NO. 45786-5-II

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

DOT FOODS, INC.,

Respondent,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Appellant.

BRIEF OF APPELLANT

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I. INTRODUCTION

This case concerns the scope of the Legislature's authority to retroactively amend a tax statute. In late 2009, the Washington Supreme Court held that Dot Foods qualified for the "direct seller's exemption" from business and occupation taxes in former RCW 82.04.423. *Dot Foods, Inc. v. Dep't of Revenue*, 166 Wn.2d 912, 215 P.3d 185 (2009) (*Dot Foods I*). That decision addressed Dot's refund claim for the tax periods January 2000 through April 2006. Soon after the Supreme Court's 2009 decision, the Legislature amended the statute to narrow the exemption for tax periods prior to May 1, 2010. The Legislature stated two key reasons for the amendment: that *Dot Foods I* was inconsistent with the Legislature's intent when it had originally enacted the statute, and that the decision would lead to "devastating" financial losses for the state. *See* Laws of 2010, 1st Spec. Sess., ch. 23, §§ 401, 402, 1704, 1706.

The Legislature declared the 2010 amendment to be retroactive, but excluded "final judgments" from its application. *Id.*, §§ 1704, 1706. Thus, while Dot no longer qualified for the direct seller's exemption, the judgment in its Supreme Court case was unaffected. In this action, which involves the tax periods May 2006 through December 2007, Dot acknowledges that it does not qualify for the direct seller's exemption under amended RCW 82.04.423. It also recognizes that if the 2010

legislation applies retroactively then it is not entitled to the refund it seeks. Dot therefore claims that retroactive application of the amended RCW 82.04.423 violates its rights under the Due Process Clause of the Fourteenth Amendment.

The trial court agreed with Dot's due process argument, holding that the 2010 amendment to the direct seller's exemption "was unconstitutional as applied to Dot Foods for the May 2006 through December 2007 periods at issue." CP 496. After the trial court's ruling, however, the Supreme Court decided *In re Estate of Hambleton*, 181 Wn.2d 802, 335 P.3d 398 (2014). *Hambleton* addresses the same retroactivity argument that Dot raised below in this case, and rejects it. Under *Hambleton*, the trial court's decision should be reversed.

Even if *Hambleton* had not been decided, the trial court's decision was wrong. Washington's courts have consistently upheld the retroactive application of tax law amendments based on the rational basis test set out in *United States v. Carlton*, 512 U.S. 26, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994). But the trial court disregarded these cases, relying instead on a Court of Appeals decision that the Supreme Court reversed without reaching the retroactivity question.

The trial court erred when it held that RCW 82.04.423 is unconstitutional as applied to Dot for the May 2006 through December

2007 tax periods. *Hambleton* erases any doubt that the trial court's decision was wrong and should be reversed.

II. ASSIGNMENTS OF ERROR

A. The trial court erred in holding that retroactive application of the 2010 amendment to RCW 82.04.423(2) is unconstitutional as applied to Dot for the periods May 2006 through December 2007.

B. The trial court erred in granting summary judgment to Dot and denying summary judgment to the Department with respect to applying the 2010 amendment to RCW 82.04.423(2) retroactively to Dot for the periods May 2006 through December 2007.

III. ISSUE PERTAINING TO ASSIGNMENTS OF ERROR

The recent Washington Supreme Court opinion in *Hambleton* reaffirmed that retroactive legislation satisfies due process if there is a legitimate legislative purpose behind the law and that purpose is furthered by rational means. The Legislature recognized that *Dot Foods I* would lead to "devastating" financial consequences unless it promptly and retroactively amended the direct seller's exemption. Under these circumstances, is the 2010 amendment to the exemption constitutional when applied retroactively to Dot Foods for the May 2006 through December 2007 tax periods?

IV. STATEMENT OF THE CASE

While the tax periods at issue here – May 2006 through December 2007 – total only 20 months, some background is helpful to understanding Dot's current dispute.

A. Dot's Business.

The following description of Dot's business is taken from *Dot Foods I.* That case concerned taxes assessed and paid from January 2000 through April 2006, but there were no material changes in Dot's business practices from those periods through December 2007. *See* CP 359-60.[1]

> Dot, an Illinois corporation, sells food products to dairies, meat packers, food processors, and other food service companies in Washington. Dot contracts with its wholly owned subsidiary, DTI, to solicit the sales of Dot products in Washington. DTI sells the products to customers that either use Dot products as ingredients to make other products, which these customers later sell to permanent retail establishments (e.g., grocery stores), or they resell Dot products to other food service operators or institutions . . . . Over 99 percent of Dot's products are consumer products . . . . The remainder of Dot's sales come from nonconsumer products . . . .

Dot Foods I, 166 Wn.2d at 916.

B. The Original Law: Former RCW 82.04.423.

Washington imposes a business and occupation (B&O) tax on every person for the act or privilege of engaging in business activities in

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[1] Due to changes in its business after December 2007, Dot's taxes for January 2008 and later dates are not at issue. *See* CP 22 n.5.

the state. RCW 82.04.220(1); *Washington Imaging Servs., LLC v. Dep't of Revenue*, 171 Wn.2d 548, 555, 252 P.3d 885 (2011). This tax applies unless the Legislature has enacted a specific exemption for the activity. *See TracFone Wireless, Inc. v. Dep't of Revenue*, 170 Wn.2d 273, 296-97, 242 P.3d 810 (2010).

Until late 1999, the Department interpreted former RCW 82.04.423 to exempt Dot's Washington sales revenue from the B&O tax. That statute, the "direct seller's exemption," exempted sales proceeds from sales by "direct seller's representatives" from the B&O tax:

> (1) This chapter shall not apply to any person in respect to gross income derived from the business of making sales at wholesale or retail if such person:
>
> ....
>
> (d) Makes sales in this state exclusively to or through a direct seller's representative.
>
> (2) For purposes of this section, the term "direct seller's representative" means a person who buys consumer products on a buy-sell basis or a deposit-commission basis for resale, by the buyer or any other person, in the home or otherwise than in a permanent retail establishment, or who sells, or solicits the sale of, consumer products in the home or otherwise than in a permanent retail establishment . . . .

Laws of 1983, 1st Extra Sess., ch. 66, § 5 (codified at former RCW 82.04.423 (1983)). Under the Department's pre-1999 interpretation,

DTI was considered to be Dot's "direct seller's representative," and the exemption applied. *Dot Foods I*, 166 Wn.2d at 920.

C. *Dot Foods I.*

Effective January 1, 2000, the Department narrowed its interpretation of the direct seller's exemption. Under this interpretation, the exemption was limited to businesses that sold *exclusively* consumer products that were not resold in permanent retail establishments.[2] *Dot Foods I*, 166 Wn.2d at 917-18. Because Dot sold some products that were not consumer products, and some were eventually resold to grocery stores, Dot was subject to B&O taxes on its Washington sales. *Id.*

Dot disputed the Department's 2000 interpretation of former RCW 82.04.423 and filed a refund action in Thurston County Superior Court. That case concerned taxes paid for January 2000 through April 2006. CP 359-60, 468-69. The trial court and the Court of Appeals rejected Dot's claims and affirmed the B&O tax assessments. *Dot Foods I*, 166 Wn.2d at 917-18.[3] In a 5-4 decision issued in September 2009, the Washington Supreme Court reversed, holding that Dot qualified

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[2] For example, the exemption would apply to sales to representatives making in-home sales of cosmetics, cookware, or jewelry. *See* CP 47 (Final Bill Report on 2ESSB 6143, 61st Leg., Spec. Sess. (Wash. 2010)) ("[t]raditionally, the exemption has been used by out-of-state sellers engaged in sales of consumer products exclusively through in-house parties or door-to-door selling").

[3] *See Dot Foods, Inc. v. Dep't of Revenue*, 141 Wn. App. 874, 173 P.3d 309 (2007), *reversed, Dot Foods I*, 166 Wn.2d at 926.

for former RCW 82.04.423's direct seller's exemption. *Dot Foods I.* Dot was, therefore, entitled to a refund of B&O taxes for the tax periods that its first case addressed.

While its first lawsuit moved through the courts, Dot paid B&O taxes on the revenues from its ongoing Washington sales, including for the periods at issue in this case, May 2006 through December 2007.

D. 2010: The Legislature Responds To *Dot Foods I.*

The Supreme Court denied reconsideration of *Dot Foods I* in February 2010. *See* CP 22. One month later, Substitute Senate Bill 6143 was read for the first time. Written in direct response to *Dot Foods I*, Sections 301 and 302 of the substitute bill contained language that would amend RCW 82.04.423 and "reaffirm the legislature's intent" that businesses such as Dot were not entitled to the direct seller's exemption. The law was explicitly intended to apply retroactively. *See* Substitute S.B. 6143, 61st Leg. (Wash. 2010), §§ 301, 302, 2205.

During the 2010 legislative session, the Department prepared an analysis that estimated the impacts of *Dot Foods I.* CP 80-81. This showed a potential revenue loss of more than $150 million for the 2009-2011 biennium and nearly $191 million more for 2011-2013. CP 80. Thus, the total loss for fiscal years 2011-2015 was estimated to be $341

million, with ongoing losses possibly exceeding $90 million per year. CP 81-82.

The Governor signed Second Engrossed Substitute Senate Bill 6143 into law on April 23, 2010. CP 352. As enacted, the law accomplished two things: it prospectively eliminated the direct seller's exemption, and it retroactively amended RCW 82.04.423 "to conform the exemption to the original intent of the legislature." *See* Laws of 2010, 1st Spec. Sess., ch. 23, § 401. The Legislature provided two specific reasons for the change. First, it anticipated that the Supreme Court's broad interpretation of the direct seller's exemption would lead to "devastating revenue losses." Second, the Legislature expressed concern that *Dot Foods I* would give out-of-state companies a competitive advantage over Washington businesses. *See id.*, §§ 401, 402, 1704.[4]

In the 2010 law, the Legislature explicitly addressed the adverse consequences of *Dot Foods I*:

> The legislature finds that most out-of-state businesses selling consumer products in this state will either be eligible for the exemption under RCW 82.04.423 or could easily restructure their business operations to qualify for the exemption. As a result, the legislature expects that the broadened interpretation of the direct sellers' exemption [in *Dot Foods I*] will lead to large and devastating revenue losses. This comes at a time when the state's existing

[4] The Legislature also stated that the Supreme Court's interpretation of the direct seller's exemption in *Dot Foods I* was contrary to the intent of the RCW 82.04.423 as originally enacted. Laws of 2010, 1st Spec. Sess., ch. 23, § 401.

> budget is facing a two billion six hundred million dollar shortfall, which could grow, while at the same time the demand for state and state-funded services is also growing. Moreover, the legislature further finds that RCW 82.04.423 provides preferential tax treatment for out-of-state businesses over their in-state competitors and now creates a strong incentive for in-state businesses to move their operations outside Washington.

Laws of 2010, 1st Spec. Sess., ch. 23, § 401.

To accomplish the Legislature's intent, the law amended RCW 82.04.423 as follows:

> Prior to the effective date of this section, this chapter ((~~shall~~)) does not apply to any person in respect to gross income derived from the business of making sales at wholesale or retail if such person:
>
> . . .
>
> (d) Makes sales in this state exclusively to or through a direct seller's representative.
>
> (1) For purposes of this section, the term "direct seller's representative" means a person who buys only consumer products on a buy-sell basis or a deposit-commission basis for resale, by the buyer or any other person, in the home or otherwise than in a permanent retail establishment, or who sells at retail, or solicits the sale at retail of, only consumer products in the home or otherwise than in a permanent retail establishment . . . .

Id., § 402.

As noted above, Dot sold both consumer and nonconsumer products during the tax periods here at issue, and some of its products were eventually sold in permanent retail establishments. Under the 2010

law, therefore, Dot's sales no longer qualified for the direct seller's exemption.

In addition to amending RCW 82.04.423 to conform to the Legislature's original intent, the 2010 Legislature made clear its intent that the amended direct seller's exemption apply retroactively except as to final judgments. *Id.*, §§ 1704 ("Sections 402 and 702 of this act apply both retroactively and prospectively"); 1706 ("Section 402 of this act does not affect any final judgments, not subject to appeal, entered by a court . . . before the effective date of this section"). Thus, the 2010 law preserved *Dot Foods I* and Dot's exemption for January 2000 through April 2006.

E. *Dot Foods II.*

Following the decision in *Dot Foods I*, Dot applied to the Department for a refund of the taxes it paid after April of 2006. *See* CP 364, 356-57.[5] Based on the 2010 amendment to RCW 82.04.423, the Department denied Dot's refund request. CP 366-67. Dot next filed a refund action in Thurston County Superior Court. *See* CP 7-11. In October 2012, Dot filed an amended complaint seeking a refund for the period May 2006 through December 2007. *See* CP 12-16. Dot also asked the court for a declaratory judgment holding that the 2010 amendment to

[5] Dot's original claim sought a refund for the tax periods January 2005 through August 2009. The beginning of that period was included in *Dot Foods I* and the end was after Dot changed its business practices and agreed that it was not qualified for the direct seller's exemption after. *See* CP 73, 356-57, 364, 360.

RCW 82.04.423 could not lawfully have retroactive application. *See* CP 15-16.

Dot raised three arguments against retroactive application of the 2010 amendment to the direct seller's exemption. First, it claimed that it was entitled to the continued benefits of *Dot Foods I* under principles of collateral estoppel. *See, e.g.*, CP 332-35. Second, it argued that the Legislature's amendment to RCW 82.04.423 violated the separation of powers doctrine because it amounted to "a legislative intrusion on the authority of the courts." In this regard Dot maintained that "the Legislature could not, in 2010, constitutionally take away the fruits of [Dot's] 2009 judgment." CP 336. On cross-motions for summary judgment the trial court rejected both of these arguments. *See* CP 468-71, 496-97.[6]

The court, however, accepted Dot's third argument against retroactive application of the 2010 amendment to the tax periods May 2006 through December 2007. Dot argued that subjecting it to the post-*Dot Foods I* legislation violates constitutional due process limitations. *See, e.g.*, CP 14-15, 337-45. This was because, Dot claimed, the period of retroactivity reached back too far to pass constitutional muster. *E.g.*,

[6] Dot has cross-appealed, *see* CP 559-60, and may re-argue its collateral estoppel and separation of powers claims. To the extent necessary the Department will address these claims in its response to Dot's opening brief.

CP 344. As the trial court noted, Dot based that argument "almost exclusively" on *Tesoro Refining & Marketing Co .v. Department of Revenue*, 159 Wn. App. 104, 246 P.3d 211 (2010), *reversed on other grounds*, 173 Wn.2d 551, 554, 269 P.3d 1013 (2012). *See* CP 471.

The trial court issued a letter opinion granting the Department's motion for summary judgment as to the collateral estoppel and separation of powers claims, and granting Dot's motion for summary judgment on the due process argument. CP 468-74. In its summary judgment order, the trial court held that "retroactive application of Laws of 2010, 1st Spec. Sess., ch. 23, § 402 (amending RCW 82.04.423(2)), was unconstitutional as applied to Dot Foods for the May 2006 through December 2007 periods at issue." CP 496. The trial court subsequently denied the Department's request for reconsideration. CP 549-50.

The Department timely appealed, and Dot cross-appealed. CP 551-58, 559-66. Shortly thereafter, the Washington Supreme Court heard oral argument in *Hambleton*. In March 2014, the Department asked this Court to stay the proceedings in the present case because *Hambleton*, like this case, involved a due process challenge to retroactive application of a tax statute. *See* Department of Revenue's Mot. to Stay Proceedings and Decl. in Support Thereof.

In April 2014, this Court granted the Department's motion for stay. The Supreme Court issued its decision in *Hambleton* in October 2014. *In re Estate of Hambleton*, 181 Wn.2d 802, 335 P.3d 398 (2014). With the parties' agreement, this Court lifted the stay in this case in February 2015.

V. ARGUMENT

A. Dot Carries The Burden Of Establishing That Applying RCW 82.04.423 Retroactively To Dot Is Unconstitutional Beyond A Reasonable Doubt.

The trial court decided this case on summary judgment. This Court's review is therefore de novo. *Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 842-43, 246 P.3d 788 (2011). While the Court's review is de novo, Dot retains the heavy burden that a constitutional challenge to a statute carries. Statutes enacted by the Legislature are presumed to be constitutional and a party seeking to invalidate a statute on constitutional grounds must establish that the provision is unconstitutional beyond a reasonable doubt. *Washington State Grange v. Locke*, 153 Wn.2d 475, 486, 105 P.3d 9 (2005).

The trial court ruled that the 2010 amendment to RCW 82.04.423 was unconstitutional "as applied to Dot Foods for the May 2006 through December 2007 periods at issue." CP 496. The issue this case presents, therefore, is whether retroactive application of the amended law is constitutional "in the specific context" of Dot's refund claim for the

post-*Dot Foods I* periods at issue. *See City of Redmond v. Moore*, 151 Wn.2d 664, 668-69, 91 P.3d 875 (2004) (as-applied constitutional challenge "is characterized by a party's allegation that application of the statute in the specific context of the party's actions or intended actions is unconstitutional").

B. *Hambleton* Controls This Case.

As noted above, the Department asked that this case be stayed because *Hambleton* involved the same issue – retroactive application of an amended tax statute. *See* Department of Revenue's Mot. to Stay Proceedings and Decl. in Support Thereof. In its amicus brief filed in *Hambleton*, Dot agreed, describing the 2010 amendment to RCW 84.02.423 as "remarkably similar" to the legislation at issue in *Hambleton*. *See* Department's Mot., Ex. 4 at 1. This Court granted the Department's motion for stay, observing that "a stay pending the Supreme Court's decision in *Hambleton* . . . serves judicial economy, even though this appeal raises some issues not contained in *Hambleton* . . . ." April 21, 2014 Letter Ruling.

The Supreme Court issued its *Hambleton* decision on October 2, 2014. Upholding retroactive application of a revenue statute against a due process challenge, the *Hambleton* Court reaffirmed the rational basis test for such legislation: retroactive application of a tax statute does not violate

due process provided that it is (a) supported by a legitimate legislative purpose, and (b) furthered by rational means. *Hambleton*, 181 Wn.2d at 829.

Hambleton does not simply address the same retroactivity question as this case does; it conclusively answers that question, in a manner contrary to the trial court judgment below.

1. *Hambleton* arose when the Legislature amended the estate tax statutes retroactively in response to the Supreme Court's decision in *Bracken*.

Hambleton is an estate tax case concerning 2013 amendments to ch. 83.100 RCW, the 2005 Estate and Transfer Tax Act (ETTA). *Hambleton*, 181 Wn.2d at 810, 813-14. More specifically, the case addressed the taxability of qualified terminable interest property (QTIP) trusts. Such a trust "is created by a deceased spouse and gives the surviving spouse a life interest in the income or use of trust property." *Id.* at 809. Upon the death of the surviving spouse a QTIP trust "is deemed to be transferred to the residual beneficiaries." *See In re Estate of Bracken*, 175 Wn.2d 549, 556, 290 P.3d 99 (2012), *superseded by statute*, *see Hambleton*, 181 Wn.2d at 813-14.

The ETTA imposes a tax "on every transfer of property located in Washington." RCW 83.100.040(1); *see also* RCW 83.100.047 (discussing calculation of Washington taxable estate for estates created under Internal

Revenue Code's QTIP provisions). As originally enacted, the ETTA defined "transfer" primarily by reference to the Internal Revenue Code. *See* Laws of 2005, ch. 516, § 2. The ETTA applied prospectively only. *Id.*, § 20.

The Department promulgated regulations in 2006 that resulted in the imposition of the estate tax on the QTIP "transfer" that occurred when the surviving spouse died and the trust assets were transferred to the residual beneficiaries. *See Bracken*, 175 Wn.2d at 554, 561, 588 (Madsen, C.J., concurring/dissenting). Under this interpretation of the ETTA, a taxable "transfer" applied to QTIPs as long as the surviving spouse died on or after the ETTA's effective date – regardless of when the spouse that created the QTIP had died.

Two estates sued the Department over its QTIP transfer rules. These estates claimed that, for ETTA purposes, the only QTIP "transfer" was that made upon the death of the first spouse. *See Bracken*, 175 Wn.2d at 553. The first spouses in both cases had died before the effective date of the ETTA. Because the ETTA applied prospectively only and the taxable transfer pre-dated that law, the estates argued that their QTIPs were not subject to estate tax. *Id.* The Supreme Court agreed, holding that the Legislature did not intend the ETTA to apply to the transfer that

occurred at the surviving spouse's death. *Bracken*, 175 Wn.2d at 553, 575-76.

The effect of *Bracken* was to exempt from taxation every QTIP created by a person who died prior to the effective date of the ETTA, *i.e.*, May 17, 2005. *See* Laws of 2005, ch. 516, § 22. This was a major blow to the state's budget, with an estimated loss to the education legacy trust account of more than $118 million in 2014 alone. *Hambleton*, 181 Wn.2d at 826-27. The Legislature, therefore, responded at its first opportunity by amending the ETTA. *See* Laws of 2013, 2d Spec. Sess., ch. 2. Specifically, the Legislature amended the definitions of "transfer" and "Washington taxable estate" to allow the value of QTIP to be included within the taxable estate of the surviving spouse. *Id.* at § 2.

As it made these changes to the law, the 2013 Legislature also explained that the holding in *Bracken* was contrary to federal estate tax law, which defined "transfer" broadly. *Id.*, § 1 (quoting *Fernandez v. Wiener*, 326 U.S. 340, 352, 66 S. Ct. 178, 90 L. Ed. 116 (1945)). Describing its overall intent, the Legislature stated that it:

> finds that it is necessary to reinstate the legislature's intended meaning when it enacted the estate tax, restore parity between married couples and unmarried individuals, restore parity between QTIP property and other property eligible for the marital deduction, and prevent the adverse fiscal impacts of the Bracken decision by reaffirming its intent that the term "transfer" as used in the Washington

> estate and transfer tax is to be given its broadest possible meaning consistent with established United States supreme court precedents, subject only to the limits and exceptions expressly provided by the legislature.

Id. at § 2.

The 2013 ETTA amendments applied prospectively and retroactively "to all estates of decedents dying on or after May 17, 2005," with the exception of final judgments. *Id.* at §§ 9, 10. The effect of the legislation was to reinstate the pre-*Bracken* rule that QTIP transfers were taxable under the ETTA upon the death of the surviving spouse if that death took place after the ETTA's effective date – regardless of when the first spouse had died. There was, however, no impact on the *Bracken* estates, because *Bracken* was a final judgment. *See generally Hambleton*, 181 Wn.2d at 813-14.

2. In *Hambleton*, the Supreme Court reaffirmed the "rational basis" standard of *United States v. Carlton* and *W.R. Grace v. Department of Revenue*.

After the Legislature amended the ETTA so that certain estates exempt under *Bracken* would be taxed retroactively, more litigation ensued. Various estates sued the Department, claiming that the 2013 amendments did not apply to them. *Hambleton*, 181 Wn.2d at 809. The estates raised a number of arguments against the legislation, including separation of powers, uniformity of taxes, impairment of contracts,

equitable and collateral estoppel, statute of limitations, and the existence of a final judgment. *Id.* at 816-23, 830-36. While several of these bear on Dot's arguments that the trial court rejected, it is the Supreme Court's analysis of the estates' due process claim that controls this appeal.

Just as Dot does here, the *Hambleton* estates claimed that retroactive application of the 2013 law to them violated constitutional due process protections. *See id.* at 823. The Court rejected that argument, explaining that "[w]e use a rational basis standard" when reviewing challenges to retroactive application of a statute. *Id.* Relying on United States Supreme Court precedent, the *Hambleton* court continued:

> The due process standard to be applied to tax statutes with retroactive effect ... is the same as that generally applicable to retroactive economic legislation:
>
> > 'Provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches. . . .
> >
> > 'To be sure, ...retroactive legislation does have to meet a burden not faced by legislation that has only future effects. . . . The retroactive aspects of legislation, as well as the prospective aspects, must meet the test of due process, and the justifications for the latter may not suffice for the former.... *But that burden is met simply by showing that the retroactive application of the legislation is itself justified by a rational legislative purpose.*'

Hambleton, 181 Wn.2d at 823-24 (quoting *United States v. Carlton*, 512 U.S. 26, 30-31, 114 S. Ct. 2018, 129 L. Ed.2d 221 (1994)) (emphasis added in *Hambleton*; internal citation omitted). Citing its 1999 decision in *W.R. Grace*, the Court added that "[o]ur court applied the same standard when examining the retroactive application of a business and occupation tax." *Hambleton*, 181 Wn.2d at 824 (citing *W.R. Grace & Co. v. Dep't of Revenue*, 137 Wn.2d 580, 602-03, 973 P.2d 1011 (1999)).

Under *Carlton* and *W.R. Grace*, retroactive application of a statute does not violate due process provided that it is (a) supported by a legitimate legislative purpose, and (b) furthered by rational means. Addressing a significant and unanticipated revenue loss is a legitimate legislative purpose. *Hambleton*, 181 Wn.2d at 825 (citing *Carlton*, 512 U.S. at 32). And the rational means standard is satisfied as long as "[t]he period of retroactivity is rationally related to preventing the fiscal shortfall." *Id.* at 827. The Court noted that there was no set rule for determining the permissible length of a law's retroactivity, but observed that it had upheld legislation with a "retroactive period spanning more than seven years." *Id.* at 825 (citing *W.R. Grace*, 137 Wn.2d at 586-87). The Court also rejected the Estates' suggestion that *Carlton* creates a threshold on the period of retroactivity. "Our court has allowed periods of

retroactivity extending beyond one year, as have other jurisdictions." *Hambleton*, 181 Wn.2d at 826 n.4 (citations omitted)).

Applying the rational basis test to the 2013 ETTA amendments, the Court unanimously concluded that retroactive application of the amendments was constitutional. First, "[l]ike the legitimate purposes in *Carlton*, the purposes of the 2013 amendments is largely economic."[7] In this regard the Court quoted the Department analysis predicting a revenue loss of $118.4 million in the year after *Bracken* was decided. *Id.* at 826-27. Second, the Court found that the period of retroactivity was also rationally related to the fiscal shortfall and was "directly linked with the purpose of the amendment, which is to remedy the effects of *Bracken*." *Id.* at 827. Finally, addressing the period of retroactivity, the Court emphasized that "the eight-year period of retroactivity is not far outside other retroactive periods that courts have accepted." *Id.* at 827.

3. Under the *Hambleton* rational basis analysis, applying the 2010 amendment to RCW 82.04.423 retroactively to Dot's 2006 and 2007 tax periods comports with due process.

The retroactivity principles from *Hambleton* apply directly to this case and require the trial court's order be reversed on Dot's due process

[7] *Carlton* was a federal estate tax case in which Congress amended a statute to avoid "a significant and unanticipated revenue loss." The amendment applied retroactively to the date the law had originally been enacted, approximately one year earlier. *Carlton*, 512 U.S. at 28, 32.

claim. First, retroactive application of a statutory amendment is constitutional provided that it is (a) supported by a legitimate legislative purpose, and (b) furthered by rational means. *Hambleton*, 181 Wn.2d at 823-24. Second, responding to the fiscal impact of a Court decision is a legitimate legislative purpose. *Id.* at 825. Third, there is no set period of time against which to measure retroactive application of a law. *Id.* at 826 n.4. Finally, provided that the period of retroactive application is not arbitrary and is "linked to the purpose of the amendment," the rational means test will be satisfied. *Id.* at 827.

Dot's case presents the same material facts as in *Hambleton*. Both cases began with Supreme Court decisions interpreting existing tax laws in ways that would have cost the state millions of dollars. In both cases, the Legislature responded at its first opportunity, amending the laws to avoid the fiscal blow of the Supreme Court decisions (and, with respect to the direct seller's exemption, to avoid an interpretation that would have given out-of-state businesses an advantage over Washington companies). In both cases, the Legislature applied the new laws retroactively, but preserved the results of the Supreme Court's decisions. And in both cases, taxpayers challenged the retroactive application of the laws to them, arguing that such application was prohibited by the due process clause.

Properly understood, this case is *Hambleton* with a B&O tax. The fact that *Hambleton* involved an estate tax while *Dot Foods* concerns a B&O tax does not distinguish the cases. *W.R. Grace*, upon which *Hambleton* relies in large part, was a B&O tax case. *See W.R. Grace*, 137 Wn.2d at 585; *see also* Department of Revenue's Mot. to Stay Proceedings and Decl. in Support Thereof, Ex. 4, p.1 (Dot's amicus brief filed in *Hambleton* stating that "[l]ike the taxpayers in these consolidated cases, Dot Foods faces the denial of tax relief under a statutory amendment that purports to retroactively expand a tax provision after this Court has interpreted the statute's plain meaning to limit the tax's scope").

Because these cases are essentially the same, there can be no question that the Legislature's 2010 amendment to RCW 82.04.423 satisfies *Hambleton*'s standard. As explained above, the Department estimated that *Dot Foods I* would cost the state more than $341 million from fiscal years 2011 through 2015. Ongoing losses might have exceeded $90 million per year. These amounts exceed the potential fiscal impact of *Bracken*, and the Supreme Court in *Hambleton* found that there was a legitimate legislative purpose in amending the ETTA to avoid that loss. Moreover, the present case is, if anything, more compelling than *Hambleton*, since *Dot Foods I* gave an unfair advantage to out-of-state businesses.

As for whether the period of retroactivity met the rational means test, *Hambleton* concluded that eight years was not irrational given the purpose of the amendment. *Hambleton*, 181 Wn.2d at 827. The period at issue in this case is even shorter than those in *Hambleton* (eight years) and *W.R. Grace* (seven years): four years from the beginning of the tax periods to the effective date of the 2010 legislation. It is also directly linked to the purpose of the amendment: to avoid the possibility that other businesses would "be eligible for the exemption [as construed in *Dot Foods I*]. . . or could easily restructure their business operations to qualify for the exemption." Laws of 2010, Spec. Sess., ch. 23, §401; *see also id.* (finding that *Dot Foods I* "provides preferential tax treatment for out-of-state businesses over their in-state competitors and now creates a strong incentive for in-state businesses to move their operations outside Washington").

Dot has argued at various times that the period of retroactivity in this case should be measured against the date the direct seller's exemption was enacted – 1983. *See*, *e.g.*, CP 328 (describing 2010 amendment as a legislative effort to "apply its own interpretation retroactively for 27 years"), 431 ("[t]he Department's denial of a 27-year retroactive effect from the 2010 legislation is counterfactual"). The trial court, however, held that the 2010 amendment to the direct seller's exemption was

"unconstitutional *as applied to Dot Foods for the May 2006 through December 2007 periods at issue*." CP 496 (emphasis added). The question before this Court is therefore whether retroactive application of the amended law is constitutional "in the specific context" of Dot's refund claim for the post-*Dot Foods I* period at issue. *City of Redmond*, 151 Wn.2d at 668-69.[8]

In sum, retroactive application to Dot for the period here at issue easily meets the due process test set out in *W.R. Grace* and *Hambleton*. "Tax legislation is not a promise, and a tax payer has no vested right" to a static tax code. *Hambleton*, 181 Wn.2d at 829 (quoting *Carlton*, 512 U.S. at 33). If the trial court had had the benefit of *Hambleton* when it decided the present case, it likely would have ruled differently. Now that *Hambleton* has been decided, this Court should reverse the trial court and award summary judgment to the Department.[9]

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[8] If Dot's method of measuring retroactivity were correct, then the retroactive period upheld in *W.R. Grace* would have been 36 years. *See W.R. Grace*, 137 Wn.2d at 586-87; Laws of 1951, ch. 9, § 1.

[9] Dot also argued below that, regardless of the 2010 legislation, it was entitled to the benefit of *Dot Foods I* after the tax periods that case concerned. *See* CP 332-36 (arguing collateral estoppel and separation of powers violations). The trial court rejected both of these arguments, CP 496-97, and the Supreme Court rejected similar arguments in *Hambleton*. *Hambleton*, 181 Wn.2d at 817-23, 833-35.

C. The Trial Court Erred When It Relied On The Court of Appeals Decision In *Tesoro.*

The trial court concluded that retroactive application of the 2010 amendment to RCW 82.04.423 "was unconstitutional as applied to Dot Foods for the May 2006 through December 2007 tax period." CP 496. The trial court's letter opinion accepting Dot's due process argument relied entirely on the Court of Appeals decision in *Tesoro Refining & Marketing Co. v. Dep't of Revenue*, 159 Wn. App. 104, 246 P.2d 211 (2010), *reversed on other grounds*, 173 Wn.2d 551, 269 P.3d 1013 (2012). *See* CP 471 (noting that Dot's argument was based "almost exclusively" on *Tesoro*), 473 (Department "fails to meaningfully distinguish" the Court of Appeals decision in *Tesoro*, "and this court must apply that case").[10] Conspicuously absent from the trial court's opinion is any mention of *W.R. Grace*.

In light of the *Hambleton* decision, there is no need to address the trial court's reliance on the Court of Appeals *Tesoro* decision. But even if this Court considered the issue, the trial court's erroneous reliance on *Tesoro* would create an independent basis for reversal.

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[10] The trial court did note that the *Tesoro* Court of Appeals "analyzed the scope of the retroactivity on its face – 24 years – rather than as applied to the case before it." CP 473. The present case is an as-applied challenge, *see* CP 496, further reducing the relevance of *Tesoro*.

1. The Court of Appeals decision in *Tesoro* is not precedential.

The Court of Appeals in *Tesoro* addressed a 2009 amendment to RCW 82.04.433. The amendment, which the Legislature passed the day before the trial court hearing on Tesoro's case, "applie[d] both prospectively and retroactively." *Tesoro*, 159 Wn. App. at 110 (quoting Laws of 2009, ch. 494, § 4). The tax periods at issue in *Tesoro* began on December 1, 1999, making the potential retroactive period less than ten years. *See Tesoro*, 159 Wn. App. at 107-08. However, the Court of Appeals turned to the date the statute was originally enacted – 1985 – and concluded that "the 24-year retroactivity clause violates due process." *Tesoro*, 159 Wn. App. at 116.[11]

The Supreme Court reversed the Court of Appeals decision in *Tesoro*. *Tesoro Ref. & Mktg. Co. v. Dep't of Revenue*, 173 Wn.2d 551, 269 P.3d 1013 (2012). It described the 2009 legislation as a "clarifying

[11] There was, in fact, no such retroactivity clause in RCW 82.04.433. Rather, the Court of Appeals held the statute's application to be unconstitutional based on its assumption that the Legislature's use of the word "retroactively" meant that every business that had paid taxes at any time during the preceding 24 years would necessarily be impacted by the 2009 amendment. *See, e.g.*, *Tesoro*, 159 Wn. App. at 118 ("the legislature may not apply a 'clarification' retroactively for 24 years when it is in direct conflict with the reasonable expectations of qualifying taxpayers"). As set out below, that was not the case in *Tesoro*, and it is not the case here.

Furthermore, if the Court of Appeals in *Tesoro* were correct that (a) retroactivity must be measured from a statute's original enactment, and (b) a 24-year period of retroactivity was *per se* unconstitutional, then the Supreme Court's decision in *W.R. Grace* was wrong. As noted above, *see supra* n.8, the statute at issue in *W.R. Grace* had been enacted 36 years before the challenged amendment. The Supreme Court upheld retroactive application of that amendment. *W.R. Grace*, 137 Wn.2d at 598-603.

amendment," but did not address the retroactivity issue because it concluded that Tesoro could not prevail under the statute as originally enacted. *Id.* at 556-59, 559 n.3. While the Supreme Court reversed the Court of Appeals on grounds other than retroactivity, however, the trial court here was not bound by the lower court's retroactivity analysis. Indeed, according such weight to an opinion reversed on other grounds has been explicitly rejected in Washington. *See Tibbs v. Johnson*, 30 Wn. App. 107, 113, 632 P.2d 904 (1981) (declining to give precedential effect to a Court of Appeals decision reversed on other grounds).

The reversed *Tesoro* decision did not bind the trial court. Certainly the case could be considered, but the controlling authority was a Supreme Court case that has *not* been reversed – *W.R. Grace.*[12]

2. *Tesoro* is distinguishable.

Another reason the trial court should not have relied on *Tesoro* in granting summary judgment to Dot is that the case is factually distinguishable. The Court of Appeals in *Tesoro* addressed a 24-year period of retroactivity, compared to the four-year period that this case involves. In addition, the history of the retroactive legislation in *Tesoro*

[12] The *Hambleton* Court based its retroactivity analysis primarily on *Carlton* and *W.R. Grace*. *See Hambleton*, 181 Wn.2d at 823-29. It makes no mention of *Tesoro*, despite the fact that Dot's amicus brief called the case to the Court's attention. *See* Department of Revenue's Mot. to Stay Proceedings and Decl. in Support Thereof, Ex. 4, at 4, 7-8.

indicates that the statute was amended in reaction to a single taxpayer's refund request. Here, in contrast, the amendment to RCW 82.04.423 was a legislative response to the Supreme Court's decision in *Dot Foods I.*

a. The Court of Appeals in *Tesoro* addressed a 24-year period of retroactivity, a period far longer than the four-year period at issue here.

According to the *Tesoro* Court of Appeals decision, retroactive application of the 2009 amendment to RCW 82.04.433 amounted to a "24-year retroactivity clause." *See Tesoro*, 173 Wn.2d at 557. Dot Foods and the trial court both used this language to support their argument that retroactive application of the 2010 direct seller's exemption amendment is unconstitutional. *See* CP 328, 431, 472-73 (court's letter opinion describing *Tesoro*'s 24-year retroactivity period as "very similar to the present case").

What this reasoning ignores is that, absent fraud or waiver, the 2010 amendment to RCW 82.04.423 is not and could never be applied to a 27-year period, a 24-year period, or even a ten-year period. Such retroactivity is explicitly prohibited by the time bar applying to excise tax assessments, which states that "[n]o assessment or correction of an assessment for additional taxes, penalties, or interest due may be made by the department more than four years after the close of the tax year. . . ."

RCW 82.32.050(4);[13] *see also* RCW 82.32.060 (applying same four-year non-claim period to taxpayer refund requests). The Legislature amended RCW 82.04.423 effective May 1, 2010. This means that no assessment or correction of a taxpayer's taxes related to the direct seller's exemption may affect tax periods prior to May 2006.

Taxpayer appeals and refund requests, of course, take time. A retroactive statutory amendment enacted during a pending appeal could, therefore, affect a tax year slightly more than four years in the past. However, an appeal would not remain unresolved for the decades it would take for application of a statute to become irrational under *Carlton*. Certainly that is not the case here: Dot seeks a refund for the periods May 2006 through December 2007, a time that falls within the scope of the amended statute, within the period that RCW 82.32.050(4) permits, and well within *Carlton*'s rational means limitation.

Instead of discussing the limits the time bar statute would create, the Court of Appeals in *Tesoro* simply assumed the amendment at issue to have a "24-year retroactivity clause." That statement was incorrect, but the court was convinced that the Department could and apparently would reach back a quarter century and recalculate taxes for every taxpayer

[13] Where an unregistered taxpayer conducts business in Washington, the Department may assess unpaid taxes, interest, and penalties for "a period of seven years plus the current year." WAC 458-20-230(3).

covered by the former statute. This was never the case – not in *Tesoro* and not here. *Cf. W.R. Grace* (upholding retroactive application of amendment enacted 37 years after original statute).

When it amended RCW 82.04.423 in 2010, the Legislature revised the statute in a way that would apply not to the past 27 years, but to the past four years – plus, perhaps, an additional period reflecting pending appeals – absent fraud or waiver. Dot's refund request falls within that period, and is therefore subject to the amended law. A four-year period of retroactive application easily satisfies the "rational means" standard of *Carlton* and *W.R. Grace*.

b. *Tesoro* is distinguishable because the Court was concerned that the Legislature might have targeted an individual taxpayer.

Another difference between *Tesoro* and the present case is, as the trial court noted in its letter opinion, "*Tesoro I* involved legislation that apparently targeted a particular taxpayer, while the present legislation does not contain such a targeted approach." CP 473. Signed into law the day before the scheduled summary judgment arguments in Tesoro's trial court case, the amendment was plainly intended to prevent Tesoro from obtaining the refund it sought. *See Tesoro*, 159 Wn. App. at 118 ("the legislative history of the 2009 act shows the recent amendment was in direct response to Tesoro's refund request").

Even if the facts in *Tesoro* might not have satisfied the rational basis standards under *Carlton* and *W.R. Grace*, this case presents an entirely different a set of circumstances. The Legislature enacted the 2010 amendment to RCW 82.04.423 *after* Dot's refund litigation was complete, and explicitly *excluded* final judgments from its scope. *See* Laws of 2010, 1st Spec. Sess., ch. 23, § 1706 ("this act does not affect any final judgments, not subject to appeal, entered by a court of competent jurisdiction before May 1, 2010"). Moreover, the Legislature in this case was concerned with a "devastating" revenue loss and was not targeting a single taxpayer. *Id.*, § 401. Thus, even if *Tesoro* is relevant here, *Hambleton* is precedential, more closely analogous, and controls the outcome in this case.

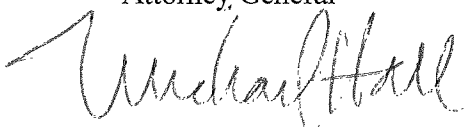
VI. CONCLUSION

The trial court granted summary judgment to Dot based on the wrong case. The proper analysis for retroactivity challenges is set out in *W.R. Grace* and *Hambleton*. These decisions establish that retroactive application of the 2010 amendment to RCW 82.04.423 in the present case – to Dot's tax periods of May 2006 through December 2007 – is perfectly

constitutional. The trial court's decision should therefore be reversed and summary judgment granted to the Department on all of Dot's claims.

RESPECTFULLY SUBMITTED this 22nd day of April, 2015.

ROBERT W. FERGUSON
Attorney General



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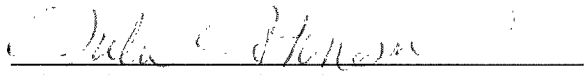

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