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

LEE'S DRYWALL CO., INC.,

Appellant,

v.

STATE OF WASHINGTON DEPARTMENT OF LABOR &
INDUSTRIES,

Respondent.

FILED
COURT OF APPEALS
DIVISION II
07 MAY 22 PM 12:13
STATE OF WASHINGTON
BY *[Signature]*
DEPUTY

BRIEF OF RESPONDENT

ROBERT M. MCKENNA
Attorney General

James S. Johnson
Assistant Attorney General
WSBA No. 23093
PO Box 40121
Olympia, Washington
(360) 586-7707

TABLE OF CONTENTS

I. INTRODUCTION.....1

II. COUNTERSTATEMENT OF THE ISSUES1

III. COUNTERSTATEMENT OF THE FACTS3

IV. KEY STATUTE AND OTHER AFFECTED PROVISIONS5

V. SUMMARY OF ARGUMENT.....7

VI. ARGUMENT9

A. Standard of Review9

B. The Board Correctly Interpreted and Applied RCW 51.12.070 when It Found that Lee’s Had Failed to Meet its Burden of Establishing that Zagy’s Had Adequate Books and Records and a Principal Place of Business Eligible for IRS Deduction.10

1. Subsection (2)’s requirement that the subcontractor have a separate IRS-qualifying principal place of business.....11

2. Subsection (3)’s requirement that the subcontractor keep separate books or records.....15

3. Lee’s complaint that it encountered difficulty in proving its case for the subcontractor exception is not a valid legal argument.17

C. The Department Is Not Required to Attempt Collection from the Subcontractor Before Imposing Liability on a Prime Contractor.....19

D. The Department’s 2005 Information Sheet Is Not a Rule and Does Not Determine whether Lee’s Qualifies for the Exception in RCW 51.12.07021

E. Lee’s Constitutional Challenges Are Without Merit	26
1. Lee’s waived its constitutional challenges by failing to raise constitutional issues below without excuse.	26
2. RCW 51.12.070 does not violate privacy protections in article 1, section 7 of the Washington Constitution	26
3. Applying a statutory provision enacted in 1981 to an oral contract formed in 2003 does not impair Lee’s contractual obligations.....	29
VII. CONCLUSION	31

TABLE OF AUTHORITIES

Federal Cases

<i>United States v. Phillips</i> 433 F.2d 1364, 1366 (8 th Cir. 1970)	27
---	----

Washington Cases

<i>Ackley-Bell v. Dep't of Labor & Indus.</i> 87 Wn. App. 158, 940 P.2d 685 (1997)	9
<i>Allan v. Dep't of Labor & Indus.</i> 66 Wn. App. 415, 832 P.2d 489 (1992)	23
<i>Black Real Estate Co. v. Dep't of Labor & Indus.</i> 70 Wn. App. 482, 854 P.2d 46 (1993)	9, 25
<i>Bolin v. Kitsap Cty</i> 114 Wn.2d 70, 785 P.2d 805 (1990)	19
<i>Budget Rent a Car Corp. v. Dep't of Licensing</i> 144 Wn.2d 889, 31 P.3d 1174 (2001)	24
<i>Carnation Co., Inc. v. Hill</i> 115 Wn.2d 184, 796 P.2d 416 (1990)	18, 21
<i>Cf. Manor v. Nestle Food Co.</i> 131 Wn.2d 439, 932 P.2d 628 (1997)	23
<i>City of Bellevue v. Lorang</i> 140 Wn.2d 19, 992 P.2d 496 (2000)	12, 16
<i>Cosmopolitan Eng'g Group, Inc. v. Ondeo</i> 128 Wn. App. 885, 117 P.3d 1147 (2005)	26
<i>Dep't of Labor & Indus. v. Gongyin</i> 119 Wn. App. 188, 79 P.3d 488 (2003)	26

<i>Duke v. Boyd</i> 133 Wn.2d 80, 942 P.2d 351 (1997).....	18, 21
<i>Federated American Ins. Co. v. Marquardt</i> 108 Wn.2d 651, 741 P.2d 18 (1987).....	30
<i>Ford Motor Co. v. Barrett</i> 115 Wn.2d 556, 800 P.2d 367 (1990).....	27
<i>Frazier v. Dep't of Labor & Indus.</i> 101 Wn. App. 411, 3 P.3d 221 (2000).....	23
<i>Glaubach v. Regence Blue Shield</i> 149 Wn.2d 827, 74 P.3d 115 (2003).....	14
<i>Hamel v. Empl. Sec. Dep't</i> 93 Wn. App. 140, 966 P.2d 1282 (1998).....	9
<i>Harrison Memorial Hosp. v. Gagnon</i> 110 Wn. App. 475, 40 P.3d 1221 (2002).....	10
<i>Hillis v. Dep't of Ecology</i> 131 Wn.2d 373, 982 P.2d 139 (1997).....	24
<i>In re the Matter of Rosier</i> 105 Wn.2d 606, 717 P.2d 1353 (1986).....	27
<i>Jamison v. Dep't of Labor & Indus.</i> 65 Wn. App. 125, 827 P.2d 1085 (1992).....	9
<i>Kilian v. Atkinson</i> 147 Wn.2d 16, 50 P.3d 638 (2002).....	12
<i>Kilian v. Atkinson</i> , 147 Wn.2d at 21	16
<i>Littlejohn v. Dep't of Labor & Indus.</i> 74 Wn. App. 420, 873 P.2d 583 (1994).....	12
<i>McDonald v. Dep't of Labor & Indus.</i> 104 Wn. App. 617, 17 P.3d 1195 (2001).....	25

<i>Olympia Brewing Co. v. Dep't of Labor & Indus.</i> 34 Wn.2d 498, 208 P.2d 1181 (1949).....	25
<i>Pierce County v. State of Washington</i> 159 Wn.2d 16, 148 P.3d 1002 (2006).....	30
<i>Postema v. Pollution Control Hearings Bd</i> 142 Wn.2d 68, 11 P.3d 726 (2000).....	23
<i>R & G Probst v. Dep't of Labor & Indus.</i> 121 Wn. App. 288, 88 P.3d 413 (2004).....	10
<i>Ludwig v. Dept. of Retirement Systems</i> 31 Wn. App. 379, 127 P.3d 781 (2006).....	29
<i>Stafford v. Dep't of Labor & Indus.</i> 33 Wn. App. 231, 653 P.2d 1350 (1982).....	24
<i>State v. Clark</i> 124 Wn.2d 90, 875 P.2d 613 (1994).....	27
<i>State v. Gunwall</i> 106 Wn.2d 54, 720 P.2d 808 (1986).....	27
<i>State v. Mierz</i> 127 Wn.2d 460, 10, 901 P.2d 286 (1995).....	27
<i>State v. Reding</i> 119 Wn.2d 685, 835 P.2d 1019 (1992).....	27

Statutes

RCW 34.05.230(1).....	23
RCW 34.05.510	9
RCW 34.05.554	26
RCW 34.05.570(3)(d) and (e).....	9

RCW 50.04.145(2)(c)	7, 19
RCW 50.24.130(3).....	7, 19
RCW 51.08.070	19
RCW 51.08.070(2).....	7, 19
RCW 51.08.180	19
RCW 51.08.180(1)(b)	7, 19
RCW 51.08.195	19
RCW 51.08.195(3).....	7, 19
RCW 51.12.010	19
RCW 51.12.070	passim
RCW 51.12.070(1).....	11
RCW 51.12.070(2).....	1, 11, 14
RCW 51.12.070(3).....	2, 14
RCW 51.16.150	2, 20
RCW 51.16.200	2, 20
RCW 51.48.131	passim
RCW 51.52.050	17, 25
RCW 51.52.060	24
RCW 51.52.100	17, 24
Under RCW 34.05.030(2)(c)	23

Other Authorities

26 U.S.C. §280A..... 13

40 USC §280A..... 13

Administrative Procedure Act..... 5, 9

Cook v. CIR, TC Memo 1997-378 at 2 (1997) 13

Laws of 2004, chapter 243, § 2..... 5

Rules

RAP 2.5..... 26

RAP 2.5(a) 26

WAC 263-12-125..... 17

I. INTRODUCTION

At issue in this case is an order of the Department of Labor and Industries (Department) assessing Lee's Drywall Co., Inc. (Lee's), for workers' compensation premiums owed for work Lee's subcontracted to Zagy's Drywall (Zagy's). For nearly 100 years, under RCW 51.12.070 and its predecessor codifications, the general rule in Washington has been that anyone who lets a contract for work to a subcontractor is responsible for the industrial insurance premiums on the work if the subcontractor fails to pay the premiums. Since 1981, registered construction contractors have been able to protect themselves from this "prime contractor liability" by hiring subcontractors that meet certain requirements. In this appeal, Lee's seeks the benefit of the protection of the 1981 amendments, despite having hired a subcontractor who did not meet the requirements of the statute.

II. COUNTERSTATEMENT OF THE ISSUES

1. Does substantial evidence support the Board of Industrial Insurance Appeals' findings and conclusions that Lee's failed to establish:
 - a) subcontractor Zagy's had a principal place of business eligible for IRS deduction during the relevant period as required by RCW 51.12.070(2)?

- b) subcontractor Zagy's maintained a separate set of books that reflected all items of income and expenses of the business as required by RCW 51.12.070(3)?

The Department answers yes, Lee's failed to meet its burden.

2. Does RCW 51.16.200 or RCW 51.16.150 or any other provision of the Industrial Insurance Act require the Department to attempt to collect premiums from a defaulting subcontractor employer such as Zagy's before the Department assesses premiums against the primary contractor under RCW 51.12.070?

The Department answers no.

3. Was the Department required to adopt as a rule a publication it provided contractors in 2005 that discussed how they might protect themselves under RCW 51.12.070, such that the Department should be precluded from enforcing the prime contractor responsibility provisions of RCW 51.12.070 in this case?

The Department answers no.

4. Did Lee's waive any constitutional challenge to the subcontractor exception of RCW 51.12.070 by failing to raise such challenge at Superior Court and at the Board?

The Department answers yes.

5. Does the subcontractor exception of RCW 51.12.070, as applied by the Department, Board and Superior Court, transform prime contractors into agents of the State and require that they conduct warrantless, non-consenting searches of the premises and records of subcontractors, and thus violate article 1, section 7 of the Washington constitution?

The Department answers no.

6. Where Zagy's had contracted with Lee's that Zagy's would pay industrial insurance premiums for Zagy's employees, does RCW 51.12.070, as applied by the Department, Board and Superior Court, violate state and federal constitutional protections against impairment of contracts?

The Department answers no.

III. COUNTERSTATEMENT OF THE FACTS

In the second quarter of 2003, Lee's hired Zagy's to do some drywall work. *See* BR Exhibit 2.¹ Lee's understood that the quantity of work involved would require the owner of Zagy's to employ others to do the work. Tr. Jeffrey Lee, 64.

Lee's made sure Zagy's was a registered construction contractor. Tr. Jeffrey Lee, 61. Lee's made sure Zagy's carried the required liability

¹ "BR" references the Certified Appeals Board Record. Exhibits are separately collected in the BR. References to testimony in the BR will be "Tr." indicating the page number and name of witness. Other documents in the Board record, such as the Board decision, will be referenced by the stamped page number in the BR.

insurance. Tr. Jeffrey Lee, 61. Lee's made sure that Zagy's had a business license. Tr. Jeffrey Lee, 61-62. But Lee's did nothing to determine whether Zagy's books and records were complete. Tr. Jeffrey Lee, 62. And Lee's did not determine whether Zagy's had a separate place of business that would be eligible for a business deduction for internal revenue service (IRS) tax purposes. Tr. Jeffrey Lee, 70.

Zagy's failed to pay industrial insurance premiums for employees who were engaged in drywall work during the second quarter of 2003. BR 26 (FF 3). A Department auditor reviewed Zagy's books and records, and found them to be incomplete. Tr. Linda Wilcox, 109-110. The Department auditor also determined that Zagy's owner did his paperwork at his kitchen table, something that would not qualify for IRS deduction. Tr. Linda Wilcox, 112. Pursuant to RCW 51.12.070, the Department issued an order assessing Lee's for premiums owed on the work performed by Zagy's in the second quarter of 2003. BR 51-52.

Lee's appealed the Department order to the Board of Industrial Insurance Appeals (Board). BR 29-30. Lee's and the Department each presented evidence. Lee's did not call as a witness the owner of Zagy's, and there is nothing in the record suggesting that Lee's attempted to subpoena him or the records of his business.

After holding a hearing, the Board's Industrial Appeals Judge (IAJ) entered a proposed decision recommending that the Board affirm the Department order. BR 20-28. The IAJ's proposed decision included the following key findings of fact addressing two of the requirements of the subcontractor exception of RCW 51.12.070:

4. Sufficient evidence was not presented to establish that Zagy's Drywall maintained a separate set of books or records that reflect all items of income and expenses of the business during the second quarter of 2003.

5. Sufficient evidence was not presented to establish that Zagy's Drywall had a principal place of business which would be eligible for a business deduction for IRS tax purposes other than that furnished by the contractor for which the business had contracted to furnish services during the second quarter of 2003.

BR 26 (FF 4, 5).

Lee's petitioned the three-member Board for review of the IAJ's proposed decision, and the Board denied review, thus adopting the IAJ's proposed decision as the Board's final decision. BR 2.

Lee's appealed to Thurston County Superior Court, CP 3-4, which affirmed the Board's decision following review of the Board record under the standards of the Administrative Procedure Act. CP 71-72.

IV. KEY STATUTE AND OTHER AFFECTED PROVISIONS

The key statutory provision is RCW 51.12.070. The section was amended in 2004. See Laws of 2004, chapter 243, § 2. The parties agree

that this case is controlled by the pre-2004 version of the statute in place when the facts of this case arose.² However, the 2004 amendment did not change any of the provisions of the statute relevant to this dispute. Thus, resolution of the statutory construction issues before this Court will affect activity under the current version of the law.

RCW 51.12.070 provides in relevant part:

The provisions of this title apply to all work done by contract; the person, firm, or corporation who lets a contract for such work is responsible primarily and directly for all premiums upon the work. The contractor and any subcontractor are subject to the provisions of this title and the person, firm, or corporation letting the contract is entitled to collect from the contractor the full amount payable in premiums and the contractor in turn is entitled to collect from the subcontractor his or her proportionate amount of the payment.

For the purposes of this section, a contractor registered under chapter 18.27 RCW or licensed under chapter 19.28 RCW is not responsible for any premiums upon the work of any subcontractor if:

- (1) The subcontractor is currently engaging in a business which is registered under chapter 18.27 RCW or licensed under chapter 19.28 RCW;
- (2) *The subcontractor has a principal place of business which would be eligible for a business deduction for internal revenue service tax purposes other than that furnished by the contractor for which the business has contracted to furnish services;*
- (3) *The subcontractor maintains a separate set of books or records that reflect all items of income and expenses of the business;*
- (4) The subcontractor has contracted to perform:

² The Department's references to RCW 51.121.070 in this brief are to the pre-2004 version of the statute. For simplicity, the Department will refer to it herein without using the modifier "former."

- (a) The work of a contractor as defined in RCW 18.27.010;
- or
- (b) The work of installing wires or equipment to convey electric current or installing apparatus to be operated by such current as it pertains to the electrical industry as described in chapter 19.28 RCW.

RCW 51.12.070 (Emphasis added to highlight subsections at issue).

It should be noted that the subcontractor exception language of subsections (2) and (3) at issue here is also found in the same or essentially same form in the following additional statutes, all of relatively long standing in Washington: RCW 50.04.145(2)(c), (f) (exception to unemployment law coverage); RCW 50.24.130(3), (4) (exception to prime contractor responsibility for subcontractor unemployment taxes); RCW 51.08.070(2), (3) (exclusion in definition of “employer” for workers’ compensation coverage and employer tax liability purposes); RCW 51.08.180(1)(b), (c) (exclusion in definition of “worker” for workers’ compensation coverage purposes); RCW 51.08.195(3), (6) (alternative exception to definition of “worker” and “employer” for Industrial Insurance Act coverage purposes).

V. SUMMARY OF ARGUMENT

At the hearing before the Board of Industrial Insurance Appeals Lee’s bore the burden of establishing that its subcontractor met the requirements of RCW 51.12.070. Lee’s presented no evidence from

which the Board could have concluded that the subcontractor met two of the requirements. The Board properly read the statute according to its plain meaning, and properly concluded Lee's failure to present evidence on two critical points meant the Department had properly assessed Lee's for the premiums due on the work performed by the subcontractor.

The Department was not obligated to attempt collection of the premiums from the subcontractor because a prime contractor's liability is primary and direct.

A Department publication explaining how contractors such as Lee's can try to protect themselves under RCW 51.12.070 did not have to be adopted as an administrative rule. The issue that was properly presented to and resolved by the Board was whether the subcontractor met the requirements of the statute.

This Court should decline to address the constitutional issues raised for the first time. Regardless, RCW 51.12.070 does not require contractors to violate their subcontractors' constitutionally protected privacy rights, and the application of the statute in this case does not impair any contractual obligations that predate the statute.

VI. ARGUMENT

A. Standard of Review

The Administrative Procedure Act (APA) governs this Court's review of the Board's decision in an industrial insurance tax assessment case. RCW 51.48.131 (incorporating by reference RCW 34.05.510 through 34.05.598 for judicial review of Board decisions in assessment cases); *Jamison v. Dep't of Labor & Indus.*, 65 Wn. App. 125, 127, 827 P.2d 1085 (1992).

The employer bore the burden of proof before the Board to show that the assessment was incorrect. *Black Real Estate Co. v. Dep't of Labor & Indus.*, 70 Wn. App. 482, 486-87, 854 P.2d 46 (1993). Under the APA, this Court applies the standards of error of law (to the agency's conclusions of law) and substantial evidence (to the agency's findings of fact) when it reviews an agency order. RCW 34.05.570(3)(d) and (e); *see Hamel v. Empl. Sec. Dep't*, 93 Wn. App. 140, 144-45, 966 P.2d 1282 (1998).

On issues of law, this Court may substitute its judgment for that of the agency, though according substantial weight to the interpretation by the agency (here, both the Department and Board). *Id.*; *Ackley-Bell v. Dep't of Labor & Indus.*, 87 Wn. App. 158, 165, 940 P.2d 685 (1997) (Board and Department interpretations considered). On mixed questions

of law and fact, the Court determines the law independently and then applies it to the facts as the agency has found them, to the extent that, as here, the findings are supported by substantial evidence. *Hamel*, 93 Wn. App. at 145.

Evidence is substantial if “sufficient to persuade a fair-minded, rational person of the truth of the matter.” *R & G Probst v. Dep’t of Labor & Indus.*, 121 Wn. App. 288, 293, 88 P.3d 413 (2004). In determining whether substantial evidence exists, the Court must take the “record in the light most favorable to the party who prevailed [before the fact-finding tribunal],” here, the Department. *Harrison Memorial Hosp. v. Gagnon*, 110 Wn. App. 475, 485, 40 P.3d 1221 (2002).

B. The Board Correctly Interpreted and Applied RCW 51.12.070 when It Found that Lee’s Had Failed to Meet its Burden of Establishing that Zagy’s Had Adequate Books and Records and a Principal Place of Business Eligible for IRS Deduction.

Lee’s argues that RCW 51.12.070 must be interpreted according to its plain meaning. Appellant’s Brief (AB) 15-19. The Department agrees. The plain meaning of RCW 51.12.070 supports the Board’s decision in this case.

RCW 51.12.070 declares that anyone “who lets a contract for . . . work shall be responsible primarily and directly for all premiums upon the work.” RCW 51.12.070. The second paragraph of RCW 51.12.070

carves out an exception to the general rule of liability that the first paragraph establishes, and imposes conditions on that exception.

To qualify for the exception, both parties to the contract must be registered construction contractors, and the work must be something one must be registered as a contractor to do. RCW 51.12.070(1), (4). Those two requirements of the four-part test are met here. In addition, however, the statute contains two more requirements, both of which must be met to qualify for the exception, and neither of which were met by Lee's proof in this case.

1. Subsection (2)'s requirement that the subcontractor have a separate IRS-qualifying principal place of business

Subsection (2) of RCW 51.12.070 requires that "the subcontractor ha[ve] a principal place of business which would be eligible for a business deduction for the internal revenue service tax purposes other than that furnished by the contractor for which the business has contracted to furnish services." RCW 51.12.070(2). In other words, the subcontractor must have a separate "principal place of business" as defined by the IRS statutes.

Lee's asks this Court to read this provision as requiring only that the subcontractor have a separate place of business that was not furnished by the contractor. AB at 15-19, 24-28. Yet this interpretation ignores a

significant part of the plain language of the provision. Courts should not construe statutes to render meaningless any of the words of the statute. *City of Bellevue v. Lorang*, 140 Wn.2d 19, 25, 992 P.2d 496 (2000); *Kilian v. Atkinson*, 147 Wn.2d 16, 21, 50 P.3d 638 (2002) ("Statutes must be construed so that all the language is given effect and no portion is rendered meaningless or superfluous.").

Lee's uses a quote from *Littlejohn v. Dep't of Labor & Indus.*, 74 Wn. App. 420, 424, 873 P.2d 583 (1994), to justify ignoring the plain language of subsection (2). AB 16-18. In the *Littlejohn* passage, the Court provided a summary overview of the provisions of the four-part exception to RCW 51.12.070. 74 Wn. App. at 424. In that overview discussion, the Court provided element-by-element incorporating references to each of the four subsections of the statute. *Id.* Lee's has omitted those footnotes from the *Littlejohn* quote. See AB 16. Not only does this out-of-context quoting of the *Littlejohn* Court's summary overview of the four-part test of the subcontractor exception not support Lee's argument, but quoting that summary overview without including the element-by-element footnotes distorts the quoted material.

Furthermore, "principal place of business" is a term of art in the area of federal income taxes, and the provision requires that the principal place of business be eligible for deduction for federal tax purposes. 26

U.S.C. §280A specifies that to be eligible for deduction, a principal place of business must meet certain requirements.

Without citation to any supporting case law or tax bulletins or authority such as IRS regulations, Lee's quotes some IRS language and then apparently attempts at AB 26-27 to argue that the kitchen table of Zagy's owner did qualify for the IRS "principal place of business" federal tax exemption. Lee's is apparently asserting that the mere fact that a drywaller does his paperwork at his residential kitchen table meets the IRS "principal place of business" proof requirement. AB 26-27. Under Lee's theory, it would not matter that a broad range of non-business activities are carried out at that kitchen table. AB 26-27. Lee's contention is unsupportable.

To be eligible for deduction, a portion of a private residence must be (1) exclusively used, (2) on a regular basis, (3) for the purposes enumerated in the federal statute. *Cook v. CIR*, TC Memo 1997-378 at 2 (1997)³; 40 USC §280A. *Exclusively* means that the portion of the home for which deduction is sought is used solely for the business purpose. *Cook, supra*. If it used for any other purpose, then it is simply not *eligible* for deduction.

³ For the court's convenience, a copy is attached as Appendix A.

It appears that Lee's is also arguing, in the alternative, that the phrase "*would be* eligible" in RCW 51.12.070(3) means that all that need be done is to identify a place of business, no matter what its characteristics. Thus, at AB 28, Lee's argues that it should prevail on the subsection (3) question "because a residence or some portion thereof, 'would be' eligible for a business deduction *provided Mr. Guerrero complied with provisions in the IRS code.*" (Emphasis added). Why does Lee's stop at "a residence or some portion thereof"? Under Lee's tautology, one's toilet, hammock, or family car "would be" eligible as an IRS "principal place" provided that the toilet, hammock, or car "complied with provisions of the IRS code."

This, of course, reduces subsection (3) to a pointless requirement under this and the many other Washington statutes (*see supra* Part IV) that use the same test. The argument is absurd and should be rejected for that reason. Courts must avoid readings of statutes that result in absurd or strained consequences. *Glaubach v. Regence Blue Shield*, 149 Wn.2d 827, 833, 74 P.3d 115 (2003).

RCW 51.48.131 places the burden on Lee's to prove that the Department's assessment was incorrect. RCW 51.12.070(2) conditions exemption from prime contractor liability on a subcontractor having a principal place of business eligible for deduction on federal income taxes.

Federal law sets conditions on the deductibility of a principal place of business. Yet Lee's presented no evidence from which the Board could determine that Zagy's place of business would qualify for the IRS "principal place" deduction.

In sum, the Board correctly applied and interpreted RCW 51.12.070(2) when it determined that Lee's had failed to meet its burden. BR 26 (FF 5). And, regardless of whether Zagy's met subsection (3)'s separate books and records requirement (addressed below), subsection (2) was not met and the four-part test of the RCW 51.12.070 subcontractor exception was not satisfied.

2. Subsection (3)'s requirement that the subcontractor keep separate books or records

Lee's argument under subsection (3) of RCW 51.12.070 fails as well. Subsection (3) requires that for a contractor to avoid liability for a subcontractor's premiums, the subcontractor must "maintain[] a separate set of books or records that reflect *all* items of income and expenses of the business" (Emphasis added). Lee's argues that this provision should be interpreted as requiring only that a subcontractor use business records such as invoices and receipts *in its dealings with the particular contractor, here Lee's, letting the contract.* AB 19-24.

Lee's suggested interpretation, however, renders meaningless the clear language of the statute that requires that the subcontractor's records reflect *all* items of income and expenses of the business, not just those items of income and expenses of the subcontractor that are tied to the prime contractor seeking to prove exemption under RCW 51.12.070. Courts should not construe statutes to render meaningless any of the words of the statutes. *City of Bellevue v. Lorang*, 140 Wn.2d at 25; *Kilian v. Atkinson*, 147 Wn.2d at 21 ("Statutes must be construed so that all the language is given effect and no portion is rendered meaningless or superfluous.").

As with its argument under subsection (2)'s "principal place" test, Lee's relies on the *Littlejohn* decision for its cropping of language from subsection (3)'s complete-records requirement. AB 16, 19-20. But just as Lee's reliance on *Littlejohn* is misplaced in its subsection (2) argument, such reliance is misplaced here as well. As noted above, Lee's relies on a *Littlejohn* passage (*see* AB 16) in which the Court provided a summary overview, but also provided element-by-element incorporating references to each of the four subsections of the statute, and Lee's has omitted those footnotes from the *Littlejohn* quote. *See* AB 16. As noted, this out-of-context quoting does not support Lee's argument, and it distorts the quoted material.

The statute conditions protection from liability on the adequacy of the subcontractor's books and records. Lee's had the burden of proof, yet failed to present evidence about the adequacy of Zagy's books and records. Instead, Lee's chose to present evidence only that Zagy's used receipts and invoices in its dealings with Lee's. Thus, the Board correctly determined that Lee's failed to meet its burden on this issue as well. BR 26 (FF 4).

Lee's appears to complain that the Department's audit of Zagy's could have been more intensive. *See, e.g.*, AB 8-9. But again, Lee's had the burden of proof in this case. RCW 51.48.131; RCW 51.52.050. Furthermore, the civil rules for superior court apply to Board proceedings. *See* WAC 263-12-125. Lee's thus had a full and fair opportunity to subpoena the owner of Zagy's and his books and records. *Id.*; RCW 51.52.100. Lee's chose not to call Zagy's owner as a witness, and there is nothing in the record suggesting that any subpoenas were issued to him. Lee's complaint about the audit process is an exercise in irrelevancy.

3. Lee's complaint that it encountered difficulty in proving its case for the subcontractor exception is not a valid legal argument.

Most of Lee's attacks on the Board's determination that Lee's failed to meet its burden of proof for the subcontractor exception under subsections (2) and (3) of RCW 51.12.070 are essentially complaints

about the Legislature's unassailable and clear choices (1) to put the burden of proof at the Board on the appealing party (Lee's) under RCW 51.48.131, and (2) to set a particular four-part test for meeting the subcontractor exception. *See, e.g.*, AB 19 (complaining that a prime contractor needs to master the IRS tax code or hire an accountant); AB 20 (complaining that a subcontractor's books and records are not necessarily available to the prime contractor); AB 22-24 (complaining that it is easier for the Department than the prime contractor to gain access to the subcontractor's books and records); AB 27 (complaining that a prime contractor cannot force a subcontractor to allow access to his residence to determine if the residence or a part of it qualifies under the IRS test for "principal place of business").

Lee's provides no on-point authority or even a legal rationale to support its attack on the Legislature's policy choices on burden of proof and on prime contractor premiums responsibility. Lee's is essentially asking this Court to rewrite the statute, and this request for judicial legislation must be rejected. *See generally Carnation Co., Inc. v. Hill*, 115 Wn.2d 184, 189, 796 P.2d 416 (1990) ("It would be judicial legislating of the most egregious nature for this court simply to amend the statute . . ."); *Duke v. Boyd*, 133 Wn.2d 80, 87, 942 P.2d 351 (1997) (Courts should apply literal meaning of a statute and not question wisdom of a statute).

Finally in this regard, the Court would be rewriting a number of other statutes with the same or similar language were it to accept Lee's invitation to rewrite the law on burden of proof and on prime contractor responsibility for premiums. *See supra* Part IV, noting that the subcontractor exception language of subsections (2) and (3) at issue here is also found in the same or essentially the same form in the following additional statutes: RCW 50.04.145(2)(c), (f); RCW 50.24.130(3), (4); RCW 51.08.070(2), (3); RCW 51.08.180(1)(b), (c); RCW 51.08.195(3), (6). Of particular concern would be the provisions of RCW 51.08.070, 51.08.180, and RCW 51.08.195 because they affect workers' rights to benefits under the Act. Because the Industrial Insurance Act must be liberally construed (RCW 51.12.010), including its coverage provisions, *see Bolin v. Kitsap Cty*, 114 Wn.2d 70, 72, 785 P.2d 805 (1990), logic dictates that the exceptions language at issue in this case should be strictly construed to ensure coverage of injured workers.

C. The Department Is Not Required to Attempt Collection from the Subcontractor Before Imposing Liability on a Prime Contractor

Without citation to any supporting case law authority in an attack on a statutory scheme that has been in existence for almost 100 years, Lee's argues that the Industrial Insurance Act requires the Department to attempt collection of industrial insurance tax assessments from a

subcontractor before pursuing “prime contractor liability” under RCW 51.12.070. AB 28-31. Yet RCW 51.12.070, as it has in some form since the early 1900’s, states clearly that the liability of the person letting a contract for work is *primary* and *direct*. Neither RCW 51.12.070 nor any other Washington statute supports Lee’s contention that the Department is required to pick one option over another in pursuing recovery of tax assessments due.

One of the statutory sections Lee’s cites in support of this argument, RCW 51.16.200, is concerned with successor liability, not prime contractor liability. Nothing in this statute suggests that the Department must pursue successors to a subcontractor instead of or in addition to pursuing prime contractors. The other statutory section Lee’s cites in support of this argument, RCW 51.16.150, allows the Department to pursue a delinquent employer such as Zagy’s, but also provides that “any such right of action shall be in addition to any other right of action or remedy.”

Lee’s asserts without logical support that not requiring the Department to pursue subcontractors as a first priority “would render RCW 51.12.070 a nullity.” This statement is nonsensical and should be ignored.

Lee's provides no on-point authority or even a legal rationale to support its attack on the legislative policy choices in play here. Lee's is again essentially asking this Court to rewrite the statute, and this additional request for judicial legislation likewise must be rejected. *Carnation Co., Inc. v. Hill*, 115 Wn.2d at 189; *Duke v. Boyd*, 133 Wn.2d at 87.

D. The Department's 2005 Information Sheet Is Not a Rule and Does Not Determine whether Lee's Qualifies for the Exception in RCW 51.12.070

In 2005, after the 2004 Legislature added a fifth requirement to the subcontractor exception (*see discussion supra* Part IV), the Department sent to Lee's Drywall and other contractors an information sheet entitled "Prime Contractor Liability in the Construction Industry." BR Ex. 12; Tr. Linda Wilcox, 125. The Department explained that contractors have "a right⁴ to examine and verify a subcontractor's books and records and their place of business," and stated that assurances in this regard "can only be achieved by physical verification by you or your representative (For example your accountant)." BR Ex. 12. Lee's argues that the Department's distribution of this information sheet somehow constitutes

⁴ Lee's asserts that contractors have no such right. AB 33. This is not true. Every contractor has the right to insist in its business relations with every subcontractor that the subcontractor agree to a method for the contractor to verify that the subcontractor meets the four-part test for exemption under RCW 51.12.070.

the unlawful adoption of a new administrative rule, that the “new rule”⁵ mandates private searches on behalf of the government,⁶ and that the would-be unlawfulness of the “new rule” requires that the assessment against Lee’s be invalidated. AB 31-35.

This argument is misplaced and diverts attention from the issues of statutory construction in this case. Regardless of whether the Department expressed in part its interpretation of the statute in this information sheet, Lee’s attempt to invoke the subcontractor exception fails unless Lee’s can meet the 4-part test under RCW 51.12.070.

The statutory construction issues were determined as a matter of law at the Board and at Superior Court. What is before this Court is this same question of law to be decided by this Court in de novo review. Ultimately, regardless of whether or not the Department indicated its interpretation of elements of the statute in the information sheet, it is for this Court to determine the meaning and application of RCW 51.12.070 in

⁵ Lee’s also asserts that the Department has only very recently decided to exercise its authority under RCW 51.12.070, suggesting that the Department has done so on only one other occasion, that time in 2006. *See* AB 32 (citing a Board decision). There is no evidence to support Lee’s claim. Furthermore, in light of the several other statutory contexts in which the identical statutory language appears and no doubt has been implicated in other litigation (*see supra* Part IV), Lee’s claim is wholly irrelevant.

⁶ Lee’s argues that the information sheet somehow suggests that the Department was establishing a mandate, and that a contractor “must ‘physically’ verify” that a subcontractor’s books, records and place of business meet the statutory requirements. AB 34. The information sheet does no such thing. But for diligent and cautious contractors, the information sheet would suggest that the contractors would be well advised to exercise their rights to seek voluntary consent from their subcontractors, as part of contract negotiations, to allow the contractors to physically or otherwise verify these things.

this case. *Postema v. Pollution Control Hearings Bd*, 142 Wn.2d 68, 77, 11 P.3d 726 (2000).

The Department's information sheet is irrelevant to that question. Indeed, while the information sheet was not a policy, it is permissible for agencies to express their statutory interpretation in a policy. *See* RCW 34.05.230(1) (agencies may advise public of statutory interpretation in policies). However, such policies are advisory only and do not have the force or effect of law. RCW 34.05.230(1). Policies (and certainly information sheets) are not binding on review, as would be a duly promulgated rule. *Cf. Manor v. Nestle Food Co.*, 131 Wn.2d 439, 445, 932 P.2d 628 (1997). Whether something express or implied in the information sheet might be adopted as a rule at some point, thus is not relevant to the issue before this Court.

The Department information sheet is also irrelevant because the subject of the appeal is the correctness of an order of the Department. An appealable Department order adjudicating a single employer's tax assessment for a particular period of time is not rule-making; it is an individual decision applying the law to the facts of the case. *Frazier v. Dep't of Labor & Indus.*, 101 Wn. App. 411, 42-23, 3 P.3d 221 (2000) (*citing Allan v. Dep't of Labor & Indus.*, 66 Wn. App. 415, 421, 832 P.2d 489 (1992) (Under RCW 34.05.030(2)(c), the APA does not apply to the

Department with respect to adjudicative actions by the Department that are subject to appeal to the Board of Industrial Insurance Appeals)). *See also Budget Rent a Car Corp. v. Dep't of Licensing*, 144 Wn.2d 889, 898, 31 P.3d 1174 (2001) (recognizing that agencies must be able to interpret statutes in the context of adjudicating individual cases that come before them).

When Lee's appealed to the Board, Lee's exercised its remedy to contest the statutory interpretation of the Department.⁷ The order is reviewed de novo at the Board. RCW 51.52.100. Thus, Lee's, as an aggrieved party, had the opportunity to fully contest the Department's order as to whether RCW 51.12.070 applied to the facts of its case based on the evidence before the Board. RCW 51.52.060, .100; RCW 51.48.131.

The Board does not treat the Department's order as evidence or with a presumption of correctness. *See Stafford v. Dep't of Labor & Indus.*, 33 Wn. App. 231, 234, 653 P.2d 1350 (1982) (citing *Olympia Brewing Co. v. Dep't of Labor & Indus.*, 34 Wn.2d 498, 208 P.2d 1181

⁷ Even assuming that the information sheet was impermissible rule-making, the remedy is not invalidation of the Department's order of tax assessment as Lee's suggests. AB 34-35 (citing *Budget Rent-a-Car* and *Hillis v. Dep't of Ecology*, 131 Wn.2d 373, 982 P.2d 139 (1997)). This is because the Department order was directly appealed to the Board as provided for in RCW 51.48.131 and RCW 51.52.060. This review provided Lee's a full and fair opportunity to challenge the statutory interpretation of the Department and to do so in a de novo context.

(1949). Although the Department may state its interpretation of the statute at the hearing under the de novo standard (and that interpretation may be given some weight if persuasive), the Board does not defer to the decision of the Department, and the Department's decision-making process is irrelevant. *See McDonald v. Dep't of Labor & Indus.*, 104 Wn. App. 617, 623, 17 P.3d 1195 (2001).

The singular question at the Board was whether Lee's satisfied the requirements of RCW 51.12.070 by showing it met the subcontractor exception. Lee's had the burden of proof at the Board to show it met the statutory exception. *See Black Real Estate Co.*, 70 Wn. App. at 496-87; RCW 51.48.131; RCW 51.52.050. Engaging in its de novo review, the Board correctly interpreted the statute and applied it to the evidence presented. BR 25-26.

Lee's may be suggesting that the Department should have adopted rules before attempting to enforce RCW 51.12.070 against Lee's. The Department has not attempted to give the force of law to any document it has published to help businesses understand their legal obligations. The Department is merely applying the statute as it was written over 25 years ago. The statute does not require the adoption of rules to be effective. Therefore, Lee's rules argument is without merit.

E. Lee's Constitutional Challenges Are Without Merit

1. Lee's waived its constitutional challenges by failing to raise constitutional issues below without excuse.

This Court should decline to address Lee's constitutional issues because Lee's has raised them for the first time at the Court of Appeals. RCW 34.05.554; RAP 2.5; *Dep't of Labor & Indus. v. Gongyin*, 119 Wn. App. 188, 192, 79 P.3d 488 (2003), *reversed on other grounds*, 154 Wn.2d 38, 109 P.3d 816 (2005); *Cosmopolitan Eng'g Group, Inc. v. Ondeo*, 128 Wn. App. 885, 893-894, 117 P.3d 1147 (2005) (raising an issue only in a footnote in a trial brief did not adequately preserve the issue under RAP 2.5(a)).

2. RCW 51.12.070 does not violate privacy protections in article 1, section 7 of the Washington Constitution

Without citing any relevant authority, Lee's claims a violation of the right to privacy under article 1, section 7 of the Washington constitution in the Department's interpretation of RCW 51.12.070. AB 35-37. There are numerous defects in Lee's theory under article 1, section 7. The **first** defect in Lee's theory is that Lee's offers no case law authority even remotely supporting it. "Naked castings into the constitutional sea are not sufficient to command judicial consideration and discussion." *In re the Matter of Rosier*, 105 Wn.2d 606, 616, 717 P.2d

1353 (1986) (quoting *United States v. Phillips*, 433 F.2d 1364, 1366 (8th Cir. 1970)).

A **second** defect in the theory is that Lee's does not raise and cannot support a Fourth Amendment claim, and the brief does not contain any of the "independent grounds" analysis required under *State v. Gunwall*, 106 Wn.2d 54, 61-62, 720 P.2d 808 (1986).

Washington courts will not consider whether the Washington Constitution provides greater protection against search or seizure in a particular area absent a timely and adequate *Gunwall* analysis. *See, e.g., State v. Mierz*, 127 Wn.2d 460, 473 n.10, 901 P.2d 286 (1995) ("The failure to engage in a *Gunwall* analysis in timely fashion precludes us from entertaining a state constitutional claim."). The failure to present the *Gunwall* analysis in the trial court constitutes a waiver. *See State v. Reding*, 119 Wn.2d 685, 696, 835 P.2d 1019 (1992) ("This court has previously declined to consider state constitutional arguments not raised at the trial or appellate court levels."); *Ford Motor Co. v. Barrett*, 115 Wn.2d 556, 570-71, 800 P.2d 367 (1990) (Utter, J., concurring) (failure to perform an adequate *Gunwall* analysis in the trial court will preclude a party from raising a state constitutional issue on appeal). The analysis also may not be raised for the first time in a reply brief. *See State v. Clark*, 124 Wn.2d 90, 95 n. 2, 875 P.2d 613 (1994).

A **third** defect in Lee's theory is that it depends wholly on mischaracterizing of the Department's interpretation of RCW 51.12.070. Lee's asserts that the Department requires prime contractors to conduct unconsenting searches of the books and records and premises of subcontractors. Neither the Department nor the statute nor the numerous other statutes containing the same or similar provisions require that. *See supra* Part IV.

Lee's is free to subcontract work to whomever it can. And Lee's is likewise free to make whatever contractual arrangements it can lawfully reach with those subcontractors. The statute and the Department's interpretation and application of the statute do not require Lee's to inspect the books or the premises of its subcontractors.⁸ The statute simply establishes the parameters of a rule of liability. But Lee's has at least two protective options under the statute, though the statute does not require Lee's to avail itself of the protective options.

First, RCW 51.12.070 gives contractors such as Lee's the right to protect themselves from exposure to subcontractor premiums liability by allowing the prime contractors to withhold from the contract price, per agreement with the subcontractor, the amount of the premiums, and then

⁸ Even if we were to assume that Lee's were accurately characterizing the Department's interpretation of RCW 51.12.070, Lee's constitutional privacy argument would suffer from the defect that Lee's lacks standing to assert the rights of subcontractors. *See generally State v. Jacobs*, 101 Wn. App. 80, 87, 2 P.3d 974 (2000).

to pay those premiums directly to the Department. The statute thus states: “the person . . . letting the contract shall be entitled to collect from the contractor the full amount payable in premiums . . .” RCW 51.12.070.

Lee’s has a second option under the statute. Being exposed to potential liability, a business may decide to require inspection of records or premises as a condition of doing business. Mortgage lenders do this all the time. Just as lenders may require disclosures of private facts and inspections of private residences prior to agreeing to lend money, so may contractors: the disclosures Lee’s objects to do not raise constitutional issues because no state action is involved. *See Ludwig v. Dept. of Retirement Systems*, 131 Wn. App. 379, 384, 127 P.3d 781 (2006) (retiree’s exercise of pension option that eliminated beneficiary’s survivorship right was not state action).

Whether Lee’s requires its subcontractors to open their books and records and places of business for inspection as a condition of doing business with Lee’s is a private matter between Lee’s and its subcontractors. It is not an issue of constitutional concern for this Court.

3. Applying a statutory provision enacted in 1981 to an oral contract formed in 2003 does not impair Lee’s contractual obligations.

Lee’s also misses the mark with its claim at AB 37-38 that the Department’s alleged “new rules” unconstitutionally impair the agreement

between Zagy's and Lee's. Again, there are no "new rules" at issue. *See* discussion *supra* Part VI.D. There is only a statutory exception that has been in place since 1981, more than twenty years before any contract between Lee's and Zagy's came into being.

State and federal protections against impairment of contracts by statutes and regulations are the same. *Pierce County v. State of Washington*, 159 Wn.2d 16, 27 n. 5, 148 P.3d 1002 (2006) (Washington constitution's article 1, section 23 and United States constitution's article 1, section 10 are "coextensive and are given the same effect"). Constitutional prohibitions against impairment of contracts by statutes or regulations are not implicated where the contract was written after the effective date of the statute or regulation challenged. *Federated American Ins. Co. v. Marquardt*, 108 Wn.2d 651, 658, 741 P.2d 18 (1987) ("A contract is not considered impaired by a statute or regulation in force when the contract was made, since it is presumed that the contract was made in contemplation of existing law.")

Here, because the 1981 statute long precedes Lee's entering into a contract with Zagy's in 2003, Lee's constitutional impairment of contracts argument must be rejected. *Federated*, 108 Wn.2d at 658.

VII. CONCLUSION

For the reasons stated above, the order of the Board of Industrial Insurance Appeals and the order of the superior court should be affirmed.

RESPECTFULLY SUBMITTED this 21st day of May, 2007.

ROBERT M. MCKENNA
Attorney General

A handwritten signature in black ink, appearing to read 'James S. Johnson', written in a cursive style.

JAMES S. JOHNSON
Assistant Attorney General
WSBA No. 23093
(360) 586-7715

PROOF OF SERVICE

I certify that I served a copy of this document on all parties or their counsel of record on the date below as follows:

US Mail Postage Prepaid via Consolidated Mail Service

Klaus O. Snyder
Snyder Law Firm, LLC
920 Alder Ave., Suite 201
Sumner, WA 98390-1406

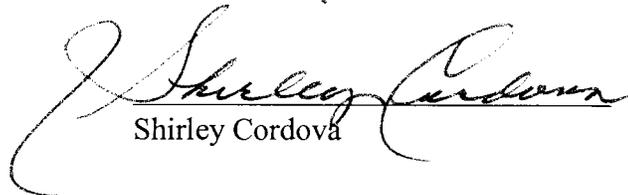
ABC/Legal Messenger

State Campus Delivery

Hand delivered by _____

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

DATED this 21st day of May, 2007, at Tumwater, Washington.


Shirley Cordova

FILED
COURT OF APPEALS
DIVISION II
07 MAY 22 PM 12:13
STATE OF WASHINGTON
BY DEPUTY

(Cite as: T.C. Memo. 1997-378)



Cook v. C.I.R.
U.S. Tax Ct., 1997.

United States Tax Court.
Richard G. and Patricia A. COOK, Petitioners,
v.
COMMISSIONER OF INTERNAL REVENUE, Re-
spondent.
No. 26918-95.

Aug. 19, 1997.

Richard G. Cook, pro se.
David W. Sorensen, for respondent.

MEMORANDUM OPINION
COUVILLION, *Special Trial Judge*:
*1 This case was heard pursuant to section 7443A(b)(3) and Rules 180, 181, and 182.^{FN1}

^{FN1} Unless otherwise indicated, section references are to the Internal Revenue Code in effect for the years at issue. All Rule references are to the Tax Court Rules of Practice and Procedure. The petition was filed pursuant to sec. 7463. At the commencement of trial, petitioners orally moved that the case be heard pursuant to sec. 7443A(b)(3). The Court granted petitioners' motion. Respondent thereafter filed an answer of general denial.

Respondent determined deficiencies in Federal income taxes of \$1,061 and \$408 and accuracy-related penalties of \$212 and \$82 under section 6662(a), respectively, for petitioners' 1991 and 1992 tax years.

The issues for decision are: (1) Whether home office expenses incurred by Richard G. Cook (petitioner) in a trade or business activity are allowable as deductions under section 280A(c)(1), and (2) if such expenses are not allowable, whether petitioners are liable for the accuracy-related penalties under section 6662(a). If the Court holds that the expenses at issue are not deductible pursuant to section 280A(c)(1), the Court must then consider petitioner's contention that

the disallowance of the subject expenses as deductions constitutes invidious discrimination and a violation of due process under the U.S. Constitution.

Some of the facts were stipulated. Those facts, with the exhibits attached thereto, are so found and are incorporated herein by reference. At the time the petition was filed, petitioners' legal residence was Salt Lake City, Utah.

Petitioner is an attorney at law and, during the years at issue, was engaged in the practice of law at Salt Lake City, Utah. For the year 1991 and for the first 5 months of 1992, petitioner's law practice was conducted out of petitioners' personal residence at Salt Lake City, Utah. For the remaining 7 months of 1992, petitioner conducted his law practice at a downtown Salt Lake City office.

The expenses at issue involve the home office expenses incurred by petitioner for the periods noted in 1991 and 1992, which petitioners deducted as trade or business expenses on their 1991 and 1992 Federal income tax returns. Respondent has not questioned the substantiation of these expenses. Respondent, however, has questioned the percentage amount petitioners claim constituted the portion of their home that was used for petitioner's law practice.

Petitioners' home consisted of an upstairs and a downstairs, totaling 3,200 square feet. During 1991, petitioners and four children lived in the home. During 1992, petitioners and three children lived in the home. Petitioners contend that 75 percent of the total floor space of their home was used for the law practice; however, this space was used only two-thirds of the time for the law practice. For the remainder of the time, when the space was not used for law practice, the space was available and was in fact used by petitioners and their children as their residence for personal purposes. On their income tax returns, consistent with the recited percentages, petitioners claimed 50 percent of their home expenses as deductible home office expenses (2/3 X 3/4 = 1/2). Although respondent did not seriously dispute that 75 percent of the home's floor space was used at some time for the

(Cite as: T.C. Memo. 1997-378)

law practice, respondent questioned petitioners' contention that this floor space was used two-thirds of the time for the law practice.

*2 As noted, the facts necessary to decide this case are not in dispute—the **principal place of business** for petitioner's law practice was petitioners' personal residence, and it was the place used by petitioner's clients in meeting or dealing with petitioner in the normal course of petitioner's trade or business as a lawyer. Petitioner's law practice, therefore, was carried on or conducted exclusively at his home. Petitioner was not an employee, nor was his law practice conducted in a separate structure from petitioners' home. A very crucial fact of this case, however, is that the portions of petitioners' home used for the law practice were not used exclusively for the law practice; i.e., after business hours, and presumably on weekends and holidays, the portions of the home used for the law practice were also used by petitioners for their personal purposes.^{FN2}

^{FN2}. As an example, the living room where petitioner's clients were interviewed, or the **kitchen table** used for conferences, was also used by the family as their residence during off-business hours.

Generally, under section 280A(a) no deduction otherwise allowable shall be allowed with respect to the use of a dwelling unit that is used by a taxpayer as a residence during the taxable year, except, under section 280A(b) for interest, taxes, and casualty losses, which would otherwise be allowable. Section 280A(c)(1) provides certain limited and specific exceptions to this general rule, which are, in pertinent part, as follows:

SEC. 280A(c). Exceptions for Certain Business or Rental Use; Limitation on Deductions for Such Use.—

(1) Certain business use.—Subsection (a) shall not apply to any item to the extent such item is allocable to a portion of the dwelling unit which is exclusively used on a regular basis—

(A) [as] the **principal place of business** for any trade or business of the taxpayer,

(B) as a place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of his trade or busi-

ness, or

(C) in the case of a separate structure which is not attached to the dwelling unit, in connection with the taxpayer's trade or business.

In the case of an employee, the preceding sentence shall apply only if the exclusive use referred to in the preceding sentence is for the convenience of his employer.

Therefore, for a deduction to be allowed under section 280A(c)(1), the taxpayer must establish that a portion of the dwelling unit is (1) exclusively used, (2) on a regular basis, (3) for the purposes enumerated in subparagraphs (A), (B), or (C) of section 280A(c)(1), and (4) if the taxpayer is an employee, the office is maintained for the convenience of the employer. See *Hamacher v. Commissioner*, 94 T.C. 348, 353-354 (1990). On the facts of this case, the sole question is whether petitioner's home was used exclusively for his trade or business. It was not so used. Even though petitioner's trade or business was exclusively conducted in his home, the portion of his home in which he conducted his trade or business was not used exclusively for that purpose. That factual circumstance precludes petitioners' entitlement to a deduction of the home office expenses at issue. This Court has previously passed upon this same question. In *Gomez v. Commissioner*, T.C. Memo. 1980-565, this Court stated:*3 Exclusive use of a portion of a taxpayer's dwelling unit means that the taxpayer must use a specific part of a dwelling unit *solely* for the purpose of carrying on his trade or business. *The use of a portion of a dwelling unit for both personal purposes and for the carrying on of a trade or business does not meet the exclusive use test.* Thus, for example, a taxpayer who uses a den in his dwelling unit to write legal briefs, prepare tax returns, or engage in similar activities as well for personal purposes, will be denied a deduction for the expenses paid or incurred in connection with the use of the residence which are allocable to these activities. [Emphasis added.]

S. Rept. No. 94-938 (1976), 1976-3 C.B. (Vol.3) 49, 186; *H. Rept. No. 94-658 (1975)*, 1976-3 (Vol.2) 695, 853; Joint Committee Explanation, 1976-3 C.B. (Vol.2) 1, 152.

Since petitioners' home (or the portion thereof used

(Cite as: T.C. Memo. 1997-378)

for the law practice) was not used exclusively for petitioner's trade or business, it follows that the home office expenses claimed for that home office are not deductible under section 280A(c)(1). Respondent is sustained on this issue.

Petitioners next contend that such an interpretation of section 280A(c)(1) is unconstitutional. Petitioner argues that it is irrational not to allow the matching of costs against revenues as it not only deviates from generally accepted accounting principles but it also requires taxpayers to pay taxes on gross income with no benefit of the deduction for the expenses incurred to produce that income. Such a result, petitioners contend, violates due process principles.

To the extent that petitioners' claim is based on the Fourteenth Amendment of the U.S. Constitution, this Court has held that the Fourteenth Amendment does not apply to Federal tax statutes. Labay v. Commissioner, 55 T.C. 6, 14 (1970), affd. per curiam 450 F.2d 280 (1971). Thus, the Equal Protection and Due Process Clauses of the Fourteenth Amendment do not operate as a limitation on the taxing power of the Federal government. Hamilton v. Commissioner, 68 T.C. 603, 606 (1977).

In general, a Federal tax law is not violative of the Due Process Clause of the Fifth Amendment of the U.S. Constitution unless the statute classifies taxpayers in a manner that is arbitrary and capricious. Hamilton v. Commissioner, supra at 606; Shaffer v. Commissioner, T.C. Memo. 1994-618. Here, petitioners have not shown that section 280A(c)(1) classifies taxpayer in a manner that is arbitrary and capricious. In Hamacher v. Commissioner, supra at 354, the Court recited the background for the enactment of section 280A's restriction upon deduction of home office expenses and pointed out that one of the reasons for the enactment of section 280A was a response by Congress to numerous cases, particularly those decided by this Court, which used a liberal standard to allow deduction of home office expenses that were "appropriate and helpful" to the taxpayer's business under the circumstances. Congress was concerned that, under such a standard, personal, living, and family expenses attributable to the home that are not otherwise deductible were being allowed as deductions.

The purpose of section 280A was to restrict what Congress considered too liberal a standard in this area of tax law. The restrictive provisions of section 280A, therefore, apply to all taxpayers. The Court, therefore, rejects petitioners' contention that section 280A(c)(1) violates the Due Process Clause of the Fifth Amendment.

*4 Respondent determined that petitioners were liable for penalties under section 6662(a) for negligence or disregard of rules or regulations under section 6662(b)(1).

Section 6662(a) provides that, if it is applicable to any portion of an underpayment in taxes, there shall be added to the tax an amount equal to 20 percent of the portion of the underpayment to which section 6662 applies. Under section 6664(c), no penalty shall be imposed under section 6662(a) with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion, and that the taxpayer acted in good faith with respect to such portion.

Section 6662(b)(1) provides that section 6662 shall apply to any underpayment attributable to negligence or disregard of rules or regulations. Section 6662(c) provides that the term "negligence" includes any failure to make a reasonable attempt to comply with the provisions of the Internal Revenue laws, and the term "disregard" includes any careless, reckless, or intentional disregard of rules or regulations. Negligence is the lack of due care or failure to do what a reasonable and ordinarily prudent person would do under the circumstances. Neely v. Commissioner, 85 T.C. 934, 947 (1985). It is well established that the taxpayer bears the burden of proof on this issue. Bixby v. Commissioner, 58 T.C. 757, 791 (1972).

Petitioners have not met their burden of proof on this issue. Section 280A(c)(1) explicitly provides that the deduction for home office expenses applies only to a portion of a home used exclusively for a trade or business. Such expenses are not allowed if the portion of the home is used for any nonqualifying purpose. Several cases have interpreted section 280A(c)(1) in this manner and have elaborated on differing factual situations that, in some instances,

T.C. Memo. 1997-378

Page 4

T.C. Memo. 1997-378, 1997 WL 470356 (U.S. Tax Ct.), 74 T.C.M. (CCH) 339, T.C.M. (RIA) 97,378, 1997 RIA TC Memo 97,378

(Cite as: T.C. Memo. 1997-378)

met the standards of section 280A and, in other cases, did not satisfy those standards. Petitioners did not show any reasonable cause as to how and why their factual situation was such that their expenses should be allowed. The Court, therefore, sustains respondent on this issue.

Decision will be entered for respondent.

U.S. Tax Ct., 1997.

Cook v. C.I.R.

T.C. Memo. 1997-378, 1997 WL 470356 (U.S. Tax Ct.), 74 T.C.M. (CCH) 339, T.C.M. (RIA) 97,378, 1997 RIA TC Memo 97,378

END OF DOCUMENT