices to the customers the taxpayer separately-stated a charge for the sale of pallets. The wholesale sale to distributors was completed when distributors took possession and title of their purchases at the brewery dock.

When the taxpayer sold its palletized products to a distributor, it considered the transfer of the pallets to be a sale and accounted for the transfer as such. The charge for the pallets was not a "deposit," and the distributor was under no obligation to return the pallets to the taxpayer. If a distributor subsequently resold a pallet back to the taxpayer, the taxpayer treated the acquisition as a purchase of the pallet by the taxpayer and provided the distributor with a credit.

The taxpayer purchased the pallets from unrelated third parties. The taxpayer resold some pallets that did not meet its standards for shipping manufactured product. Pallets the taxpayer purchased were not imprinted with the company name.

In an audit report dated November 6, 1996, for the period January 1, 1991 through August 31, 1996, the Department of Revenue's Audit Division agreed with the taxpayer that the taxpayer purchased pallets for resale for purposes of sales and use tax. The Audit Division further concluded that the pallets, along with all other associated packaging materials (cans, bottles, boxes, etc.), became part of the product sold and must be included in the value of the products sold that is taxable under the manufacturing business and occupation (B&O) tax classification. Prior to the audit report, the taxpayer had reported under the manufacturing classification on all items except pallets. It had accounted for the pallets as fixed assets, and had paid retail sales and/or use tax on the pallets.

Upon completion of the audit investigation for the 1991 through August 1996 period, the Audit Division issued an assessment against the taxpayer. The audit assessment allowed the taxpayer credits for sales and use tax paid in error on pallets which became a component part of the product sold, and assessed manufacturing B&O tax on separately-stated pallet charges included in the total sales price of products. The assessment also assessed wholesaling B&O tax on those pallet charges for product sold at wholesale in the state, and allowed the taxpayer the multiple activities credit on charges that were subject to both manufacturing and wholesaling B&O tax. The taxpayer paid the assessment. Subsequent to the November 1996 audit report, the taxpayer included the separately-stated charges for pallets in the its manufacturing B&O tax base, and ceased paying retail sales and/or use tax on pallets it acquired and used for shipping.

On October 21, 1999, the taxpayer filed a petition for refund of the manufacturing B&O tax it had paid on pallet charges for the period January 1, 1991 through June 30, 1999, in the approximate amount of $. . ., plus interest. The petition contends the separately-stated pallet charges are not properly included in the measure of the taxpayer's manufacturing B&O tax. The petition contends the taxpayer does not manufacture the pallets, but rather purchases and then resells them to the taxpayer's wholesale customers. It contends the separate charge for the pallets should only be included in the measure of the wholesaling B&O tax.

In response, the Audit Division contends that manufacturing B&O tax was due on the separately-stated pallet charges, because the charges were part of the selling price of the manufactured product. Therefore, the taxpayer is not entitled to a refund of manufacturing B&O tax paid on the pallet charges during the refund period.

ISSUE:

Should the separately-itemized charges for pallets be part of the measure of the taxpayer's manufacturing B&O tax?

DISCUSSION:

The taxpayer was a manufacturer of beer. RCW 82.04.240 imposes the B&O tax on manufacturers, as follows:

> Upon every person . . . engaging within this state in business as a manufacturer; as to such persons the amount of the tax with respect to such business shall be equal to the value of the products, including byproducts, manufactured . . . .
>
> The measure of the tax is the value of the products, including byproducts, so manufactured regardless of the place of sale or the fact that deliveries may be made to points outside the state.

Purchases of tangible personal property for the purposes of consuming the property purchased in producing for sale a new article of tangible personal property or substance, of which such property becomes an ingredient or component, are not "retail sales." RCW 82.04.050. A manufacturer who purchases property that it incorporates into a product it manufactures does not pay retail sales tax on the purchase, and the property becomes part of the value of the product manufactured. A person who purchases tangible personal property for the purpose of resale as tangible personal property in the regular course of business, without consuming the property in producing a new article for sale and without intervening use, does not owe retail sales tax on the purchase, and the subsequent resale is subject to retailing B&O tax (and retail sales) if at retail, and subject to wholesaling B&O tax if at wholesale. *See* RCW 82.04.050(1), RCW 82.08.020, RCW 82.04.060, RCW 82.04.220, RCW 82.04.250, and RCW 82.04.270.

Were the pallets in question part of the "value of the products manufactured," and therefore part of the measure of the taxpayer's manufacturing B&O tax, or were they property purchased for resale to the distributors, and therefore properly included solely in the measure of the tax on wholesaling?

RCW 82.04.450 specifies how the value of products manufactured is to be determined for purposes of the manufacturing B&O tax. It provides, in pertinent part: "The value of products, including byproducts, extracted or manufactured shall be determined by the gross proceeds derived from the sale thereof whether such sale is at wholesale or retail . . . ." *See also* WAC 458-20-112 (Rule 112). The term "gross proceeds of sales" means "the value proceeding or

accruing from the sale of tangible personal property . . . without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expenses whatsoever paid or accrued and without any deduction on account of losses." RCW 82.04.070; Rule 112.

What items were included in the "gross proceeds" from the taxpayer's sale of beer? The taxpayer did not simply sell beer which it poured into containers provided by its customers. It wholesaled beer in containers and cartons, shrink-wrapped with a pallet for shipping. The whole bundle was what was held for sale. The gross proceeds of the sale included the pallet. Thus, RCW 82.04.450 directs that the charge for the pallet be included in the measure of the manufacturing B&O tax.

The taxpayer argues that the phrase "the value of the products, including byproducts, manufactured" in RCW 82.04.240, and the phrase "from the sale thereof" in RCW 82.04.450, limit the measure of the manufacturing B&O tax to the value of the products the taxpayer itself manufactures, i.e., beer. Because the taxpayer did not manufacture the pallets, gross proceeds from their sale were not proceeds of sales from the business of being a manufacturer. We disagree. The measure of the manufacturing B&O tax is not limited to components the taxpayer manufactures from scratch. The measure of the tax is determined by the gross proceeds of sales of the finished product. The gross proceeds of sales include numerous items the taxpayer did not itself manufacture. Neither RCW 82.04.450 nor Rule 112 allows any deduction from the value of items manufactured for parts obtained from others that are incorporated into the finished product. Det. No. 88-37, 5 WTD 107 (1988); Det. No. 92-034, 12 WTD 77 (1993).

Moreover, the fact that the value of manufactured products is to be determined by the gross proceeds of sales implies that the manufacturing process is not considered complete until the product is in a saleable condition. When viewing the total activity of the taxpayer, the palletizing and other packaging must be considered an integral part of its manufacturing process. The taxpayer had to package the beer in order for the beer to be in a saleable condition for distributors. The packaging clearly added value to the extent the beer was not a completely manufactured product until it was packaged into a form necessary for sale.

Treating the charges for the pallets as part of the selling price of the product is consistent with the treatment of the charges for sales and use tax purposes. In Det. No. 88-440, 7 WTD 43 (1988), the Department noted that it "has long taken the position that packing materials, including pallets, are not subject to [sales or use] tax when a manufacturer or processor for hire delivers these items, along with a product, to customers and no substantial non-manufacturing use has taken place."[2] Subsection (2)(c) of WAC 458-20-115 (Rule 115) specifically provides

[2] In Det. No. 90-302, 10 WTD 101 (1990), the Department noted that it "has consistently interpreted pallets as falling within [WAC 458-20-115's] definition of packing materials and taxable in the same manner." We note that pallets thus are distinguished from dunnage, although they may take the place of dunnage during shipping. Taxation of the sale or use of dunnage is explained in WAC 458-20-117 (Rule 117). The term "dunnage" means "any material used for the purpose of protecting or holding in place cargo or freight during transportation by any carrier of property, and which is not an integral part of the carrier itself," such as wood blocks, separating strips, and

that title to containers for beverages and food sold at retail will be deemed to pass to the customer along with the contents, and the "amounts charged for the containers are **part of the selling price**." In Det. No. 90-302, 10 WTD 101 (1990), the Department held that a cardboard box manufacturer's separately-itemized charges for pallets were part of the selling price of the product where title passed to the customer upon delivery. While Rule 115 and these determinations concern sales or use tax, the principle that when title to packaging materials passes to the customer upon delivery, the charges for the packaging materials are part of the selling price of the product, is equally applicable to the manufacturing B&O tax. (Emphasis added.)

Subsection (5)(c) of Rule 115 provides: "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." (Emphasis added). The clear implication of this section is that pallets a manufacturer sells with the product are to be considered part of the selling price of the product.

We note that the Department has addressed the specific question presented in the property tax context, and reached a similar conclusion. In Property Tax Bulletin 90-3 (1990), the Department provided the following guidance for property tax purposes:

> PACKAGING MATERIALS -- DEFINITION: "Packaging materials" means and includes all boxes, crates, bottles, cans, bags, drums, cartons, wrapping papers, cellophane, twines, gummed tapes, wire, bands, excelsior, wastepaper, and all other materials in which tangible personal property may be contained or protected within a container for transportation or delivery to a purchaser.
>
> DUNNAGE -- DEFINITION: The term "dunnage" means any material used for the purpose of protecting or holding in place cargo during shipping by any type of carrier. Examples of these type materials are: wood blocks, timbers, separating forms, bulkheads, double floors, or any other type of bracing or support structures.
>
> **BUSINESS CATEGORIES:**
>
> **MANUFACTURING/PROCESSING**
>
> PACKAGING SUPPLIES: The location in the production stream is the determining factor whether packaging materials are inventory or supplies.

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bracing. Rule 117 distinguishes "dunnage" from "packing material" as follows: "Dunnage generally does not remain with the cargo that is being transported and will not be delivered to the person who will ultimately receive the cargo. On the other hand, packing materials are generally part of the total package containing the cargo and are ultimately delivered to the customer as part of the cargo or merchandise."

> When manufactured or processed products are considered a final sale by the manufacture or processor, all packaging materials in which the product is held for sale **becomes a part of that product and is considered inventory for resale**. An example of packaging components used to contain a product held for sale might include some or all of the following: individual wrappings of each item; cardboard used for layering; the package containing each item; the box holding numerous individual items; staples, banding, glue, or other material used to seal the box; **pallets holding numerous boxes which might also be sealed in plastic and or banded together for shipping**.
>
> If the product has not been completed and is packaged for shipment to another step in the manufacturing process where it will be repacked, the materials or containers used to ship the product from one step to another are considered supplies. Containers may be considered equipment if they are returned and are reusable by the shipper.

(Emphasis added.)

While statutes, rules, and interpretations applicable to property tax do not control excise tax treatment, the Department may properly look to the property tax treatment for insight. *See Western Ag Land Partners et al. v. Dept. of Revenue*, 43 Wn. App. 167, 716 P.2d 310 (1986).

The taxpayer argues that the shipping pallet and the manufactured product were separate and distinct articles, which was the reason for charging the distributors a separate and distinct amount for the pallets. It argues that the pallets were not like packaging material, such as cans, bottles, and kegs, because the latter held the product until eventual use by the retail customer, whereas the pallets were only in temporary contact with the beer, and were separated from the beer after shipment. We agree that, factually, the pallets differed from bottles, cans, and kegs, in that they generally were not part of the packaging that reaches the retail customer. However, we see that as a distinction without a difference for manufacturing B&O tax purposes. The pallets were part of the packaging at the time the beer was sold at wholesale, which is when the value of the products manufactured is to be determined. RCW 82.04.450; Rule 112.

We conclude that the taxpayer's separately-itemized charges for pallets sold with its packaged beer products were part of the measure of its manufacturing B&O tax. Therefore, the taxpayer is not entitled to the requested refund of B&O tax it paid on charges for pallets.

DECISION AND DISPOSITION:

The taxpayer's petition for refund is denied.

Dated this 21st day of June, 2000.

CERTIFICATE OF SERVICE

I certify that on March 23, 2020, I served a copy of the foregoing CORRECTED PETITION FOR REVIEW OF ADVANCED H20, LLC & TYSON FRESH MEATS, INC., via electronic mail, per agreement, upon the following counsel of record:

ROSANN FITZPATRICK
Assistant Attorney General of Washington
Revenue Division
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PO Box 40123
Olympia, WA 98504-0123
Email: rosann.fitzpatick@atg.wa.gov; and
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Counsel for Respondent

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

DATED: March 23, 2020, at Seattle, Washington.

Pear Brown, Legal Assistant
LANE POWELL PC

LANE POWELL PC

March 23, 2020 - 3:31 PM

Transmittal Information

Filed with Court:	Court of Appeals Division II
Appellate Court Case Number:	51468-1
Appellate Court Case Title:	Dept. of Revenue, Respondent v. Advanced H2O, LLC & Tyson Fresh Meats, Inc., Appellants
Superior Court Case Number:	17-2-00672-3

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