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OF THE STATE OF WASHINGTON

U.S. SMOKELESS TOBACCO BRANDS INC.,
PREVIOUSLY KNOWN AS
UNITED STATES TOBACCO SALES
AND MARKETING COMPANY INC.,

Petitioner

v.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,

Respondent

ON PETITION FOR REVIEW FROM
COURT OF APPEALS, DIVISION II

AMICUS CURIAE MEMORANDUM OF
ASSOCIATION OF WASHINGTON BUSINESS
IN SUPPORT OF PETITION FOR REVIEW

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I.

INTRODUCTION

The Association of Washington Business ("AWB") submits this memorandum in support of the petition for review filed by U.S. Smokeless Tobacco Brands Inc., formerly known as United States Tobacco Sales and Marketing Company Inc. ("U.S. Tobacco" or "Brands").

II.

IDENTITY AND INTEREST OF AMICUS CURIAE

AWB, founded in 1904, is the state's oldest and largest general business trade association. AWB acts as the state of Washington's chamber of commerce, is the principal voice of business in this state and frequently files amicus curiae briefs in cases of importance to its membership, including cases involving proper application or interpretation of Washington taxing statutes. AWB represents over 5,000 member businesses, of which 85 percent are small businesses employing fewer than 50 workers. Its members are engaged in all aspects of commerce in Washington.

AWB has reviewed this case's progression through the lower courts,¹ and is concerned that any of its members could be treated as U.S. Tobacco has been treated in this case. Eight years of litigation has not

¹This case was initially filed in April 1997 and has been the subject of two published decisions of the Court of Appeals. See United States Tobacco Sales & Marketing Co. Inc. v. Department of Revenue, 96 Wn. App. 932, 982 P.2d 652 (1999) ("U.S. Tobacco I"), and United States Tobacco Sales & Marketing Co. Inc. v. Department of Revenue, 128 Wn. App. 426, 115 P.3d 1080 (2005) ("U.S. Tobacco II").

identified a single disputed issue of material fact, yet the Court of Appeals has told the parties, in effect, to go back to the trial court a third time and start over. The result is taxpayer abuse, not tax fairness. While this case involves a tax paid by relatively few taxpayers, the substantive and procedural issues raised apply to a broad spectrum of Washington taxes and taxpayers, and for that reason, this Court should grant review.

III.

STATEMENT OF THE CASE

Amicus AWB adopts the statement by petitioner U.S. Tobacco. To frame the issues and argument of amicus, AWB presents the following additional facts and procedural background information.

The OTP tax is imposed on a tobacco manufacturer's "wholesale sales price," which is defined as the "established price" at which a manufacturer sells tobacco products to a distributor. RCW 82.26.010(7). As recognized by the Court of Appeals, Brands is a distributor that purchases smokeless tobacco products from its manufacturing affiliate, U.S. Smokeless Tobacco Manufacturing L.P. ("Tobacco Manufacturing"). See U.S. Tobacco I, 96 Wn. App. at 937-38.

Throughout this proceeding, the Department of Revenue ("Department") has argued that the wholesale sales price, for purposes of calculating Brands' OTP tax liability, was the price at which Brands resold the tobacco products to unaffiliated customers, and that the price which

Brands paid to Tobacco Manufacturing should be disregarded. The Court of Appeals has twice rejected this argument.²

In U.S. Tobacco I, the Court of Appeals held that the measure of the OTP tax (the manufacturer's established price) includes an implicit fair market value requirement for affiliate transactions, as a safeguard against potential tax avoidance.³ On remand, Brands presented uncontroverted evidence of the fair market value for Brands' purchases of OTP from Tobacco Manufacturing. The Department presented no valuation evidence. The trial court determined its own value of the OTP, which was higher than the highest value indicated by Brands' evidence.

Both parties appealed, and in U.S. Tobacco II, the Court of Appeals agreed that no evidence supported the trial court's conclusion of value. 128 Wn. App. at 435-36. But the court also held that Brands' evidence was insufficient, and remanded the case for yet another trial. Id. at 437-38. In doing so, the Court of Appeals adopted a new and unsupported view of what proof is required in order to establish fair

²See U.S. Tobacco II, 128 Wn. App. 434 ("[W]e reiterate that it is not appropriate to measure the value of OTP sold by Tobacco Manufacturing by the price [Brands] sold to independent distributors. The trial court properly rejected DOR's position that the \$1.43 price was the fair market value of OTP sold by Tobacco Manufacturing" (footnote omitted)).

³See U.S. Tobacco I, 96 Wn. App. at 939-40 (A "manufacturer's established price is a generally available, stable, fixed price, such as a list price or invoice price. Because an 'established price' is available to all customers, it reflects the market value of the product" (footnotes omitted)). Under this requirement, if the affiliates set a transfer price at less than market value, the tax is measured by market value rather than the actual transaction price. U.S. Tobacco I, 96 Wn. App. at 940.

market value: "The parties are directed to provide evidence on remand of the price of a completely unaffiliated entity would have had to pay to purchase OTP from Tobacco Manufacturing in 1992." U.S. Tobacco II, 128 Wn. App. at 437-38 (court's emphasis).

IV.

ARGUMENT

A. Introduction.

AWB addresses two issues in this memorandum:

1. Is the Court of Appeals' decision based upon an erroneous interpretation of fair market value and of what evidence is relevant in proving fair market value? AWB believes the answer to this question is "yes" and that review of that decision is appropriate under RAP 13.4(b)(1), because it conflicts with decisions of this Court.

2. Did the Court of Appeals in U.S. Tobacco II unfairly and improperly change the rules as to what Brands is required to prove on remand? AWB believes the Court of Appeals has indeed changed the rules, by requiring Brands to prove the price at which Tobacco Manufacturing would sell to a "completely unaffiliated entity." Brands already proved the fair market value for the OTP that it purchases from Tobacco Manufacturing. The Court of Appeals, in effect, changed the rules after the fact and ordered the taxpayer to go back for trial under the court's new rule. This deprived the taxpayer a timely and meaningful remedy, and this deprivation raises an issue of substantial public interest warranting review under RAP 13.4(b)(4).

B. The Court of Appeals' Erroneous Interpretation of Fair Market Value Conflicts With This Court's Decisions.

The Court of Appeals' decision is inconsistent with fundamental valuation principles, and therefore with the decisions of this Court. At trial, Brands presented substantial, highly credible and uncontested evidence of fair market value. Yet the Court of Appeals rejected that evidence, and instead directed that, on remand, the parties should present evidence of the price at which Tobacco Manufacturing would have sold its product directly to a so-called "completely unaffiliated entity." U.S. Tobacco II, 128 Wn. App. at 438. Such evidence does not exist, and is not relevant to fair market value, because speculation about what Tobacco Manufacturing would have asked as a selling price for transactions that did not occur is not admissible to prove fair market value.⁴ The idea that such speculation would show market value violates established evidentiary and appraisal principles that apply to all taxes measured by market value.

⁴Motor Mill Co. v. Wilson, 128 Wash. 592, 594-95, 223 P. 1041 (1924) ("[P]roof of value cannot be shown by proving what the owner would take for his property," (citing Watt v. Nevada C. Ry. Co., 23 Nev. 154, 44 P. 423, 46 P. 52, 726, 62 Am. St. Rep. 772; Sedgwick on Damages (9th ed.) vol. 4, § 1294; Auman v. Philadelphia & R.R. Co., 133 Pa. 93, 20 A. 1059; Kiernan v. Chicago, S.F. & C. Ry. Co., 123 Ill. 188, 14 N.E. 18)); see also Port Townsend Southern Ry. Co. v. Barbare, 46 Wash. 275, 277, 89 P. 710 (1907) ("In estimating the value of property taken for public use, it is the market value of the property which is to be considered. The market value of property is the price which it will bring when it is offered for sale by one who desires, but is not obliged to sell it, and is bought by one who is under no necessity of having it. In estimating its value all the capabilities of the property, and all the uses to which it may be applied or for which it is adapted, are to be considered, and not merely the condition it is in at the time and the use to which it is then applied by the owner. It is not a question of the value of property to the owner. Nor can the damages be enhanced by unwillingness to sell" (quoting 2 Lewis on Eminent Domain § 478 (2d ed.)))

The Department argues that the Court of Appeals' decision is not in conflict with decisions of this Court, and that Brands "failed to prove the fair market value price for a sale between unaffiliated entities." Answer at 10-12, 17. But if fair market value is truly the valuation standard, that is exactly what Brands proved at trial, and that proof was uncontested. The appraisal evidence met all requirements of the Uniform Standards of Professional Appraisal Practice ("USPAP") (the nationally recognized standard for valuation methods and practices), and was neither impeached nor seriously questioned by the Department (whose own witnesses complimented the work of Brands' expert). (CP 311-12, 359.) The Department claims the valuation standard applied by Mr. Reilly in his appraisal is different from a fair market value price for a sale between unaffiliated entities, see Answer at 17, but that plainly is not the case. Mr. Reilly appraised the fair market value for Tobacco Manufacturing's 1992 sales to Tobacco Sales. Pl. Ex. 1 at 2-3 & 4-6. Reilly's appraisal was based on an arm's-length price study prepared in full compliance with requirements of I.R.C. § 482. All of the valuation experts, including the Department's valuation expert, agreed that the arm's-length standard under I.R.C. § 482 is the same as the fair market value standard. RP 52, 183-84 & 356. This is all consistent with Washington law, and is a universally accepted standard.

The Court of Appeals suggests that fair market value is the price at which an actual owner would sell to an unaffiliated buyer. 128 Wn. App. 426, 437-38. That is contrary to both Washington law and generally

accepted valuation standards. The actual owner's selling price is not the measure of fair market value. See n.4, supra (citing cases). The evidence that the Court of Appeals now orders to be taken is not admissible on fair market value. The Court of Appeals' evidence requirement warrants review under RAP 13.4(b)(1) because it is inconsistent with general principles (USPAP § 482, uniform understanding and practice) and in conflict with this Court's decisions.

C. The Decision of the Court of Appeals to Require Proof of the Price at Which Tobacco Manufacturing Would Sell to a Completely Unaffiliated Entity Implicates Taxpayer Rights, and Therefore Raises an Issue of Substantial Public Interest.

The decision in Tobacco Sales II places an undue and illegal burden on taxpayers. Brands proved the Department calculated the OTP tax on the wrong "wholesale sales price."⁵ Brands also proved the actual manufacturer's price (never disputed), and it presented the only evidence of fair market value at trial. Based on that record, the Court of Appeals should have ruled either that (1) Brands proved fair market value by a preponderance of the evidence or (2) the tax is to be measured by Tobacco Manufacturing's actual selling price, because the evidence did not show that the actual price was less than fair market value. Instead, the Court of Appeals remanded the case for another trial, at which Brands would have

⁵That was confirmed by the Court of Appeals in both of its published decisions. See U.S. Tobacco I, 96 Wn. App. at 941 (RCW 82.26.010(7) "imposes the [OTP] tax upon the value of a manufacturer's products, measured at the time the manufacturer sells the products"); U.S. Tobacco II, 128 Wn. App. at 434 ("[I]t is not appropriate to measure the value of OTP sold by Tobacco Manufacturing by the price [Brands] sold to independent distributors").

to prove the price at which Tobacco Manufacturing would sell to an unaffiliated purchaser.

This requirement is both new and not supported by the statutory language.⁶ Given the record before the Court of Appeals, the court should have ruled that Brands established the taxable price was between 68 and 72 cents, and remanded for the sole purpose of determining where within that range to fix the price. Instead, the parties have been sent back to determine the price paid by a so-called "completely unaffiliated entity" -- a concept utterly lacking support either in the record, or the statute.

And what is the default if no such price can be established? AWB submits that the Court of Appeals has effectively opened a back door by which the Department can reinject the wholesale price of \$1.43, by arguing that the combined effect of the Court of Appeals' rejection of Brands' price range of 68-72 cents, and Brands' inability to satisfy the "completely unaffiliated entity" requirement, leaves only the wholesale sales price. Yet this is precisely the price the Court of Appeals previously rejected, twice, as lacking any support in the statutory language.

The Court of Appeals' approach has grave implications for the rights of taxpayers. Brands may be able to continue to afford this litigation, but the ordinary small business taxpayer could not. Eight years after the litigation commenced, the Department is continuing to tax at the \$1.43 rate and is continuing to keep the money collected at that rate,

⁶The "wholesale sales price" is "the established price for which a manufacturer sells a tobacco product to a distributor, exclusive of any discount or other reduction." RCW 82.26.010(7).

because our remedy statutes afford taxpayers no prospect of injunctive relief. See RCW 82.32.150.⁷ This case has been going on for eight years, through two summary judgments, a full trial, two Court of Appeals decisions, and now the Court of Appeals has remanded the matter for another trial, to take evidence that is not even properly admissible to prove fair market value. This has become a case about the fair administration of justice, and resolving taxpayers' claims equitably and promptly. Taxpayers are entitled to a meaningful right to appeal their tax and to a timely decision based on the evidence. See Wash. Const. art. IV, § 6; RCW 82.32A.020(3). That right is denied by Tobacco Sales II, and that warrants review by this Court.

The Department argues that this case no longer involves issues of substantial public interest, because the Legislature amended the OTP tax statute in 2005 to change the tax measure so that affiliate transactions are now disregarded in calculating the measure of the tax. See Laws of 2005, ch. 180, § 1. Whether the 2005 legislation will adequately address the problems in administering the OTP tax remains to be seen.⁸ That

⁷Incidentally, whether the 2005 legislation will adequately resolve the problems in administering an OTP tax based on price remains to be seen. The Court of Appeals has already recognized that other states have adopted a more straightforward approach that avoids any possible valuation or controversy: taxing tobacco products by weight. See U.S. Tobacco I, 96 Wn. App. at 941 n.16.

⁸The Court of Appeals noted that other states have adopted a more straightforward approach, which avoids any possible valuation controversy: taxing tobacco products by weight. See United States Tobacco Sales & Marketing Co. v. Department of Revenue, 96 Wn. App. at 941 n.16.

legislation, however, does nothing to address AWB's broader concerns regarding the Court of Appeals' misinterpretation of the fair market value standard and its failure to provide taxpayers with a fair, adequate and speedy remedy for erroneous taxation. These concerns extend far beyond Washington's OTP tax and call for corrective action by this Court.

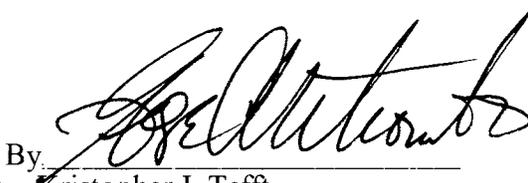
V.

CONCLUSION

This Court should grant Brands' petition for review.

RESPECTFULLY SUBMITTED this 2nd day of December,

2005.

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