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SUPREME COURT OF THE STATE OF WASHINGTON

UNITED STATES TOBACCO SALES AND MARKETING COMPANY
INC.,

Petitioner,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

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Respondent's Supplemental Brief

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ORIGINAL

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I. NATURE OF THE CASE

From 1959 to 2005, the Washington State Legislature taxed smokeless tobacco products based upon the manufacturer's wholesale sales price. The tax is called the Other Tobacco Products tax (OTP). In 1990, U.S. Tobacco, the largest manufacturer of smokeless tobacco products, changed its corporate structure to create two affiliated companies, a manufacturer and a sales and marketing company. Unlike a typical manufacturer that sold its smokeless tobacco products to any distributor, U.S. Tobacco's manufacturing arm began selling its products only to its affiliate. This change gave rise to the present litigation.

The sales and marketing arm of U.S. Tobacco seeks a refund of the OTP tax for samples it distributed in Washington based upon the price it obtained the smokeless tobacco product from its manufacturing affiliate. The Department of Revenue asserted the tax should be based upon the wholesale sales price between a manufacturer and an unaffiliated distributor.

The Court of Appeals ruled that the wholesale sales price is the fixed and generally available price reflecting fair market value of the tobacco products, which is the amount a willing buyer would pay a seller who is willing but not obligated to sell. It further ruled that the taxpayer did not meet its burden of proof under RCW 82.32.180 to establish the wholesale sales price of the products it purchased from its affiliate. The expert opinion the taxpayer presented at trial was based on a study of the affiliated companies and did not reflect the price between a typical

manufacturer and a typical distributor, i.e., what a willing and unaffiliated manufacturer would have sold its smokeless tobacco products to a distributor with which it did not have an exclusive distribution and marketing arrangement. In short, this evidence did not prove a fair market value of the OTP between an independent manufacturer and distributor, as the Legislature intended. The Court properly remanded the case to provide the taxpayer another opportunity to prove its case under the correct standard.

II. STATEMENT OF THE ISSUE

In seeking a refund of excise taxes on smokeless tobacco product samples, did Tobacco Sales fail to meet its burden under RCW 82.32.180 to establish the wholesale sales price of smokeless tobacco products, which is the fixed and generally available price a willing buyer would pay a seller who is willing but not obligated to sell?

III. STATEMENT OF THE CASE

A. Procedural History.

Before 1990, United States Tobacco Company performed all functions relating to the manufacture, sale, and marketing of its smokeless tobacco products. In 1990, United States Tobacco Company formed two wholly-owned subsidiaries: United States Tobacco Manufacturing Company Inc. (Tobacco Manufacturing) and United States Tobacco Sales and Marketing Company Inc. (Tobacco Sales).¹ Tobacco Manufacturing

¹ CP at 128, 132-33.

manufactures smokeless tobacco products, primarily the brand names Copenhagen and Skoal, which are sold only to its affiliate Tobacco Sales. Tobacco Sales markets and sells the smokeless tobacco products.²

In 1997, Tobacco Sales filed an action seeking a refund of Other Tobacco Product (OTP) taxes for the year 1992 for samples it distributed in this state.³ Tobacco Sales and the Department filed cross motions for summary judgment before the Thurston County Superior Court. Tobacco Sales argued that the price between Tobacco Manufacturing and Tobacco sales known as a “transfer price” derived from a company formula for its smokeless tobacco products of \$.625 per can should be the price to measure the OTP tax.⁴

The trial court concluded that the \$.625 per can transfer price from Tobacco Manufacturing to Tobacco Sales was a “discounted” price under the OTP statute and entered an order denying Tobacco Sales’s summary judgment motion and granting summary judgment to the Department. Tobacco Sales appealed.

1. ***Tobacco Sales I* reversed and remanded the case to the trial court to determine whether Tobacco Manufacturing’s transfer price is a discounted price compared to the fair market value of its product.**

In *U.S. Tobacco Sales & Mktg. Co. v. Dep’t of Revenue*, 96 Wn. App. 932, 982 P.2d 652 (1999) (*Tobacco Sales I*), the Court of Appeals

² CP at 128, 132-33; RP Vol. I at 100, ll. 13-16; RP Vol. II at 209, ll. 9-12.

³ CP at 120.

⁴ CP at 129, 133. This formula was described in the subsequent 2005 trial on remand from the Court of Appeals. RP Vol. I at 146, ll. 3-25; 147, ll. 4-7; Ex. 1 at 14.

affirmed the denial of summary judgment to Tobacco Sales, but reversed the grant of summary judgment to the Department. The court concluded that the statutory definitions of “wholesale sales price,” “manufacturer,” “distributor,” and “person” were unambiguous.⁵ In evaluating the term “wholesale sales price,” which was defined as an “established price exclusive of any discount or other reduction,”⁶ the court concluded that an “‘established price’ from a manufacturer must be a generally available, stable, fixed price, such as a list price or invoice price.”⁷ The court further concluded that a manufacturer’s “‘established price’ is available to all customers; it reflects the fair market value of the products.”⁸

The court then defined “fair market value” as “the amount a willing buyer would pay a seller who is willing but not obligated to sell.”⁹ The court further explained: “In the case of affiliated companies, which, in effect, are obligated to buy and sell from each other, the ‘established price’ must be based upon fair market value rather than the manufacturer’s price to its affiliate.”¹⁰

The court remanded to the trial court to make a “factual determination” whether Tobacco Manufacturing’s price to Tobacco Sales was a fair market price or a discounted price.¹¹

⁵ *Tobacco Sales I*, 96 Wn. App. at 938.

⁶ Former RCW 82.26.010(7) (“‘Wholesale sales price’ means the established price for which a manufacturer sells a tobacco product to a distributor, exclusive of any discount or other reduction.”).

⁷ *Tobacco Sales I*, 96 Wn. App. at 937-38.

⁸ *Id.* at 940.

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.* at 941-42, 944.

2. On remand, the trial court derived its own fair market value price at \$.82 per can.

On remand, both parties again moved for summary judgment, but the motions were denied.¹² Thereafter, the trial court held a three-day bench trial.¹³ At trial, Tobacco Sales offered a transfer price study prepared by an accounting firm in 2000 for sales in 1992 between Tobacco Manufacturing and Tobacco Sales.¹⁴ Additionally, it engaged the services of an appraiser, Robert Reilly of Willamette Management Associates, who provided an appraisal and provided his opinion of fair market value.¹⁵ The Department offered testimony from two Department employees, an economist and an appraiser.¹⁶

To arrive at a fair market value price between Tobacco Manufacturing and Tobacco Sales, the study prepared by the accounting firm applied a residual profit split method to arrive at a transfer price in a range between \$.68 and \$.72 per can, and the appraiser testified that he agreed with the study.¹⁷ Furthermore, the appraiser tested the company's internal transfer pricing model. He entered the actual data such as

¹² CP at 735-737. In denying both parties' summary judgment motions, the trial court stated, "And what the Court of Appeals said, as I read their decision, was fair market value is what determines the appropriate wholesale price for which tax is appropriate. And one of the issues when there is a sale or a transfer between Manufacturing and Sales that are affiliated is the transfer may be discounted, and that is a factual issue." RP Summary Judgment Ruling (6/29/01) at 3. Tobacco Sales petitioned the Court of Appeals for discretionary review of the denial of its summary judgment motion, which was denied. CP at 4-5.

¹³ RP Vol. I at 1.

¹⁴ Exhibit II, Ernst & Young, LLP Transfer Pricing Report July 2000, attached to Plaintiff's Trial Exhibit 1. (Transfer Pricing Study)

¹⁵ *Id.* See also RP Vol. I at 25, ll. 8-11.

¹⁶ RP Vol. II at 284-318, 323, 340-370, 378-79.

¹⁷ RP Vol. I at 55, ll. 1-3, Transfer Pricing Study at 36-37, 68-73. Ex. 1, at 23.

expenses, income and production into the company's internal transfer pricing formula for the tax year 1992 to arrive at \$.73 per can.¹⁸

To prove fair market value, the Department presented invoice prices that showed the average established and generally available price per can to unaffiliated customers/distributors was \$1.43.¹⁹

The trial court found that the accounting firm's established price of \$.68 to \$.72 and the price of \$.625 originally asserted by Tobacco Sales were discounted prices and did not represent the fair market value of the smokeless tobacco products.²⁰ Based upon the testimony that Tobacco Manufacturing would not sell to an unaffiliated distributor, the trial court concluded as a matter of law that the transfer prices did not reflect fair market value.²¹ The trial court also rejected the Department's average \$1.43 price, because it was a price between Tobacco Sales (a distributor) and an independent distributor instead of a price between Tobacco Manufacturing and an independent distributor.²²

Having rejected Tobacco Sales' proposed values and the Department's proposed value, the trial court nevertheless calculated a fair market value for smokeless tobacco products in 1992 of \$.82 per can.²³ The trial court derived this price simply by "taking the middle price of \$.70 per can" and re-allocating the residual profit split from the accounting

¹⁸ RP Vol. I at 146-47, ll. 3-25, ll. 5-7. *See also* Ex. 1, at 23.

¹⁹ CP at 130, 134. *See also* Ex. 4, 5, 6.

²⁰ CP at 135.

²¹ CP at 135; RP Vol. I at 452-53, ll. 20-25, 1-5.

²² RP Vol. III at 436, ll. 9-21.

²³ CP at 134.

firm's transfer price study.²⁴ The trial court then ordered a refund based upon its calculation of OTP tax being due on \$.82 per can.²⁵ The Department appealed and Tobacco Sales cross appealed.

3. *Tobacco Sales II* held substantial evidence did not support the trial court's finding of \$.82 per can and that Tobacco Sales failed to prove an established price that was a fair market value price between unaffiliated entities.

The Court of Appeals issued a published decision and again reversed the trial court. *U.S. Tobacco Sales & Mktg. Co. v. Dep't of Revenue*, 128 Wn. App. 426, 115 P. 3d 1080 (2005) (*Tobacco Sales II*). In *Tobacco Sales II*, the Court concluded that substantial evidence did not support the "trial court's finding of \$.82 as the fair market value[.]"²⁶ The court also rejected the Department's argument that the correct measure of the OTP tax was Tobacco Sales' selling price of \$1.43 per can.²⁷ The court likewise rejected Tobacco Sales' evidence, stating: "But as discussed in *U.S. Tobacco I*, the internal transfer price between the two subsidiaries does not establish fair market value, i.e., what a willing buyer would pay a willing seller in an arm's length transaction in a free

²⁴ RP Vol. III at 456, ll. 12-17; 457, ll. 4-7. The court initially calculated a fair market value price of \$1.00 per can, but subsequently determined that it had not calculated the price correctly and re-determined the price at \$.82 per can based upon his reasoning: "And I'm pausing for just a minute because I want to make sure that I haven't overlooked something. Well, it appears that I probably have. . . So we're going to have to recalculate and I'll do so based on my understanding. So instead of the dollar that I've indicated, it's going to be a lesser amount but it is going to be an amount greater than 68 to 72 cents." RP Vol. III at 456, ll. 17-25, 457, ll. 1-3. *See also* RP Vol. III. at 437, ll.1-4, 465, ll. 13-21.

²⁵ CP at 135.

²⁶ *Tobacco Sales II*, 128 Wn. App. at 436.

²⁷ *Id.* at 433-34, 437.

market.”²⁸ The Court found that certain language in the studies offered at trial and the testimony offered by Tobacco Sales continued to reflect a price that was not a fair market value price between two unaffiliated companies.²⁹ Therefore, the Court remanded the case and directed the parties to present evidence “of the price a *completely unaffiliated entity* would have had to pay to purchase OTP from Tobacco Manufacturing in 1992.”³⁰

IV. SUMMARY OF ARGUMENT

RCW 82.32.180 requires a taxpayer to “prove that the tax as paid by the taxpayer is incorrect, either in whole or in part, and to establish the correct amount of the tax.” To meet this burden, Tobacco Sales must prove the wholesale sales price of the smokeless tobacco products it distributed in Washington. The Washington Legislature intended the OTP tax to measure the manufacturer’s wholesale sales price that is available to all distributors or retailers.

Tobacco Sales failed to prove a wholesale sales price that was an established price reflecting a generally available market price to prevail in its request for a tax refund of the OTP tax. The price of \$.625 between Tobacco Manufacturing and its affiliate Tobacco Sales represented a discounted price, because Tobacco Manufacturing would not sell tobacco products at that price to any unaffiliated entity and therefore, this was not

²⁸ *Id.* at 435-36.

²⁹ *Id.* at 437.

³⁰ *Id.* at 438 (emphasis in original).

an established price that was generally available to its customers or distributors.

The evidence offered by Tobacco Sales to prove an established price was defective because it incorporated the affiliation or exclusive arrangement between Tobacco Manufacturing and Tobacco Sales. Again, this evidence failed to show an established price that was generally available in the market place between a typical manufacturer and a typical distributor i.e. what a willing and unaffiliated manufacturer would have sold its smokeless tobacco products to a distributor with which it did not have an exclusive distribution and marketing agreement. The Court of Appeals correctly remanded the matter to provide Tobacco Sales yet another opportunity to prove an established price that is generally available and does not reflect the exclusive distribution and marketing arrangement between the two companies. Alternatively, because Tobacco Sales failed to carry its burden at trial, its tax refund should have been denied.

V. ARGUMENT

A. Standard of Review.

In reviewing a trial court's findings of fact, the appellate court examines the record applying the substantial evidence test. *Miller v. City of Tacoma*, 138 Wn.2d 318, 323, 979 P.2d 429 (1999). "Substantial evidence" has been defined as "evidence in sufficient quantum to persuade

a fair minded person of the truth of the declared premise.”³¹ The appellate court reviews a trial court’s legal conclusions in a tax refund action de novo. *Simpson Investment Co. v. Dep’t of Revenue*, 141 Wn.2d 139, 148, 3 P.3d 741 (2000), citing *Nordstrom Credit, Inc. v. Dep’t of Revenue*, 120 Wn. 2d 935, 940, 845 P.2d 1331 (1993).

The appellate court reviews constructions and meaning of a statute de novo. *Wash. Pub. Ports Ass’n v. Dep’t of Revenue*, 148 Wn.2d 637, 645, 62 P.3d 462 (2003), citing *Dep’t of Ecology v. Campbell & Gwinn, L.L.C.*, 146 Wn.2d 1, 9, 43 P.3d 4 (2002). In construing the statute, the court looks to see “if the statute’s meaning is plain on its face . . . [and] gives effect to that plain meaning as an expression of legislative intent.” *Wash. Pub. Ports Ass’n*, 148 Wn.2d at 645. The “plain meaning” includes “not only the ordinary meaning of the words, but the underlying legislative purposes and closely related statutes to determine the proper meaning of the statute.” *Id.* The OTP tax statute is not ambiguous.

B. The Washington Legislature Intended The OTP Tax To Measure The Manufacturer’s Wholesale Sales Price At A Price That Is Available To All Distributors Or Retailers.

During the tax period at issue, Washington State imposed an excise tax on the “sale, use, consumption, handling, or distribution of all tobacco products in this state[.]”³² “Tobacco products” include all types of

³¹ *Id.*, citing *Robinson v. Safeway Stores, Inc.*, 113 Wn.2d 154, 157, 776 P.2d 676 (1989) (quoting *Holland v. Boeing Co.*, 90 Wn.2d 384, 390-91, 583 P.2d 621 (1978)).

³² Former RCW 82.26.020(1). Under the statute’s current version, as amended in 2005, the tax is imposed on the “sale, handling, or distribution of all tobacco products in this state[.]” RCW 82.26.020(1) (2005). See Laws of 2005, ch. 180, § 3.

chewing and smoking tobacco, snuff, and cigars, but the term does not include cigarettes.³³ The OTP tax formerly was measured by the “wholesale sales price” of tobacco products brought into the state.³⁴ From 1959 to 2005, the “wholesale sales price” meant “the established price for which a manufacturer sells a tobacco product to a distributor, exclusive of any discount or other reduction[.]”³⁵ Although the Legislature may not have contemplated the precise factual situation in which a tobacco products manufacturer splits its manufacturing responsibilities and its sales and marketing responsibilities, the language “exclusive of any discount or other reduction” applies whether the entities are affiliated or unaffiliated. Based upon the plain meaning of the statute, a manufacturer’s “established price” must be a generally available price. A generally available price must be a price available to all distributors and not just a price available only to a single distributor or only some distributors. Otherwise, it would be a “discount or other reduction.”

For example, in *McLane Co. v. Dep’t of Revenue*, 105 Wn. App. 409, 19 P.3d 1119, *review denied*, 145 Wn. 2d 1005 (2001), two Washington distributors of tobacco products challenged the Department’s interpretation that they were responsible for paying the tax. They asserted

³³ Former RCW 82.26.010(1). The statutory definition of “Tobacco products” remains the same today as in 1992. *See* RCW 82.26.020(1) (2005)

³⁴ Former RCW 82.26.020(1). In 2005, the Legislature changed the rate and also the measurement of the OTP tax from “wholesale sales price” to “taxable sales price,” and added statutory definitions for “actual price” and “affiliated” entities such as Tobacco Sales. *See* Laws of 2005, ch. 180, § 2 (codified at RCW 82.26.010(12), (13), (18)(a)(i)-(vi), (20) and (21)).

³⁵ Former RCW 82.26.010(7). *See also* Laws of 1959, Ex. Sess. ch. 5, § 11.

that the out-of-state suppliers were responsible for the tax.³⁶ One of the distributors' arguments was that "they do not know what the out-of-state supplier pays to the manufacturer. Yet, they must pay the tax when the product is delivered to them in Washington."³⁷ The Court of Appeals rejected the argument, reasoning that under *Tobacco Sales I* "the statute sets the amount of the tax at the fair market price of the product [.]"³⁸ A fair market price is one that is generally available. Therefore, the OTP tax would be based upon the price generally available between a typical manufacturer and typical distributors, not a price available only to an affiliated entity.

Further, the OTP tax is imposed when the tobacco product enters the state: "Taxes under this section shall be imposed at the time the distributor (a) brings, or causes to be brought, into this state from without the state tobacco products for sale, (b) makes, manufactures, or fabricates tobacco products in this state for sale in this state, or (c) ships or transports tobacco products to retailers in this state, to be sold by those retailers."³⁹ The Legislature defined a "sale" as "any transfer, exchange, or barter, in any manner or by any means whatsoever, for a consideration, and includes and means all sales made by any person." It further specified that the term "sale" also "includes a gift by a person engaged in the business of selling

³⁶ *Id.* at 412.

³⁷ *Id.* at 417.

³⁸ *Id.*

³⁹ Former RCW 82.26.020(2). In 2002, the Legislature amended RCW 82.26.020(2) to add subsection d, "(d) handles for sale any tobacco products that are within this state but upon which tax has not been imposed."

tobacco products, for advertising, as a means of evading the provisions of this chapter, or for any other purposes whatsoever.”⁴⁰

Based upon this language, the Legislature intended to tax all forms of transactions in tobacco products, including providing free samples.⁴¹ Therefore, the statutory language requires the measure of the tax to be an established price generally available to all distributors or retailers.

C. Tobacco Sales Failed To Satisfy Its Burden Under RCW 82.32.180 To Obtain A Tax Refund.

Tobacco Sales seeks a refund of the OTP tax it paid on the samples it distributed in Washington. To obtain a refund, Tobacco Sales must (1) prove the tax it paid was more than was properly due and (2) establish the correct tax it should have paid. RCW 82.32.180; *Texaco Ref. & Mktg. Inc. v. Dep't of Revenue*, 131 Wn. App. 385, 398, 127 P.3d 771 (2006) (statute imposes two burdens on the taxpayer). Tobacco Sales failed to satisfy its burden of proof.

1. Tobacco Sales failed to prove an established price for its smokeless tobacco products that was generally available.

Tobacco Manufacturing's 1992 transfer price to its affiliate, Tobacco Sales, was \$.625 per can.⁴² However, Tobacco Sales's own

⁴⁰ Former RCW 82.26.010(6). Laws of 2005, ch. 180, § 2 amended the latter half of the definition, so that it now reads, “The term ‘sale’ includes a gift by a person engaged in the business of selling tobacco products, for advertising, promoting, or as a means of evading the provisions of this chapter.” RCW 82.26.010(5)(b) (2005).

⁴¹ Tobacco Sales distributes samples in Washington to adult consumers at promotional events such as rodeos, auto races, and fishing tournaments. Tobacco Sales also organizes and coordinates promotional activities for new product roll out and special promotions. CP at 130, 134.

⁴² CP at 130, 134; Ex. 7.

evidence proved this was a discounted price, because this price was not an established price that was generally available. It was a price only available between the two related companies, Tobacco Manufacturing and Tobacco Sales.⁴³ Tobacco Manufacturing would not sell at \$.625 per can to any unaffiliated entity:

Q: (Mr. Hankins) Isn't it true that the manufacturing unit does not sell to any other entities except to its affiliated entit[y], Sales and Marketing?

A: (Mr. Lofti) Domestically, that's true.^[44]

Tobacco Sales's appraisal expert agreed. He testified that Tobacco Manufacturing would **never** sell to any entity except Tobacco Sales:

Q: (Mr. Hankins) [I]t was my hypothetical about Wal-Mart that if Wal-Mart came and found out what the price was, could they go directly to the manufacturer?

...

Q: Under my hypothetical that I gave you, isn't it true that Manufacturing, if it sold directly to a distributor, it would not sell at a lower price than what it sells to Sales & Marketing?

A: (Mr. Reilly) Well, it's not a question of higher price or lower price. **Manufacturing would never sell to a distributor whether it's a wholesaler a regional director or even a retailer other than through Sales & Marketing, . . .**, so [M]anufacturing would not sell a product without Sales & Marketing, just like Sales & Marketing would not go to a manufacturer in Mexico and sell some other type of smokeless tobacco that doesn't come from Manufacturing.^[45]

⁴³ CP at 129, 133.

⁴⁴ RP Vol. I at 100, ll. 13-16.

⁴⁵ RP Vol. II at 226, ll. 19-22, 231, ll. 5-21 (emphasis added). *See also* RP Vol. II at 233, ll. 4-20; RP Vol. II at 384, ll. 13-19.

Furthermore, the \$.625 price was not even an arm's length price, as Reilly demonstrated. Under his valuation, the transfer price should have been \$.68 to \$.72 per can.⁴⁶ Therefore, based upon the plain meaning of "wholesale sales price," the price of \$.625 was not an arm's length price, but was a discounted price.

2. Tobacco Sales's valuation evidence failed to measure a manufacturer's established price, which is a generally available market price.

Under *Tobacco Sales I*, Tobacco Sales was required to prove an established price at which Tobacco Manufacturing would make its tobacco products generally available to its customers.⁴⁷ In construing the wholesale sales price definition, the Court of Appeals in *Tobacco Sales I* reasoned that an "established price" is a generally available price and because it is generally available to all customers, it reflects the fair market value of the products.⁴⁸ This interpretation is supported by examining other states' tobacco products taxes similar to Washington's.⁴⁹ Tobacco

⁴⁶ RP Vol. I at 142, ll. 11-16. Ex. 1 at 23.

⁴⁷ *Tobacco Sales I*, 96 Wn. App. at 939-40.

⁴⁸ *Id.* at 940.

⁴⁹ See Conn. Gen. Stat. § 12-330a (6) "wholesale sales price" means, in the case of a manufacturer of tobacco products, the price set for such products or, if no price has been set, the wholesale value of such products. . ."); 35 Ill. Comp. Stat. 143/10-1: ("Wholesale price" means the established list price for which a manufacturer sells tobacco products to a distributor, before the allowance of any discount, trade allowance, rebate, or other reduction. In the absence of such an established list price, the manufacturer's invoice price at which the manufacturer sells the tobacco product to unaffiliated distributors, before any discounts, trade allowances, rebates, or other reductions, shall be presumed to be the wholesale price."); Minn. Stat. § 297F.05:Subd. 23 ("Wholesale sales price" means the price stated on the price list in effect at the time of sale for which a manufacturer or person sells a tobacco product to a distributor, exclusive of any discount, promotional offer, or other reduction. For purposes of this subdivision, "price list" means the manufacturer's price at which tobacco products are made available

Sales has not challenged the holding in *Tobacco Sales I* requiring proof of a fair market value price.⁵⁰

At trial, Tobacco Sales presented a transfer price study and an appraisal as proof of fair market value.⁵¹ A transfer price study can be used as a management tool or to measure inter-company pricing to comply with income tax requirements under the Internal Revenue Code section 482.⁵² Section 482 of the Internal Revenue Code seeks to “ensure that taxpayers clearly reflect income attributable to controlled transactions, and to prevent the avoidance of taxes with respect to such transactions.”⁵³

Tobacco Sales’s evidence evaluated the profit structure of Tobacco Manufacturing and Tobacco Sales and then allocated the profits among the subsidiary companies in order to arrive at a price per can of \$.68 to \$.72 a

for sale to all distributors on an ongoing basis.); Miss. Code Ann. 27-69-13(s) (“Manufacturer’s list price” means the full sales price at which tobacco is sold or offered for sale by a manufacturer to the wholesaler or distributor in this state without any deduction for freight, trade discount, cash discounts, special discounts or deals, cash rebates, or any other reduction from the regular selling price. . .”); Ohio Rev. Code Ann. 5743.01(K): (“Wholesale price” means the invoice price, including all federal excise taxes, at which the manufacturer of the tobacco product sells the tobacco product to unaffiliated distributors, excluding any discounts based on the method of payment of the invoice or on time of payment of the invoice. . .).

⁵⁰ Tobacco Sales’s Pet. for Dis. Rev. at 3

⁵¹ See Exhibit 1 and Transfer Pricing Study.

⁵² RP Vol. I at 48-9, ll.1-10. See also 26 U.S.C. § 482; 26 C.F.R. § 1.482-1.

⁵³ 26 C.F.R. § 1.482-1 (1999). See also *E.I. Du Pont de Nemours & Co. v. United States*, 608 F.2d 445, 449 (Ct. Cl. 1979) (“Section 482 gives the Secretary of the Treasury (or his delegate) discretion to allocate income between related corporations when necessary to ‘prevent evasion of taxes or clearly to reflect the income’ of any such corporations”).

can.⁵⁴ The expert witnesses used a residual profit split method to arrive at this price range.⁵⁵

The transfer price studies and valuations performed by Tobacco Sales' expert witnesses did not analyze what a generally available price would have been. Under 26 C.F.R. § 1.482-1(3)(b), a transfer price study must determine "the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances." (Emphasis added). Tobacco Sales's appraisal expert valued the smokeless tobacco products using a similar standard:

[T]he appropriate valuation standard is the market price at which a manufacture would sell OTP to an unaffiliated distributor under the circumstances in which the parties otherwise held the same property interests and performed the same functions as are actually performed by the UST manufacturing and marketing subsidiaries.^[56]

These valuation standards incorporate the affiliation or exclusive nature of the transactions between Tobacco Manufacturing and Tobacco Sales by examining similar transactions "under the same circumstances." As such, Tobacco Sales offered only evidence of the price Tobacco Manufacturing would charge a distributor with which it had an exclusive marketing and distribution arrangement similar to its arrangement with Tobacco Sales. The evidence Tobacco Sales presented at trial did not establish the price at which Tobacco Manufacturing would make its

⁵⁴ RP Vol. I at 125, ll. 9-18. *See also* Transfer Pricing Study, Exhibit 8, at 14-15.

⁵⁵ RP Vol. I at 125, ll. 21-25; 126, 1-25. *See also* Transfer Pricing Study at 56.

⁵⁶ Ex. 1 at 3. RP at 159-60, ll. 15-25, 1-4.

tobacco products generally available, i.e., in the absence of an exclusive marketing and distribution arrangement. Therefore, the estimated price range of \$.68 and \$.72 is not an established price that is a generally available market price.

Furthermore, the residual profit split method used by Tobacco Sales's experts seems to indicate a high level of affiliation or exclusivity between the two companies, as evidenced by the profit split heavily favoring Tobacco Sales even though Tobacco Manufacturing owns the trademarks, plant and equipment.⁵⁷ The trial judge noted this inconsistency and correctly concluded the estimated price range did not reflect a generally available market price as required under *Tobacco Sales I*.⁵⁸

Since no evidence was introduced regarding what a generally available price would be, Tobacco Sales failed to carry its burden. Tobacco Sales argues no evidence exists to prove a price Manufacturing would sell to an unaffiliated purchaser and such evidence would be

⁵⁷ RP Vol. I at 128, ll. 10-20. Tobacco Manufacturing's brands are well known and established, the brand Copenhagen is one of the oldest registered brands and was introduced in 1822 and the other brand Skoal has been registered for over 66 years. See Transfer Pricing Study at 5-6.

⁵⁸ RP Vol. III at 452, ll. 20-25:

[Court]. Based upon that I find that there was not a fair market value price even though that's been determined as supposedly arm's length and here's the reason. There's not a willing buyer and willing seller. I should say more specifically, there's not a willing seller. U.S. Tobacco Manufacturing would not willingly sell to some other affiliate because they get a better deal when they sell to U.S. Tobacco [Marketing] and Sales, so it's not arm's-length from that standpoint.

See also, RP Vol. III at 453, ll. 1-23.

“speculative regarding hypothetical prices.”⁵⁹ Yet, its appraiser used a standard of a hypothetical distributor and a hypothetical manufacturer to arrive at his suggested value.⁶⁰ Therefore, he could use a hypothetical willing buyer who is not obligated to buy and a willing seller who is not obligated to sell to arrive at a hypothetical price. Indeed, this is what appraisers routinely do when determining fair market value.

Nevertheless, the Court of Appeals has provided Tobacco Sales with yet another opportunity to present evidence of an established price that is generally available in the market place between a willing buyer who is not obligated to buy and a willing seller who is not obligated to sell.⁶¹ This Court should affirm. Alternatively, because Tobacco Sales failed to carry its burden, its tax refund should have been denied.

VI. CONCLUSION

Tobacco Sales offered evidence of an exclusive price that was available only to an affiliate or an exclusive distributor performing the same national distribution and marketing functions. Tobacco Sales did not establish a “wholesale sale price” that was a fair market value price generally available to all customers. Consequently, this matter should be remanded to the trial court for the parties to present evidence of an established price that is generally available and does not represent a discounted price between a manufacturer and an exclusive marketing and

⁵⁹ Pet. for Dis. Rev. at 10.

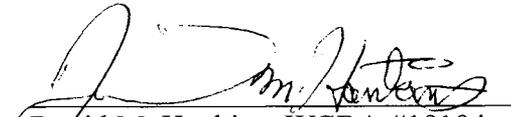
⁶⁰ Ex. 1 at 22.

⁶¹ *Tobacco Sales II*, 128 Wn. App. at 437-38.

distribution company. Alternatively, Tobacco Sales tax refund claim should be denied because it failed to carry its burden of proof.

RESPECTFULLY SUBMITTED this 14th day of July, 2006.

ROB McKENNA
Attorney General



David M. Hankins, WSBA #19194
Assistant Attorney General

APPENDIX

1. *United States Tobacco Sales and Marketing Company Inc. v. State of Washington, Department of Revenue*, 128 Wash. App. 426, 115 P.3d 1080 (2005)
2. *United States Tobacco Sales and Marketing Company Inc. v. State of Washington, Department of Revenue*, 96 Wash. App. 932, 982 P.2d 652 (1999)
3. Findings of Fact and Conclusions of Law.
4. Corrected Stipulation of Facts.
5. RCW 82.26.010 (former)
RCW 82.26.020 (former)
RCW 82.26.030 (former)
RCW 82.26.010 (current)
RCW 82.26.020 (current)
RCW 82.26.030 (current)

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▷

Court of Appeals of Washington, Division 2.
UNITED STATES TOBACCO SALES AND
MARKETING COMPANY INC., Respondent and
Cross-Appellant,
v.
WASHINGTON STATE DEPARTMENT OF
REVENUE, Appellant and Cross-Respondent.
No. 30434-1-II.

July 19, 2005.

Background: Distributor of tobacco products sued Department of Revenue, requesting judgment in the amount of allegedly overpaid excise tax on other tobacco products (OTP). The Superior Court, Thurston County, Gary Tabor, J., granted summary judgment for Department of Revenue. Distributor appealed. The Court of Appeals, 96 Wash.App. 932, 982 P.2d 652, reversed and remanded. Following a bench trial, the trial court concluded that the appropriate fair market value for OTP sold by distributor's manufacturing affiliate during the year in question was \$.82 per can. Both parties appealed.

Holding: The Court of Appeals, Quinn-Brintnall, C.J., held that trial court's finding as to fair market value of OTP sold during year in question was not supported by substantial evidence.

Reversed and remanded.

West Headnotes

Taxation 371 ↔ 3704

371 Taxation

371IX Sales, Use, Service, and Gross Receipts

Taxes

371IX(H) Payment

371k3702 Recovery of Taxes Paid

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371k3704 k. Actions. Most Cited Cases
In proceedings to determine amount of tax refund owed to distributor of tobacco products for overpaid excise tax, the finding that the fair market value of other tobacco products (OTP) sold during the year in question by distributor's manufacturing affiliate to distributor was \$.82 per can was not supported by substantial evidence; trial court had adopted a 40/60 residual profit split between distributor and manufacturer, but there was no basis for such a conclusion, leaving the court's finding of \$.82 as the fair market value unsupported by substantial evidence. West's RCWA 82.26.010, 82.26.020 (2004).

****1080 *428** William Colwell Severson, Attorney at Law, Seattle, WA, for Respondent/Cross-Appellant.
David M. Hankins, Attorney General's Ofc/Revenue Division, Olympia, WA, for Appellant/Cross-Respondent.
QUINN-BRINTNALL, C.J.

¶ 1 United States Tobacco Sales and Marketing Company Inc. (Tobacco Sales) and the Department of Revenue (DOR) each appeal a superior court ruling determining the amount of a refund owed Tobacco Sales for overpaid excise tax. Because the superior court's ruling is not supported by substantial evidence, we must reverse and remand for further proceedings.

FACTS

¶ 2 This is the second appeal in this matter. See *U.S. Tobacco Sales & Mktg. Co. v. Dep't of Revenue*, 96 Wash.App. 932, 982 P.2d 652 (1999) (*"U.S. Tobacco I"*). The facts of the first appeal were aptly set out in ****1081 U.S. Tobacco I**, but to the extent they are relevant here, we repeat them.

¶ 3 Washington's other tobacco products (OTP) tax imposes an excise tax on the "sale, use,

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consumption, handling, or distribution of all tobacco products” in the state. Former RCW 82.26.020(1) (1993).^{FN1} The tax is measured by the “wholesale sales price” of OTP brought into the state. Former RCW 82.26.020. The 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.” Former RCW 82.26.010(7) (1995).

FN1. “Tobacco products” include all types of chewing and smoking tobacco, snuff, and cigars, but does not include cigarettes. Former RCW 82.26.010(1) (1995).

¶ 4 Tobacco Sales is a corporation that buys, markets, and resells smokeless tobacco products primarily to wholesale distributors in Washington and elsewhere. Tobacco *429 Sales exclusively purchases the tobacco products it distributes from the United States Tobacco Manufacturing Company, Inc. (Tobacco Manufacturing). Tobacco Sales is Tobacco Manufacturing's only domestic customer. Both Tobacco Sales and Tobacco Manufacturing are wholly-owned subsidiaries of the United States Tobacco Company (USTC).

¶ 5 In addition to selling tobacco products to wholesalers, Tobacco Sales gives away sample products at promotional events. Until 1996, Tobacco Sales paid the OTP tax on the free samples it distributed in Washington. Tobacco Sales measured the OTP tax based on the price Tobacco Sales sold other comparable OTP to wholesale distributors. Tobacco Sales's Washington customers paid the OTP tax on products for resale.

¶ 6 DOR audited Tobacco Sales in 1996, and determined that Tobacco Sales, not its wholesale distributor customers, should have been paying the OTP tax. Tobacco Sales inquired during the audit whether its purchase price paid to Tobacco Manufacturing, rather than its selling price, was the correct measure of the tax under the statute. After DOR informed Tobacco Sales that its purchase price was the correct measure, Tobacco Sales requested a refund of the OTP tax it had overpaid on the promotional samples. DOR then took a new

position that although the correct tax measure was the manufacturer's selling price, “a sale by a manufacturer to a distributor who is an affiliate ... is not used in establishing the manufacturer's selling price.” *U.S. Tobacco I*, 96 Wash.App. at 935, 982 P.2d 652 (alteration in original). Therefore, the correct measure of the tax was Tobacco Sales's selling price to wholesale distributor customers.

¶ 7 In April 1997, Tobacco Sales sued DOR to recover the amount of allegedly overpaid OTP tax for 1992.^{FN2} In 1992, Tobacco Sales purchased OTP from Tobacco Manufacturing for \$.625 per can and sold it to wholesale distributors for *430 \$1.43 per can. On cross-motions for summary judgment, the superior court found that the price Tobacco Sales paid Tobacco Manufacturing was a “discounted” price that did not reflect the “wholesale sales price” within the meaning of the OTP taxing statute. The superior court concluded that because the two companies were subsidiaries, the \$1.43-per-can price paid by Tobacco Sales's customers was the wholesale sales price; thus, Tobacco Sales was not entitled to a refund. Tobacco Sales appealed.

FN2. Prior tax years had closed under the statute of limitations. Former RCW 82.32.060(3) (1992). The record does not indicate why Tobacco Sales did not seek a refund for OTP tax paid in 1993 through 1996.

¶ 8 On appeal, we rejected DOR's argument that because Tobacco Manufacturing and Tobacco Sales were affiliated, they should be treated as one entity and the wholesale sales price should include both entities' costs and profits:

The [OTP tax] statute makes no distinction between affiliated and nonaffiliated entities.... Under the[] [statute], Tobacco Manufacturing is the manufacturer and Tobacco Sales is the taxable distributor.

... [N]either the statute nor case law provides a basis for ignoring the entities' corporate structure....

The statute imposes the tax upon the value of a manufacturer's products, measured at the time the manufacturer sells **1082 the products. This price

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will reflect the quality, quantity, packaging, and trademark value of the products as provided by the manufacturer. At a minimum, this price must include the costs and profits associated with manufacturing and sales, because those functions are mandated by the statutory definition of "manufacturer." RCW 82.26.010(2). But it need not include value that is added to the products after the manufacturer sells them. Under this definition, the OTP tax will be higher on products that are extensively marketed by their manufacturer than on products that a manufacturer sells generically. But the statute permits this disparity, and the court may not alter the statutory language.

U.S. Tobacco I, 96 Wash.App. at 937-38, 940-41, 982 P.2d 652 (footnotes omitted). We therefore reversed the trial court's grant of summary judgment to DOR: The trial court ... bas[ed] its ruling that Tobacco Manufacturing's price is "discounted" upon its interpretation of the statutory*431 definition as excluding prices between affiliates. The trial court's analysis was in error. Whether a price is discounted is a factual determination and is evaluated without regard to the purchaser's corporate affiliation.

... [T]he statutory measure of the OTP tax is the manufacturer's list or invoice price; i.e., the fair market value of the products. Here, because Tobacco Manufacturing sells exclusively to an affiliate, its selling price does not necessarily reflect fair market value. Therefore to determine whether Tobacco Manufacturing's price is discounted, the trier of fact must compare Tobacco Manufacturing's price with the fair market value of its products.

U.S. Tobacco I, 96 Wash.App. at 941-42, 982 P.2d 652.

¶ 9 On remand, a bench trial was held to determine the fair market value of the OTP sold by Tobacco Manufacturing in 1992. Tobacco Sales presented the findings of two studies completed in 2000: a transfer pricing study performed by an accounting firm, Ernst & Young, and an analysis performed by an appraisal firm, Willamette Management Associates. Both studies concluded that the 1992 fair market value for Tobacco Manufacturing's OTP was between \$.68 and \$.72 per can.

¶ 10 DOR did not present any evidence as to the fair market value of OTP sold by Tobacco Manufacturing. Instead, it maintained its position, a position which this court rejected in the first appeal, that the correct measure of the OTP tax should be Tobacco Sales's selling price. It supported this position with testimony by a DOR economist and real property appraiser. But DOR's appraiser also testified that the fair market value of the OTP at the time it was sold by Tobacco Manufacturing, as determined by Tobacco Sales's experts, was correct:

Q. And the conclusions Ernst & Young and Willamette Management came up with indicated that that was a fair market value; is that correct?

A. That's correct.

*432 Q. And you're not disputing that that is a fair market value at that level of trade, are you?

A. No, I'm not.

2 Report of Proceedings (RP) at 360-61 (emphasis added).

¶ 11 The trial court concluded at the close of testimony that the appropriate fair market value for Tobacco Manufacturing's 1992 OTP was \$.82 per can. In rejecting Tobacco Sales's position, the court stated that although "no one really quarreled" with the \$.68 to \$.72 price, "common sense" suggested a higher price. 3 RP at 453. Both parties appeal.

ANALYSIS

¶ 12 Each party assigns error in this appeal to the trial court's determination that the 1992 fair market value of OTP sold by Tobacco Manufacturing was \$.82 per can. Because this determination is a factual finding, substantial evidence must support it. *Fisher Properties, Inc. v. Arden-Mayfair, Inc.*, 115 Wash.2d 364, 369, 798 P.2d 799 (1990). Substantial evidence does not support the trial court's finding, but in order to fully understand how the court came to enter the finding that it did, we discuss the positions of DOR and Tobacco Sales.

**1083 ¶ 13 In *U.S. Tobacco I*, we instructed the parties and the trial court to compare Tobacco

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Manufacturing's 1992 invoice price of \$.625 per can with the fair market value of its OTP because the invoice price did not "necessarily" reflect the price which would be paid between unaffiliated entities. 96 Wash.App. at 942, 982 P.2d 652. Tobacco Sales's experts testified that there are several ways to measure the fair market value of goods which have only been sold between affiliated entities. These measures have largely been codified by the Internal Revenue Service (IRS) for purposes of calculating the free market "arm's-length" price of intercompany transfers. See 26 C.F.R. § 1.482-1. Only two of these measures were presented below: the "resale price" method and the "residual profit split" method.

*433 ¶ 14 DOR's position that \$1.43 was the fair market value of OTP sold by Tobacco Manufacturing was based on the resale price method.^{FN3} This method "can be used to determine the arm's-length price to be paid by the purchaser entity in the subject intercompany transaction when that purchaser, in turn, resells the subject tangible asset to unrelated parties." Robert F. Reilly & Melvin Rodriguez, *Excise Tax and Inventory: IRC Section 482 Transfer Price Rules May Provide a Reasonable Valuation Approach*, J. of Multistate Tax'n, May 2004, at 18, 24 ("*Excise Tax and Inventory* ") (citing 26 C.F.R. § 1.482-3(c)(1)). But this method is only appropriate in cases involving the purchase and resale of tangible goods in which the reseller (here Tobacco Sales) has not added *substantial* value to the goods. *Bausch & Lomb Inc. v. Comm'r*, 92 T.C. 525, 586, 1989 WL 25026 (1989), *aff'd*, 933 F.2d 1084 (2nd Cir.1991); *Excise Tax and Inventory*, at 24.

FN3. DOR continues to maintain that the fair market value of goods can never be determined when such goods are sold only between affiliated companies. But we rejected this argument in *U.S. Tobacco I*; DOR has failed to present any evidence to support this claim; and the argument is rebutted by the IRS's codification of formulas specifically designed to determine the "arm's-length" price of intercompany transfers. See 26 C.F.R. §

1.482-1; see also *U.S. Tobacco I*, 96 Wash.App. at 942, 982 P.2d 652 ("[T]he Department failed to identify in what respect the federal arm's-length-price standard differs from fair market value.").

¶ 15 DOR presented no evidence that the OTP sold by Tobacco Manufacturing did not gain value while owned by Tobacco Sales.^{FN4} Nor has DOR ever demonstrated that Tobacco Sales was a shell entity through which the OTP was funneled to evade taxes. As set forth in the studies conducted by Tobacco Sales's experts, Tobacco Sales increased the value of the OTP through an array of activities including sales, marketing, promotions, product sampling, *434 and distribution. Thus, we reiterate that it is not appropriate to measure the value of OTP sold by Tobacco Manufacturing by the price Tobacco Sales sold to independent distributors.^{FN5} The trial court properly rejected DOR's position that the \$1.43 price was the fair market value of OTP sold by Tobacco Manufacturing.

FN4. It is in this respect that DOR's citation to *Creme Manufacturing Co. v. United States*, 492 F.2d 515 (5th Cir.1974), fails. In that case, a manufacturing corporation sold taxable fishing lures to its related selling corporation for 25 percent of list price and the selling corporation resold the lures to unrelated wholesale distributors for 40 percent of list price. *Creme Mfg.*, 492 F.2d at 518. Because there was no evidence that the lures gained value between sale to the selling corporation and sale to the unrelated distributors, the Fifth Circuit affirmed the IRS's decision to calculate an excise tax based on the higher sales price. *Creme Mfg.*, 492 F.2d at 521-22.

FN5. See Uniform Standards of Professional Appraisal Practice (USPAP), Standard Rule 7-3(b) cmt.: The appraiser must recognize that there are distinct levels of trade and each may generate its own data. For example, a

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property may have a different value at a wholesale level of trade, a retail level of trade, or under various auction conditions.

Therefore, the appraiser must analyze the subject property within the correct market context.

Available at <http://commerce.appraisalfoundation.org/html/USPAP2005/std7.htm>. Washington has adopted the USPAP as the standard of practice governing real estate appraisal activities. WAC 308-125-200(1).

¶ 16 For its part, Tobacco Sales's \$.68-to \$.72-per-can fair market value calculation was based upon the residual profit split method. This method "determines a tangible asset's arm's-length transfer price based on the relative value of each related party's contribution to the combined profit or loss in ****1084** a particular controlled transaction or set or controlled transactions." *Excise Tax and Inventory*, at 25 (citing 26 C.F.R. § 1.482-6(b)). Under this method:

[T]he controlled taxpayers' combined operating profit from the relevant business activity is allocated first to routine functions, services, and tangible and intangible assets. Any remaining unallocated profit (i.e., profit attributable to the controlled group's valuable intangible property, where similar property is not owned by the uncontrolled taxpayers) is allocated based on the related parties' relative contributions of such intangibles.

Excise Tax and Inventory, at 25 (citing 26 C.F.R. § 1.482-6(c)(3)(i)). The residual profit split method is best explained by an example: If Manufacturer sells to Distributor a widget for \$1 (which includes Manufacturer's costs and set operating profit), and Distributor sells the widget for \$3 (which includes \$1 for Distributor's costs and set operating profit), there is \$1 of residual profit. The residual profit split method allocates that \$1 based on Manufacturer and Distributor's ***435** contribution of intangible assets to the entire transaction. Thus, for example, if Manufacturer contributes 40 percent of the intangible assets while Distributor contributes the rest, the \$1 of residual profit would be split accordingly.

¶ 17 In this case, Tobacco Sales's experts each testified that the appropriate allocation of the residual profit was 24 percent for Tobacco Manufacturing and 76 percent for Tobacco Sales. DOR did not dispute the allocation, which was based on Tobacco Manufacturing's "ownership of trademarks and trade names" and Tobacco Sales's performance of "brand management and brand marketing." 1 RP at 192. The allocation captured the expenditures by each company "done to promote those sort of nonroutine intangibles." 1 RP at 126. The fair market value under this residual profit split method was \$.68 to \$.72 per can.

¶ 18 In rejecting the \$.68-to \$.72-per-can price, the trial court noted that "no one really quarreled with the ... 76/24 split," but then concluded that "common sense indicates that if there were a nonaffiliated distributor that [Tobacco Manufacturing] was going to sell to, they would not say, well, here, we'll take 24 percent of the profit and you can have 76 percent." 3 RP at 453. The court then assigned a residual profit rate of 40 percent for Tobacco Manufacturing and 60 percent for Tobacco Sales. This rate resulted in a fair market value of \$.81 to \$.84 per can, from which the court selected \$.82. But no evidence supports the trial court's 40/60 allocation rate in this context.

¶ 19 The 40/60 rate was USTC's projection, at the beginning of 1992, of how 1992 total gross profits in 1992 would be allocated between Tobacco Manufacturing and Tobacco Sales. This projection was made in order to set each company's 1992 budget, which in turn set the internal transfer prices between the two subsidiaries. These transfer prices, fixed by the 40/60 rate, included the \$.625-per-can price actually used between Tobacco Sales and Tobacco Manufacturing. But as discussed in *U.S. Tobacco I*, the internal transfer price between the two subsidiaries does ***436** not establish fair market value, i.e., what a willing buyer would pay a willing seller in an arm's-length transaction in a free market. In testimony not disputed by DOR, Tobacco Sales's expert explained that the 40/60 rate was the result of an "internal transfer pricing formula" ^{FN6} which had no bearing on the residual profit distribution or fair market value of Tobacco Manufacturing's 1992 OTP:

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FN6. 2 RP at 240.

[The 24/76 rate is] a very specific analysis to one specific slice of profits. Either level of profit has been allocated separately, one based on ... a return on assets for [Tobacco] Manufacturing or return on sales for [Tobacco Sales]. A second layer is based on a return on actual expenses, which are different for [Tobacco Sales] than for [Tobacco] Manufacturing, obviously, it's only this residual level after most of the pizza pie has been consumed there's a slice left, and we have to allocate that last slice of profits and that was based on a relative expense, a relative cost of certain intangible assets creating creation expenses. But ****1085** only that slice should be allocated 24/76 because that's the right way to allocate that slice. That slice shouldn't be allocated 40/60, just like all of the profits shouldn't be allocated 24/76.
 2 RP at 257.

¶ 20 The trial court's basis for discarding the 24/76 split-i.e., that a "nonaffiliated distributor ... would not say ... we'll take 24 percent of the profit and you can have 76 percent"^{FN7}-misconstrues the residual profit split method. The residual profit split method seeks to allocate residual profit only; it assumes that each company has already allocated for itself an operating profit. The decision to split residual profit 24/76 does not suggest the same result for overall profits. Because there was no basis for the trial court to adopt a 40/60 residual profit split, the trial court's finding of \$.82 as the fair market value is not supported by substantial evidence.

FN7. 3 RP at 453.

¶ 21 Each party advocates that, on remand, we instruct the trial court to set fair market value at its respective ***437** amount. But as already discussed, DOR's \$1.43 per can position is wholly unsupported. And we are not convinced that the \$.68 to \$.72 range championed by Tobacco Sales truly reflects the fair market value of OTP sold by Tobacco Manufacturing in 1992. The lengthy Willamette Management Associates and Ernst & Young studies both state the conclusion that the

\$.68 to \$.72 range was the appropriate measure of fair market value. And DOR's appraiser did not dispute that this range was the correct "fair market value at that level of trade." 2 RP at 360-61. But certain language from those studies and the testimony from which they were presented suggest that the qualifier "level of trade" included the affiliation between Tobacco Manufacturing and Tobacco Sales.^{FN8} As such, the court's market price would not reflect the price of OTP sold between unaffiliated entities. Moreover, although the Ernst & Young study in this appeal came to the conclusion that the 1992 fair market value was between \$.68 and \$.72 per can, the Ernst & Young study in the first appeal concluded that the \$.625 price was an appropriate arm's-length price for that same year. *U.S. Tobacco I*, 96 Wash.App. at 942, 982 P.2d 652. Neither party has clarified this disparity.^{FN9}

FN8. *See, e.g.*, 2 RP at 228-29:

Q. Let's take my hypothetical though, Mr. Reilly. Isn't it true that-let's say Wal-Mart came in and said we're going-for all our stores have our own internal unit, we don't care about you nationally, [Tobacco] Manufacturing, but we're going to push your products in our stores and we're a big customer. Isn't it true that if [Tobacco] Manufacturing did sell to them that they would charge them a higher price than what they charge to [Tobacco Sales]?

A. Well, would they, I just don't think it would ever be possible because that's just not a hypothetical that I could see occurring on the planet Earth, given the economics, the principles of economics that have, you know, been around since Malthus and Ricardo and for the last several hundred years.

FN9. We also note that while throughout these proceedings it appeared undisputed that the 1992 internal invoice price was \$.625 per can, the Willamette Management Study concluded that the invoice price was actually \$.73 per can that year. While the invoice price does not necessarily reflect

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fair market and, therefore, this discrepancy may be irrelevant, it reflects the need for further clarification below.

¶ 22 The record does not contain substantial evidence supporting the trial court's finding that the fair market value of OTP sold in 1992 by Tobacco Manufacturing was \$.82 per can. The parties are directed to provide evidence on *438 remand of the price a *completely unaffiliated entity* would have had to pay to purchase OTP from Tobacco Manufacturing in 1992.

¶ 23 Reversed and remanded.

We concur: HOUGHTON and BRIDGEWATER,
JJ.
Wash.App. Div. 2,2005.
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Court of Appeals of Washington,
Division 2.

UNITED STATES TOBACCO SALES AND
MARKETING COMPANY INC. Appellant,

v.

STATE of Washington, DEPARTMENT OF
REVENUE, Respondent.

No. 22676-6-II.

Aug. 20, 1999.

Distributor of tobacco products sued Department of Revenue, requesting judgment in the amount of allegedly overpaid other tobacco products (OTP) tax. The Superior Court, Thurston County, Gary Tabor, J., granted summary judgment for the Department of Revenue. Distributor appealed. The Court of Appeals, Houghton, J., held that genuine issues of material fact as to the fair market value of tobacco manufacturer's products sold to the distributor precluded summary judgment.

Reversed and remanded.

West Headnotes

[1] Appeal and Error ⚡ 893(1)
30k893(1)

Statutory interpretation is a question of law that the appellate court reviews de novo.

[2] Statutes ⚡ 181(1)
361k181(1)

Court's fundamental duty in construing statutes is to ascertain and to carry out the Legislature's intent.

[3] Statutes ⚡ 188
361k188

Legislative intent is derived primarily from the language of the statute.

[4] Statutes ⚡ 190
361k190

If a statute is plain and unambiguous, its meaning must be derived solely from the statutory language.

[5] Statutes ⚡ 190

361k190

Statute is "ambiguous" if it is susceptible of two or more reasonable interpretations.

[6] Statutes ⚡ 219(2)
361k219(2)

Courts defer to agency interpretations only when statutory language is ambiguous.

[7] Statutes ⚡ 219(4)
361k219(4)

Administrative interpretation that conflicts with the statutory language is not entitled to deference.

[8] Statutes ⚡ 188
361k188

In determining what a statute means, words should be ascribed their plain and ordinary meanings.

[9] Statutes ⚡ 188
361k188

When a statute does not define a nontechnical word, the court may look to the dictionary for guidance.

[10] Evidence ⚡ 113(16)
157k113(16)

"Fair market value" is the amount a willing buyer would pay a seller who is willing but not obligated to sell.

[11] Taxation ⚡ 1292
371k1292

Statute imposing an other tobacco products (OTP) tax imposes the tax upon the value of a manufacturer's products, measured at the time the manufacturer sells the products, a price which, at a minimum, must include the costs and profits associated with manufacturing and sales, because those functions are mandated by the statutory definition of "manufacturer"; however, it need not include value that is added to the products after the manufacturer sells them. West's RCWA 82.26.010(2, 7).

[12] Taxation ⚡ 1292
371k1292

(Cite as: 96 Wash.App. 932, 982 P.2d 652)

Whether a tobacco manufacturer's price is "discounted," for purposes of the other tobacco products (OTP) tax, is a factual determination evaluated without regard to the purchaser's corporate affiliation with the manufacturer. West's RCWA 82.04.030, 82.26.010(2), (3)(a), (7), 82.26.020; Wash. Admin. Code § 458-20-203.

[13] Taxation ☞ 1292
371k1292

To determine whether tobacco manufacturer's price was discounted, for purposes of the other tobacco products (OTP) tax, the trier of fact had to compare the manufacturer's price with the fair market value of its products where the manufacturer sold exclusively to an affiliate, such that its selling price did not necessarily reflect fair market value. West's RCWA 82.04.030, 82.26.010(2), (3)(a), (7), 82.26.020; Wash. Admin. Code § 458-20-203.

[14] Taxation ☞ 1292
371k1292

Law did not permit Department of Revenue to disregard tobacco distributor and tobacco manufacturer's separate corporate identities and treat them as one entity for purposes of the other tobacco products (OTP) tax, despite their corporate affiliation. West's RCWA 82.04.030, 82.26.010(2), (3)(a), (7), 82.26.020; Wash. Admin. Code § 458-20-203.

[15] Corporations ☞ 1.4(3)
101k1.4(3)

Corporate forms may be set aside only in cases of fraud.

[16] Taxation ☞ 1292
371k1292

Fact that a pricing study was undertaken in the context of federal income tax did not preclude its relevance in determining fair market value of tobacco sold by manufacturer, for purposes of the State other tobacco products (OTP) tax. West's RCWA 82.04.030, 82.26.010(2), (3)(a), (7), 82.26.020; Wash. Admin. Code § 458-20-203.

[17] Taxation ☞ 1292
371k1292

That a profit-sharing formula is used or that a transaction occurs between affiliated entities is not

determinative of whether a transfer price is a market price, for purpose of the other tobacco products (OTP) tax; the pertinent inquiry is what is the fair market value, not how it is determined, for what purpose, or by whom. West's RCWA 82.04.030, 82.26.010(2), (3)(a), (7), 82.26.020; Wash. Admin. Code § 458-20-203.

[18] Judgment ☞ 181(32)
228k181(32)

Genuine issues of material fact as to the fair market value of tobacco manufacturer's products precluded summary judgment as to whether the sale price charged by the manufacturer to an affiliated distributor was "discounted," for purposes of the other tobacco products (OTP) tax. West's RCWA 82.04.030, 82.26.010(2), (3)(a), (7), 82.26.020; Wash. Admin. Code § 458-20-203.

****654 *933** John Gerhart Hennen, Olympia, for Respondent.

Norman J. Bruns, William C. Severson, Garvey, Schubert & Barer, Seattle, for Appellant.

HOUGHTON, J.

A distributor of tobacco products appeals a trial court order denying its motion for summary judgment and granting summary judgment in favor of the Department of Revenue. The trial court ruled that the statutory measure of the tobacco products tax is the price at which the distributor, an affiliate of the manufacturer, sells tobacco products rather than the price at which it ***934** buys them from the manufacturer. We reverse and remand for further proceedings.

I. FACTS

Appellant, the United States Tobacco Sales and Marketing Company Inc. (Tobacco Sales), is a Delaware corporation that buys, markets, and resells smokeless tobacco products in the State of Washington and elsewhere. [FN1] Most of Tobacco Sales' customers are wholesale distributors who resell the products to retailers. Tobacco Sales exclusively purchases the tobacco products it distributes from the United States Tobacco Manufacturing Company Inc. (Tobacco Manufacturing). Tobacco Sales is Tobacco Manufacturing's only domestic customer. Both Tobacco Sales and Tobacco Manufacturing are wholly-owned subsidiaries of the United States Tobacco Company (USTC). [FN2]

FN1. Tobacco Sales' main product lines are

Copenhagen and Skoal.

FN2. USTC is in turn owned by UST Inc. Prior to 1990, USTC performed both the manufacturing and marketing functions. The company reorganized in 1990, creating Tobacco Manufacturing and Tobacco Sales as wholly-owned subsidiaries of USTC. Tobacco Sales employs approximately 600 full-time workers; Tobacco Manufacturing employs about 700.

Washington State imposes an excise tax on the "sale, use, consumption, handling, or distribution of all tobacco products" in the state. RCW 82.26.020(1). "Tobacco products" are all types of chewing and smoking tobacco, snuff, and cigars, but not cigarettes. RCW 82.26.010(1). The tax is known as the Other Tobacco Products tax (OTP tax). It is measured by the "wholesale sales price" of tobacco products brought into the state. [FN3] RCW 82.26.020. The 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).

FN3. The tax rate is currently 74.9%. RCW 82.26.020-.025.

In addition to selling tobacco products to wholesalers, Tobacco Sales gives away sample products at promotional events, such as rodeos, auto races, and fishing tournaments. [FN4] *935 Until 1996, Tobacco Sales paid the OTP tax on the free samples it distributed in Washington. Tobacco Sales' Washington customers paid the OTP tax on products for resale.

FN4. Some of these promotional products are marked "SAMPLE," while others are unmarked. Although Tobacco Sales buys the marked samples from Tobacco Manufacturing at a discounted price, it acknowledges that it is liable for OTP tax on both marked and unmarked samples based upon its regular purchase price. See RCW 82.26.010(6) ("Sale" means any transfer, exchange, or barter. ... [and] includes a gift by a person engaged in the business of selling tobacco products, for advertising....").

In 1996, the Washington Department of Revenue (Department) audited Tobacco Sales. The auditor determined that Tobacco Sales was the taxable "distributor" under the statute and should have been paying the OTP tax on its sales as well as its samples.

In the course of the audit, Tobacco Sales inquired **655 whether its purchase price, rather than its selling price, was the correct measure of the tax under the statute. In September 1996, the auditor informed Tobacco Sales that its purchase price was, in fact, the correct measure; thus Tobacco Sales had been overpaying the tax. Tobacco Sales revised its pricing scheme based upon this information.

In December 1996, Tobacco Sales requested a refund of the OTP tax it had overpaid on its samples in 1992. [FN5] The Department denied the refund claim because the audit had not been finalized. In February 1997, in a summary of its final audit instructions, the Department advised Tobacco Sales that its original measure of the tax, its selling price, was the correct measure after all. The Department stated that although the correct tax measure was the manufacturer's selling price, "a sale by a manufacturer to a distributor who is an affiliate ... is not used in establishing the manufacturer's selling price." [FN6] Therefore, the correct measure of the tax was Tobacco Sales' "selling price to distributors *936 who are not affiliated with you." According to the Department, this is what the Legislature meant by the phrase "established price."

FN5. Prior tax years had closed under the statute of limitations. See RCW 82.32.060(1)-(3).

FN6. In February 1997, at the Department's request, the Legislature considered a bill amending the OTP tax provisions. See HR 2202, 55th Leg. (Wash.1997). The proposed bill stated that: "Sales between affiliates are not sales for the purpose of establishing distribution sales price." The Legislature, however, failed to enact the proposed changes.

In April 1997, Tobacco Sales filed a lawsuit against the Department requesting judgment in the amount of allegedly overpaid OTP tax for 1992. Tobacco Sales and the Department filed cross motions for summary judgment. On October 27, 1997, the trial court denied Tobacco Sales' motion and granted the Department's motion, finding that the price Tobacco Sales paid to Tobacco Manufacturing was a discounted price within the meaning of RCW 82.26.010(7). Tobacco Sales appeals.

II. ANALYSIS

A. Standard of Review

Tobacco Sales appeals both the summary judgment in

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favor of the Department and the denial of its motion for summary judgment. Summary judgment is appropriate if there are no genuine issues of material fact, and the moving party is entitled to judgment as a matter of law. CR 56(c). The appellate court reviews the trial court's decision de novo. *Reid v. Pierce County*, 136 Wash.2d 195, 201, 961 P.2d 333 (1998); *Young v. Estate of Snell*, 134 Wash.2d 267, 271, 948 P.2d 1291 (1997) (citing *Safeco Ins. Co. of Am. v. Butler*, 118 Wash.2d 383, 394-95, 823 P.2d 499 (1992)). The court must construe the facts most favorably toward the nonmoving party. *Babcock v. State*, 116 Wash.2d 596, 599, 809 P.2d 143 (1991) (citing *Wendle v. Farrow*, 102 Wash.2d 380, 383, 686 P.2d 480 (1984)). Tobacco Sales has the burden of proving that the tax it paid was incorrect and establishing the correct amount. RCW 82.32.180.

B. Wholesale Sales Price

At issue is the statutory definition of "wholesale sales price." Tobacco Sales argues that the price it pays *937 Tobacco Manufacturing is the correct measure of the OTP tax. The Department contends that the tax should be based upon the wholesale value of tobacco products to a Washington wholesale purchaser (Tobacco Sales' selling price), because Tobacco Sales' purchase price is a "reduced price."

1. Statutory Definitions

The OTP tax is measured by the "wholesale sales price" of tobacco products. RCW 82.26.020. The "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). A "manufacturer" is "a person who manufactures and sells tobacco products." RCW 86.26.010(2). A "distributor" includes: "any person engaged in the business of selling tobacco products in [Washington] who brings, or causes to be brought, into this state from without the **656 state any tobacco products for sale." [FN7] RCW 82.26.010(3)(a). The statute makes no distinction between affiliated and nonaffiliated entities. It defines "person" as "any individual ... firm, copartnership, joint venture, club, company, joint stock company ... limited liability company, association, society, or any group of individuals acting as a unit." [FN8] RCW 82.04.030; *see also* WAC 458-20-203. [FN9] Under these definitions, *938 Tobacco Manufacturing is the manufacturer [FN10] and Tobacco Sales is the taxable distributor. [FN11]

FN7. The full definition includes:

(a) any person engaged in the business of selling tobacco products in [Washington] who brings, or causes to be brought, into this state from without the state any tobacco products for sale, (b) any person who makes, manufactures, or fabricates tobacco products in this state for sale in this state, (c) any person engaged in the business of selling tobacco products without this state who ships or transports tobacco products to retailers in this state, to be sold by those retailers. RCW 82.26.010(3).

FN8. Although "person" is not defined in the OTP tax chapter, the term is used throughout the tax code and is defined in RCW 82.04.030

FN9. For Washington tax purposes, "Each separately organized corporation is a 'person' within the meaning of the law, notwithstanding its affiliation with or relation to any other corporation through stock ownership by a parent corporation by the same group of individuals." WAC 458-20-203

FN10. The Department argues that Tobacco Manufacturing does not meet the statutory definition of "manufacturer" because Tobacco Manufacturing relies upon USTC for telemarketing services and UST Inc. for certain administrative functions. But Tobacco Manufacturing pays an arm's length price for these services. The Department presents no authority or argument to support its conclusion that manufacturers who contract with other entities for services are thereby excluded from the statutory definition of "manufacturer."

FN11. After instructing Tobacco Sales to pay OTP tax on its sales as well as its samples in the course of the 1996 audit, the Department reversed its position. The Department now claims that Tobacco Sales is not the taxpayer with regard to products it sells to Washington wholesalers. But the Department agrees that Tobacco Sales is the "distributor" of the free samples it distributes in Washington, and only the tax paid on the samples is at issue in this case.

2. Statutory Interpretation

[1][2][3][4][5] Statutory interpretation is a question of law that the appellate court reviews de novo. *Monroe*

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v. Soliz, 132 Wash.2d 414, 418, 939 P.2d 205 (1997); *American Legion Post No. 32 v. City of Walla Walla*, 116 Wash.2d 1, 5, 802 P.2d 784 (1991). The court's fundamental duty is to ascertain and to carry out the Legislature's intent. *State v. Chester*, 133 Wash.2d 15, 21, 940 P.2d 1374 (1997). Legislative intent is derived primarily from the language of the statute. *State v. Michielli*, 132 Wash.2d 229, 237, 937 P.2d 587 (1997). If a statute is plain and unambiguous, its meaning must be derived solely from the statutory language. *Harmon v. Department of Soc. and Health Servs.*, 134 Wash.2d 523, 530, 951 P.2d 770 (1998) (citing *State v. Mollich*, 132 Wash.2d 80, 87, 936 P.2d 408 (1997); *Marquis v. City of Spokane*, 130 Wash.2d 97, 107, 922 P.2d 43 (1996)). A statute is ambiguous if it is susceptible of two or more reasonable interpretations. *State v. Van Woerden*, 93 Wash.App. 110, 116, 967 P.2d 14 (1998) (citing *State v. Sunich*, 76 Wash.App. 202, 206, 884 P.2d 1 (1994)), *review denied*, 137 Wash.2d 1039, 980 P.2d 1286 (1999).

[6][7] The OTP tax statute is not ambiguous; it uses plain language and defines key terms. Therefore, this court must determine the Legislature's intent from the words alone. [FN12] *939 *See Waste Management of Seattle, **657 Inc. v. Utilities and Transp. Comm'n*, 123 Wash.2d 621, 629, 869 P.2d 1034 (1994).

FN12. The Department argues that its "longstanding interpretation" of the OTP tax measure is entitled to deference by the court. But courts defer to agency interpretations only when statutory language is ambiguous. *Western Telepage, Inc. v. City of Tacoma*, 95 Wash.App. 140, 974 P.2d 1270, 1274 (1999) (citing *Simpson Inv. Co. v. Department of Revenue*, 92 Wash.App. 905, 913, 965 P.2d 654 (1998), *review granted*, 137 Wash.2d 1032, 980 P.2d 1284 (1999); *Waste Management of Seattle, Inc. v. Utilities and Transp. Comm'n*, 123 Wash.2d 621, 627-28, 869 P.2d 1034 (1994)). Also, the Department submits no evidence that its current position amounts to a "longstanding interpretation." From the record, it appears that, until 1996, Tobacco Sales voluntarily paid the OTP tax based upon its selling price, without having been instructed by the Department to do so. *See Western Telepage*, 974 P.2d at 1273-74. Moreover, an administrative interpretation that conflicts with the statutory language is not entitled to deference. *Senate Republican Campaign Comm. v. Public Disclosure Comm'n*, 133 Wash.2d 229, 241, 943 P.2d 1358 (1997).

a. Discount or Other Reduction

[8][9] In determining what a statute means, words should be ascribed their plain and ordinary meanings. *North Coast Air Servs., Ltd. v. Grumman Corp.*, 111 Wash.2d 315, 321, 759 P.2d 405 (1988). When a statute does not define a nontechnical word, the court may look to the dictionary for guidance. *State v. Myers*, 133 Wash.2d 26, 33, 941 P.2d 1102 (1997) (citing *State v. Pacheco*, 125 Wash.2d 150, 154, 882 P.2d 183 (1994)). According to Webster's dictionary, "discount" means "an abatement or reduction made from the gross amount or value of anything"; and "a reduction from a price made to a specific customer or class of customers." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 646 (1969). "Reduction" means "a decrease in size, amount, extent, or number." *Id.* at 1905. The meaning of these words relies upon comparison with an objective, fixed value, in this case, the manufacturer's "established price."

b. Established Price

[10] Webster's dictionary defines "to establish" as "to make firm or stable: fix to prevent or check unsteadiness"; and "to place, install, or set up in a permanent or relatively enduring position." *Id.* at 778. A "fixed price" is "a uniform price for all customers." *Id.* at 861. Thus, a manufacturer's established price is a generally available, stable, fixed price, *940 such as a list price or invoice price. [FN13] Because an "established price" is available to all customers, it reflects the fair market value of the products. [FN14] "Fair market value" is the amount a willing buyer would pay a seller who is willing but not obligated to sell. *Crystal Chalets Ass'n v. Pierce County*, 93 Wash.App. 70, 77, 966 P.2d 424 (1998) (citing *Duwamish Warehouse Co. v. Hoppe*, 102 Wash.2d 249, 254, 684 P.2d 703, 57 A.L.R.4th 939 (1984)). In the case of affiliated companies, which, in effect, are obligated to buy and sell from each other, the "established price" must be based upon fair market value rather than the manufacturer's price to its affiliate.

FN13. Other state statutes similar to Washington's are in accordance with our interpretation. *See Ark.Code Ann. § 26-57-208(2)* ("manufacturer's selling price" is "actual manufacturer invoice price before discounts"); *Colo.Rev.Stat. § 39-28.5-101* ("[m]anufacturer's list price" means "the invoice price ... exclusive of any discount or other reduction"); *35 Ill. Comp. Stat. § 143-10-5* (" 'Wholesale price' means the established list price for which a manufacturer

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sells tobacco products ... [or] the manufacturer's invoice price ... to unaffiliated distributors..."); Ohio Rev.Code Ann. § 5743.01(K) (" 'Wholesale price' means the invoice price ... to unaffiliated distributors").

FN14. Cf. Conn. Gen.Stat. § 12-330a (" '[W]holesale sales price' [of tobacco products is] the price set for such products or, if no price has been set, the wholesale value of such products..."); *MAPCO Alaska Petroleum, Inc. v. United States*, 27 Fed. Cl. 405, 410 (1992) ("established price," as used in Federal Acquisition Regulation § 52.216-2, means "a price that ... is an established catalog or market price for a commercial item sold in substantial quantities to the general public."), *dismissed by* No. 94-5068, 1994 WL 745571 (Fed.Cir. Apr.8, 1994).

c. Components of the Manufacturer's Price

The Department argues that because Tobacco Manufacturing and Tobacco Sales are affiliated, the "established price" should include both entities' costs and profits, i.e., manufacturing and marketing costs. [FN15] But neither the statute nor case law provides a basis for ignoring the entities' corporate structure. See RCW 82.04.030; WAC 458-20-203; *Rena-Ware Distributors, Inc. v. State*, 77 Wash.2d 514, 517-18, 463 P.2d 622 (1970) (wholly-owned subsidiaries are separate entities for purposes of taxing statutes); *Washington *941 Sav-Mor Oil Co. v. Tax Comm'n*, 58 Wash.2d 518, 364 P.2d 440 (1961) (transactions between oil company and affiliated distributor are treated as sales between separate corporations for tax purposes).

FN15. Prior to the 1990 reorganization, USTC both manufactured and marketing its tobacco products. The tax base at that time was therefore substantially larger than after the reorganization.

****658** [11] The statute imposes the tax upon the value of a manufacturer's products, measured at the time the manufacturer sells the products. This price will reflect the quality, quantity, packaging, and trademark value of the products as provided by the manufacturer. At a minimum, this price must include the costs and profits associated with manufacturing and sales, because those functions are mandated by the statutory definition of "manufacturer." RCW 82.26.010(2). But it need not include value that is added to the products after the manufacturer sells them. Under this definition, the OTP tax will be higher on products that are extensively

marketed by their manufacturer than on products that a manufacturer sells generically. But the statute permits this disparity, and the court may not alter the statutory language. [FN16] See *King County v. City of Seattle*, 70 Wash.2d 988, 991, 425 P.2d 887 (1967) (courts are not to read into statutes matters that are not there, nor modify statutes by construction).

FN16. Other states have avoided this problem by taxing tobacco products by weight or item. See, e.g., Ala.Code § 40-25-2; Ariz.Rev.Stat. § 42-3052(6); see also Fla. Stat. ch. 210.30 (tobacco products tax imposed upon consumers); N.J.Rev.Stat. § 54:40B-3 (tax imposed upon retailers or consumers).

C. Summary Judgment

1. Order Granting Summary Judgment

[12] Before the court below, both parties argued that disposition of their summary judgment motions entailed resolution of a legal issue, the statutory measure of the OTP tax. The trial court agreed, basing its ruling that Tobacco Manufacturing's price is "discounted" upon its interpretation of the statutory definition as excluding prices between affiliates. The trial court's analysis was in error. Whether a price is discounted is a factual determination and is evaluated without regard to the purchaser's corporate affiliation.

[13] As discussed above, the statutory measure of the OTP *942 tax is the manufacturer's list or invoice price; i.e., the fair market value of the products. Here, because Tobacco Manufacturing sells exclusively to an affiliate, its selling price does not necessarily reflect fair market value. Therefore to determine whether Tobacco Manufacturing's price is discounted, the trier of fact must compare Tobacco Manufacturing's price with the fair market value of its products.

In support of its position that its purchase price from Tobacco Manufacturing is fair market value, Tobacco Sales submitted a transfer pricing study performed by an accounting firm, Ernst & Young, in 1995. The study was commissioned to determine, for federal tax purposes, arm's length prices for products and services transferred between various UST Inc. subsidiaries. [FN17] The study concluded that Tobacco Manufacturing's price is an arm's length price under federal law.

FN17. The study adhered to the regulations promulgated by the IRS pursuant to IRC § 482, which governs intercompany transfers.

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See 26 C.F.R. § 1.482-1. The regulations require that arm's length prices be charged for such transactions. 26 C.F.R. § 1.482-1(b). A price is arm's length if "the results of the transaction are consistent with the results that would have been realized if [unaffiliated] taxpayers had engaged in the same transaction under the same circumstances." 26 C.F.R. § 1.482-1(b).

The Department failed to submit any evidence of fair market value or pricing comparisons. Rather, the Department contended that a transfer price between affiliated companies cannot represent a market price. It attacked the Ernst & Young study as irrelevant because it was performed for federal income tax purposes and because the arm's length price was derived from a formula rather than set by market forces. [FN18] But the Department failed to identify in what respect the federal arm's-length-price standard differs from fair market value. The Department argued that a "common sense" construction of the statute is that the **659 *943 "wholesale sales price" is the wholesale price paid by a nonaffiliated Washington customer.

FN18. The transfer pricing regulations set forth specific methods for calculating the most accurate arm's-length-price for various transactions. *See* 26 C.F.R. § 1.482-1 to -7. Because Ernst & Young concluded that there are no tobacco products manufacturers similar to Tobacco Manufacturing, it relied on the alternate methods provided in the regulations. *See* 26 C.F.R. § 1.482-3 to -7.

[14][15][16][17] The Department's position is contrary to the statutory language, which refers to the manufacturer's price. Tobacco Sales is not a manufacturer. And the law does not permit the Department to disregard Tobacco Sales' and Tobacco Manufacturing's separate corporate identities and treat them as one entity for tax purposes. [FN19] That a pricing study is undertaken in the context of federal income tax does not preclude its relevance in determining fair market value for Washington tax purposes. Likewise, that a profit-sharing formula is used or that a transaction occurs between affiliated entities is not determinative of whether a transfer price is a market price. The pertinent inquiry is what is the fair market value, not how it is determined, for what

purpose, or by whom.

FN19. Corporate forms may be set aside only in cases of fraud. *Rena-Ware Distributors, Inc.*, 77 Wash.2d at 518, 463 P.2d 622 (citing *Associated Oil Co. v. Seiberling Rubber Co.*, 172 Wash. 204, 19 P.2d 940 (1933)). This safeguard will prevent the "[t]ax anarchy" the Department suggests would result from "allow[ing Tobacco Sales] to set its own tax bill." Furthermore, if Tobacco Manufacturing were to sell to Tobacco Sales at below-market rates, the Department could contest the sale price as not meeting the definition of "established price" under the statute.

[18] The trial court determined that Tobacco Sales' purchase price is a reduced price because: Tobacco Manufacturing's price is set using a calculation that takes each entity's profit margins into account, and the price is set after the transaction between Tobacco Manufacturing and Tobacco Sales; [FN20] the Ernst & Young study is not relevant because it deals with federal income tax; and, the Department's interpretation is entitled to deference. These factors do not resolve the question of what is the fair market value of Tobacco Manufacturing's products. Therefore, summary judgment in favor of the Department was not appropriate.

FN20. The price is actually set at the beginning of each year.

2. Order Denying Summary Judgment

Tobacco Sales also challenges the denial of its motion for summary judgment. Because disposition of this case entails *944 a disputed factual issue, the trial court was correct in denying the motion.

The order granting summary judgment in favor of the Department is reversed, the order denying summary judgment in favor of Tobacco Sales is affirmed, and the case is remanded for further proceedings consistent with this opinion.

ARMSTRONG, A.C.J., and HUNT, J., concur.

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HONORABLE GARY R. TABOR

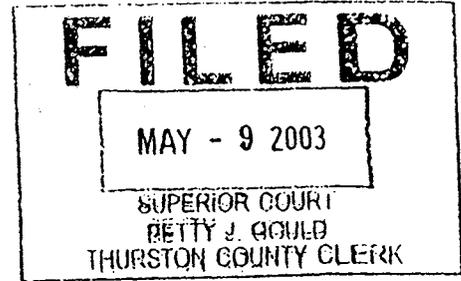
EXPEDITE (if filing within 5 court days of hearing)

Hearing is set:

Date: May 9, 2003

Time: 9:00 a.m.

Judge/Calendar Tabor / Civil



SUPERIOR COURT OF WASHINGTON FOR THURSTON COUNTY

UNITED STATES TOBACCO SALES &
MARKETING COMPANY INC.,

Plaintiff,

v.

STATE OF WASHINGTON, DEPARTMENT OF
REVENUE,

Defendant.

No. 97-2-00883-0

**FINDINGS OF FACT AND
CONCLUSIONS OF LAW**

I. FINDINGS OF FACT

1. The tax period at issue in this case is 1992 and, except as otherwise specifically provided, all facts found by the Court are as of that time period.

2. Plaintiff, U.S. Smokeless Tobacco Brands Inc., known in 1992 as United States Tobacco Sales and Marketing Company Inc. (Tobacco Sales), is a wholly owned subsidiary of U.S. Smokeless Tobacco Company, known in 1992 as United States Tobacco Company

FINDINGS OF FACT AND CONCLUSIONS OF LAW - 1

GARVEY SCHUBERT BARER
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1 (USTC). U.S. Smokeless Tobacco Company is a wholly owned subsidiary of UST Inc., as
2 was its predecessor USTC.¹

3 3. United States Tobacco Manufacturing Company Inc. (Tobacco Manufacturing) is a
4 wholly owned subsidiary of USTC.² Tobacco Manufacturing produces smokeless tobacco
5 products that are sold under a variety of brand names, primarily Copenhagen and Skoal.

6 4. Prior to 1990, USTC performed all functions relating to the manufacturing, sale and
7 marketing of its smokeless tobacco products which it sold directly to unaffiliated customers.
8 USTC reorganized in 1990 (hereinafter the 1990 Restructuring), creating Tobacco
9 Manufacturing and Tobacco Sales as wholly owned subsidiaries to perform the
10 manufacturing and sales and marketing functions previously performed by USTC.

11 5. After the 1990 Restructuring, USTC became a holding company for Tobacco Sales
12 and Tobacco Manufacturing which conduct the domestic tobacco business of the UST group
13 of corporations. It provides general administration and management services for its own
14 subsidiaries, including corporate purchasing, telemarketing activities and administration for
15 research and development activities. USTC receives a service fee from its subsidiaries for
16 services provided on their behalf.

17 6. Tobacco Manufacturing manufactures smokeless tobacco products, which are sold
18 only to other affiliated corporations, including Tobacco Sales.

19 7. Tobacco Manufacturing owns and operates manufacturing facilities at Hopkinsville,
20 Kentucky, Franklin Park, Illinois, and Nashville, Tennessee.

21 ¹ Plaintiff changed its name to U.S. Smokeless Tobacco Brands Inc. effective January 2001.

22 ² During 1999 Tobacco Manufacturing changed its structure to operate in limited partnership form and is
currently known as U.S. Smokeless Tobacco Manufacturing Limited Partnership.

1 8. Tobacco Manufacturing employs approximately 700 people in various departments
2 including tobacco leaf purchasing, manufacturing (both tobacco products and packaging),
3 engineering, quality control/quality assurance, and research and development.

4 9. Tobacco Sales engages in the business of marketing and selling the smokeless
5 tobacco products that it purchases from Tobacco Manufacturing. Tobacco Sales sells its
6 smokeless tobacco products primarily to licensed distributors who sell the product to
7 retailers.

8 10. Tobacco Sales has its principal place of business in Greenwich, Connecticut, with
9 five regional sales offices and several field office locations. Tobacco Sales employs
10 approximately 600 people, mostly in activities related to sales of smokeless tobacco
11 products and the balance in marketing such products.

12 11. Prior to the 1990 Restructuring the President of USTC, along with his senior
13 management responsible for areas such as sales, marketing and financial functions,
14 determined the price charged for its smokeless tobacco products.

15 12. After the 1990 Restructuring, senior management at Tobacco Sales responsible for
16 sales and marketing, along with senior management responsible for financial functions, have
17 determined the price charged for its smokeless tobacco products.

18 13. The price for the smokeless tobacco product sold by Tobacco Manufacturing to
19 Tobacco Sales, commonly referred to as the transfer price, is based upon a formula.

20 14. Tobacco Sales sells its smokeless tobacco products at prices higher than the prices at
21 which it purchases them from Tobacco Manufacturing.

22 15. Tobacco Manufacturing serves as Tobacco Sales' agent for the purpose of arranging
shipment of the smokeless tobacco products to Tobacco Sales' unaffiliated customers/
distributors. The bills of lading indicate this agency relationship between the two companies
with respect to the shipments.

1 16. The price and terms for each order of smokeless tobacco products by an unaffiliated
2 customer/distributor are agreed to by the unaffiliated customer/distributor prior to shipment
3 of the product.

4 17. Tobacco Sales bears the cost of shipping and risk of loss for its sales to unaffiliated
5 customers/distributors. As to each individual order shipped to an unaffiliated
6 customer/distributor, title transfers from Tobacco Manufacturing to Tobacco Sales when the
7 products are placed in the delivery vehicle at Tobacco Manufacturing's factory. Title is
8 transferred from Tobacco Sales to the unaffiliated customer/distributor when the products
9 are delivered to the customer's warehouse or distribution facilities in Washington.

10 18. Tobacco Sales advertises and promotes its smokeless tobacco products through
11 advertising and distribution of samples to adult consumers at promotional events such as
12 rodeos, auto races, and fishing tournaments. Tobacco Sales also organizes and coordinates
13 promotional activities for new product roll out and special promotions.

14 19. Tobacco Manufacturing's 1992 transfer price to Tobacco Sales for the smokeless
15 tobacco products at issue in this case was \$.625 per can.

16 20. Tobacco Sales' 1992 selling price to unaffiliated customers/distributors for the
17 smokeless tobacco products at issue in this case, exclusive of discounts and other reductions,
18 averaged \$1.43 per can.

19 21. For the samples of smokeless tobacco products that Tobacco Sales distributed in
20 1992, the OTP tax that Tobacco Sales paid was calculated based on Tobacco Sales' selling
21 price to unaffiliated customers/distributors (\$1.43 per can). Tobacco Sales paid OTP tax of
22 \$160,553 on these samples.

23 22. The 1992 fair market value for Tobacco Manufacturing's sales of smokeless tobacco
24 products to Tobacco Sales was \$.82/can.

1 23. Neither Tobacco Sales' nor Tobacco Manufacturer's 1992 selling price represents
2 the fair market value of the smokeless tobacco products sold by Tobacco Manufacturing to
3 Tobacco Sales. Tobacco Manufacturing's selling price was a discounted price as compared
4 to the fair market value price (\$.82) for those sales.

5 24. Tobacco Sales paid excessive OTP tax in the amount of \$68,488.

6
7 **II. CONCLUSIONS OF LAW**

- 8 1. The issue before the Court on remand from *U.S. Tobacco Sales v. Dep't of Revenue*, 96
9 Wn. App. 932, 982 P.2d 652 (1999) is whether the price for sales of smokeless tobacco
10 products by Tobacco Manufacturing to Tobacco Sales during 1992 was a fair market
11 value price.
- 12 2. "Fair market value is the amount a willing buyer would pay a seller who is willing but
13 not obligated to sell." *U.S. Tobacco Sales*, 96 Wn. App. at 940.
- 14 3. To determine whether Tobacco Manufacturing's selling price was a fair market value
15 price, that price must be compared to the market price at which a tobacco products
16 manufacturer would sell OTP to an unaffiliated distributor, where the parties otherwise
17 hold the same property interests, bear the same risks and performed the same functions
18 as do Tobacco Manufacturing and Tobacco Sales.
- 19 4. The transfer price of \$.625 does not reflect a fair market value price because Tobacco
20 Manufacturing would not willingly sell to an unaffiliated buyer at that price.
- 21 5. Plaintiff is entitled to a refund of OTP taxes for the difference between the price on
22 which the OTP tax was paid (\$1.43/can) and the fair market value of the OTP for sales
by Tobacco Manufacturing (\$.82/can).

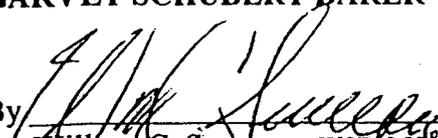
1 6. Plaintiff is entitled to an award of interest and taxable costs as provided by
2 RCW 82.32.060.

3 DONE IN OPEN COURT this 9th day of May 2007.

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5 
6 HON. GARY R. TABOR, JUDGE

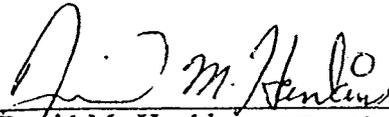
7 PRESENTED BY:

8 **GARVEY SCHUBERT BARER**

9 By 
10 William C. Severson, WSN 5846
11 Norman J. Bruns, WSN 16234
Attorneys for Plaintiff

12 APPROVED AS TO FORM; NOTICE OF PRESENTATION WAIVED:

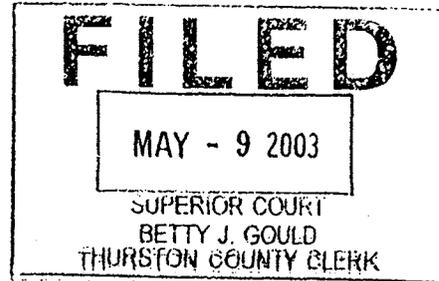
13 **CHRISTINE O. GREGIORE**
14 **ATTORNEY GENERAL**

15 By 
16 David M. Hankins, WSN 19194
Assistant Attorney General
Attorneys for Defendant

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1 EXPEDITE
2 Hearing is set:
3 Date: May 9, 2003
4 Time: 9:00 a.m.
5 Judge/Calendar: Tabor / Civil

HONORABLE GARY R. TABOR



7 **IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON**
8 **IN AND FOR THE COUNTY OF THURSTON**

9
10 UNITED STATES TOBACCO SALES
AND MARKETING COMPANY INC.,

No. 97-2-00883-0

11 Plaintiff,

**CORRECTED STIPULATION
OF FACTS**

12 v.

13 WASHINGTON STATE
14 DEPARTMENT OF REVENUE,

15 Defendant.

16
17 This Corrected Stipulation of Facts corrects an error in paragraph 20 of the original
18 stipulation that was signed and entered on January 21, 2003. The corrected fact is that the
19 amount of OTP tax paid by Tobacco Sales for OTP distributed in 1992 was \$160,553 not
\$247,385.

20 **I. STIPULATED FACTS**

21
22 1. This Stipulation of Facts applies to the 1992 tax year at issue in this case. Except as
23 otherwise indicated, the stipulated facts are those that existed at that time.

24 2. Plaintiff, U.S. Smokeless Tobacco Brands Inc., known in 1992 as United States
25 Tobacco Sales and Marketing Company Inc. (Tobacco Sales), is a wholly owned subsidiary of

CORRECTED STIPULATION OF FACTS - 1

GARVEY SCHUBERT BARER
1191 SECOND AVENUE, 18TH FLOOR
SEATTLE, WA 98101-2939
(206) 464-3939

APPENDIX 4

1 U.S. Smokeless Tobacco Company, known in 1992 as United States Tobacco Company
2 (USTC). USTC was a wholly owned subsidiary of UST Inc.¹

3 3. United States Tobacco Manufacturing Company Inc. (Tobacco Manufacturing) is a
4 wholly owned subsidiary of USTC.² Tobacco Manufacturing produces smokeless tobacco
5 products that are sold under a variety of brand names, primarily Copenhagen and Skoal. Prior
6 to 1990, USTC performed all functions relating to the manufacturing, sale and marketing of its
7 smokeless tobacco products which it sold directly to customers. USTC reorganized in 1990
8 (hereinafter the 1990 Restructuring), creating Tobacco Manufacturing and Tobacco Sales as
9 wholly owned subsidiaries to perform the manufacturing and sales and marketing functions
10 previously performed by USTC.

11 4. Since the 1990 Restructuring, USTC has been a holding company for Tobacco Sales
12 and Tobacco Manufacturing which conduct the domestic tobacco business of the UST group of
13 corporations. It provides general administration and management services for its own
14 subsidiaries, including corporate purchasing, telemarketing activities and administration for
15 research and development activities. USTC receives a service fee from its subsidiaries for
16 services provided on their behalf.

17 5. Tobacco Manufacturing manufactures smokeless tobacco products, which are sold only
18 to other affiliated corporations, including Tobacco Sales.

19 6. Tobacco Manufacturing owns and operates manufacturing facilities at Hopkinsville,
20 Kentucky, Franklin Park, Illinois, and Nashville, Tennessee.

21 7. Tobacco Manufacturing employs approximately 700 people in various departments
22 including tobacco leaf purchasing, manufacturing (both tobacco products and packaging),
23 engineering, quality control/quality assurance, and research and development.

24 ¹ Plaintiff changed its name to U.S. Smokeless Tobacco Brands Inc. effective January 2001.

25 ² During 1999, Tobacco Manufacturing changed its structure to operate in limited partnership form and is currently known as U.S. Smokeless Tobacco Manufacturing Limited Partnership.

- 1 8. Tobacco Sales engages in the business of marketing and selling the smokeless tobacco
2 products that it purchases from Tobacco Manufacturing. Tobacco Sales sells its smokeless
3 tobacco products primarily to licensed distributors who sell the product to retailers.
- 4 9. Tobacco Sales has its principal place of business in Greenwich, Connecticut, with five
5 regional sales offices and several field office locations. Tobacco Sales employs approximately
6 600 people, mostly in activities related to sales of smokeless tobacco products and the balance
7 in marketing such products.
- 8 10. Prior to the 1990 Restructuring the President of USTC, along with his senior
9 management responsible for areas such as sales, marketing and financial functions, determined
10 the price charged for its smokeless tobacco products.
- 11 11. After the 1990 Restructuring, senior management at Tobacco Sales responsible for
12 sales and marketing, along with senior management responsible for financial functions, have
13 determined the price charged for its smokeless tobacco products.
- 14 12. The price for the smokeless tobacco product sold by Tobacco Manufacturing to
15 Tobacco Sales, commonly referred to as the transfer price, is based upon a formula.
- 16 13. Tobacco Sales sells its smokeless tobacco products at prices higher than the prices at
17 which it purchases them from Tobacco Manufacturing.
- 18 14. Tobacco Manufacturing serves as Tobacco Sales' agent for the purpose of arranging
19 shipment of the smokeless tobacco products to Tobacco Sales' unaffiliated customers/
20 distributors. The bills of lading indicate this agency relationship between the two companies
21 with respect to the shipments.
- 22 15. The price and terms for each order of smokeless tobacco products by an unaffiliated
23 customer/ distributor are agreed to by the unaffiliated customer/distributor prior to shipment of
24 the product.
25

1 16. Tobacco Sales bears the cost of shipping and risk of loss for its sales to unaffiliated
2 customers/distributors. As to each individual order shipped to an unaffiliated
3 customer/distributor, title transfers from Tobacco Manufacturing to Tobacco Sales when the
4 products are placed in the delivery vehicle at Tobacco Manufacturing's factory. Title is
5 transferred from Tobacco Sales to the unaffiliated customer/distributor when the products are
6 delivered to the customer's warehouse or distribution facilities in Washington.

7 17. Tobacco Sales advertises and promotes its smokeless tobacco products through
8 advertising and distribution of samples to adult consumers at promotional events such as
9 rodeos, auto races, and fishing tournaments. Tobacco Sales also organizes and coordinates
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11 18. Tobacco Manufacturing's 1992 transfer price to Tobacco Sales for the smokeless
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13 19. Tobacco Sales' 1992 selling price to unaffiliated customers/distributors for the
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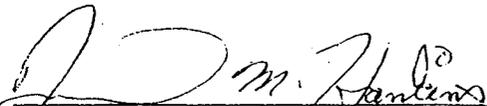
16 20. The total amount of OTP tax paid by Tobacco Sales for smokeless tobacco products
17 distributed as samples in 1992 was \$160,553. This tax amount was calculated based on
18 Tobacco Sales' selling price to unaffiliated customers/distributors.

19 DATED this 9th day of May, 2003.

20 GARVEY SCHUBERT BARER

CHRISTINE O. GREGOIRE
ATTORNEY GENERAL

21
22
23 
24 WILLIAM C. SEVERSON, WSBA #5816
Attorneys for Plaintiff

25 
DAVID M. HANKINS, WSBA # 19194
Assistant Attorney General
Attorneys for Defendant

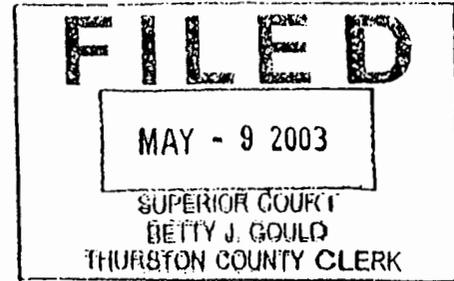
EXPEDITE (if filing within 5 court days of hearing)

Hearing is set:

Date: May 9, 2003

Time: 9:00 a.m.

Judge/Calendar Tabor / Civil



SUPERIOR COURT OF WASHINGTON FOR THURSTON COUNTY

UNITED STATES TOBACCO SALES AND
MARKETING COMPANY INC.,

Plaintiff,

v.

STATE OF WASHINGTON, DEPARTMENT OF
REVENUE,

Defendant.

No. 97-2-00883-0

JUDGMENT

CLERK'S ACTION REQUIRED

JUDGMENT SUMMARY

1. Judgment Creditor	<u>U.S. Smokeless Tobacco Brands Inc.</u> (formerly United States Tobacco Sales and Marketing Company Inc.)
2. Attorney for Judgment Creditor	<u>William C. Severson</u>
3. Judgment Debtor	<u>State of Washington Department of Revenue</u>
4. Judgment Amount (principal only).....	\$ <u>68,488.00</u>
5. Interest to Date of Judgment.....	\$ <u>46,412.00</u>
6. Taxable Costs & Attorney Fees	
Service of Process.....	\$ <u>162.50</u>
Filing Fee.....	\$ <u>110.00</u>
Statutory Attorney Fee	\$ <u>125.00</u>
Total Taxable Costs and Fees	\$ <u>397.50</u>
Total.....	\$ <u>115,297.50</u>

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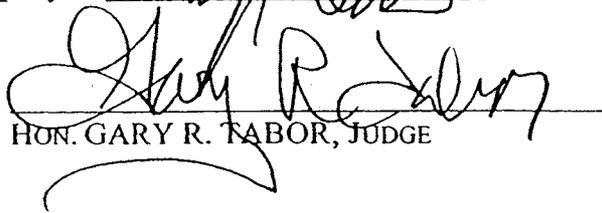
JUDGMENT

THIS MATTER having come on for trial on January 21 through January 23, 2003 before the Honorable Gary R. Tabor, sitting without jury, and the Court having previously entered Findings of Fact and Conclusions of Law; NOW, THEREFORE,

IT IS HEREBY ORDERED that judgment be entered for plaintiff, U. S. Smokeless Tobacco Brands Inc. (previously known as United States Tobacco Sales and Marketing Company Inc.) and against defendant, State of Washington Department of Revenue, in the principal amount of \$68,488, plus interest to the date of judgment in the additional amount of \$46,412, plus taxable costs in the amount of \$397.50.

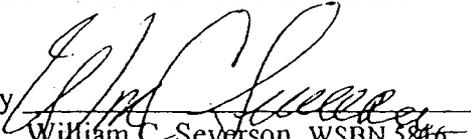
DONE IN OPEN COURT this

9th day of May 2003


HON. GARY R. TABOR, JUDGE

PRESENTED BY:

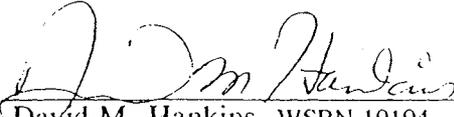
GARVEY SCHUBERT BARER

By 

~~William C. Severson, WSN 5816~~
Norman J. Bruns, WSN 16234
Attorneys for Plaintiff

APPROVED AS TO FORM; NOTICE OF PRESENTATION WAIVED:

CHRISTINE O. GREGIORE
ATTORNEY GENERAL

By 

David M. Hankins, WSN 19194
Assistant Attorney General
Attorneys for Defendant

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FILED
SUPERIOR COURT ATTORNEY GENERAL HONORABLE GARY R. TABOR
THURSTON COUNTY WASH REVENUE DIVISION

EXPEDITE (if filing within 5 court days of hearing)
 Hearing is set:
Date: May 9, 2003 ~~08~~ **MAY -9** A9:16
Time: 9:00 a.m.
Judge/Calendar Tabor / Civil
BETTY J. GOULD CLERK
BY _____ DEPUTY

FILED
MAY 9 2003
SUPERIOR COURT
BETTY J. GOULD
THURSTON COUNTY CLERK

SUPERIOR COURT OF WASHINGTON FOR THURSTON COUNTY

UNITED STATES TOBACCO SALES AND
MARKETING COMPANY INC.,

Plaintiff,

v.

STATE OF WASHINGTON, DEPARTMENT OF
REVENUE,

Defendant.

No. 97-2-00883-0

JUDGMENT

CLERK'S ACTION REQUIRED

JUDGMENT SUMMARY

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Statutory Attorney Fee	\$ <u>125.00</u>
Total Taxable Costs and Fees.....	\$ <u>397.50</u>
Total.....	\$ <u>115,297.50</u>

JUDGMENT - I

GARVEY SCHUBERT BARER
1191 SECOND AVENUE, 18TH FLOOR
SEATTLE, WA 98101-2939
(206) 464-3939

03-9-00434-3

Copy to
A.G. office

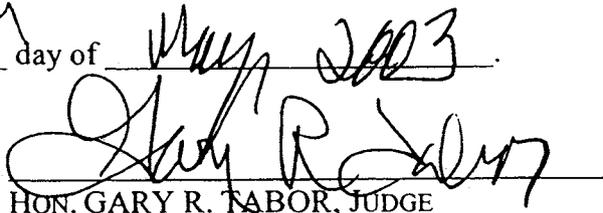
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JUDGMENT

THIS MATTER having come on for trial on January 21 through January 23, 2003 before the Honorable Gary R. Tabor, sitting without jury, and the Court having previously entered Findings of Fact and Conclusions of Law; **NOW, THEREFORE,**

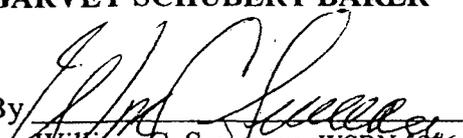
IT IS HEREBY ORDERED that judgment be entered for plaintiff, U. S. Smokeless Tobacco Brands Inc. (previously known as United States Tobacco Sales and Marketing Company Inc.) and against defendant, State of Washington Department of Revenue, in the principal amount of \$68,488, plus interest to the date of judgment in the additional amount of \$46,412, plus taxable costs in the amount of \$397.50.

DONE IN OPEN COURT this 9th day of May 2003.


HON. GARY R. TABOR, JUDGE

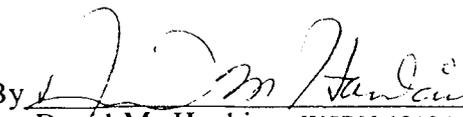
PRESENTED BY:

GARVEY SCHUBERT BARER

By 
William C. Severson, WSNB 5846
Norman J. Bruns, WSNB 16234
Attorneys for Plaintiff

APPROVED AS TO FORM; NOTICE OF PRESENTATION WAIVED:

CHRISTINE O. GREGIORE
ATTORNEY GENERAL

By 
David M. Hankins, WSNB 19194
Assistant Attorney General
Attorneys for Defendant

82.26.010 Definitions. As used in this chapter:

Old

(1) "Tobacco products" means cigars, cheroots, stogies, periques, granulated, plug cut, crimp cut, ready rubbed, and other smoking tobacco, snuff, snuff flour, cavendish, plug and twist tobacco, fine-cut and other chewing tobaccos, shorts, refuse scraps, clippings, cuttings and sweepings of tobacco, and other kinds and forms of tobacco, prepared in such manner as to be suitable for chewing or smoking in a pipe or otherwise, or both for chewing and smoking, but shall not include cigarettes as defined in RCW 82.24.010;

(2) "Manufacturer" means a person who manufactures and sells tobacco products;

(3) "Distributor" means (a) any person engaged in the business of selling tobacco products in this state who brings, or causes to be brought, into this state from without the state any tobacco products for sale, (b) any person who makes, manufactures, or fabricates tobacco products in this state for sale in this state, (c) any person engaged in the business of selling tobacco products without this state who ships or transports tobacco products to retailers in this state, to be sold by those retailers, (d) any person engaged in the business of selling tobacco products in this state who handles for sale any tobacco products that are within this state but upon which tax has not been imposed;

(4) "Subjobber" means any person, other than a manufacturer or distributor, who buys tobacco products from a distributor and sells them to persons other than the ultimate consumers;

(5) "Retailer" means any person engaged in the business of selling tobacco products to ultimate consumers;

(6) "Sale" means any transfer, exchange, or barter, in any manner or by any means whatsoever, for a consideration, and includes and means all sales made by any person. It includes a gift by a person engaged in the business of selling tobacco products, for advertising, as a means of evading the provisions of this chapter, or for any other purposes whatsoever;

(7) "Wholesale sales price" means the established price for which a manufacturer sells a tobacco product to a distributor, exclusive of any discount or other reduction;

(8) "Business" means any trade, occupation, activity, or enterprise engaged in for the purpose of selling or distributing tobacco products in this state;

(9) "Place of business" means any place where tobacco products are sold or where tobacco products are manufactured, stored, or kept for the purpose of sale or consumption, including any vessel, vehicle, airplane, train, or vending machine;

(10) "Retail outlet" means each place of business from which tobacco products are sold to consumers;

(11) "Department" means the state department of revenue;

(12) "Person" means any individual, receiver, administrator, executor, assignee, trustee in bankruptcy, trust, estate, firm, copartnership, joint venture, club, company, joint stock company, business trust, municipal corporation, the state and its departments and institutions, political subdivision of the state of Washington, corporation, limited liability company, association, society, or any group of individuals acting as a unit, whether mutual, cooperative, fraternal, nonprofit, or otherwise. The term excludes any person immune from state taxation, including the United States or its instrumentalities, and federally recognized Indian tribes and enrolled tribal members, conducting business within Indian country;

(13) "Indian country" means the same as defined in chapter 82.24 RCW. [2002 c 325 § 1; 1995 c 278 § 16; 1975 1st ex.s. c 278 § 70; 1961 c 15 § 82.26.010. Prior: 1959 ex.s. c 5 § 11.]

82.26.020 Tax imposed—Additional taxes for general fund, health services account. (1) There is levied and there shall be collected a tax upon the sale, use, consumption, handling, or distribution of all tobacco products in this state at the rate of forty-five percent of the wholesale sales price of such tobacco products.

(2) Taxes under this section shall be imposed at the time the distributor (a) brings, or causes to be brought, into this state from without the state tobacco products for sale, (b) makes, manufactures, or fabricates tobacco products in this state for sale in this state, (c) ships or transports tobacco products to retailers in this state, to be sold by those retailers, or (d) handles for sale any tobacco products that are within this state but upon which tax has not been imposed.

(3) An additional tax is imposed equal to seven percent multiplied by the tax payable under subsection (1) of this section.

(4) An additional tax is imposed equal to ten percent of the wholesale sales price of tobacco products. The moneys collected under this subsection shall be deposited in the health services account created under RCW 43.72.900. [2002 c 325 § 2; 1993 c 492 § 309; 1983 2nd ex.s. c 3 § 16; 1982 1st ex.s. c 35 § 9; 1975 1st ex.s. c 278 § 71; 1971 ex.s. c 299 § 77; 1965 ex.s. c 173 § 25; 1961 c 15 § 82.26.020. Prior: 1959 ex.s. c 5 § 12.]

82.26.030 Legislative intent—Purpose. It is the intent and purpose of this chapter to levy a tax on all tobacco products sold, used, consumed, handled, or distributed within this state and to collect the tax from the distributor as defined in RCW 82.26.010. It is the further intent and purpose of this chapter to impose the tax once, and only once, on all tobacco products for sale in this state, but nothing in this chapter shall be construed to exempt any person taxable under any other law or under any other tax imposed under Title 82 RCW. [2002 c 325 § 4; 1961 c 15 § 82.26.030. Prior: 1959 ex.s. c 5 § 13.]

82.26.010 Definitions.

The definitions in this section apply throughout this chapter unless the context clearly requires otherwise.

(1) "Tobacco products" means cigars, cheroots, stogies, periques, granulated, plug cut, crimp cut, ready rubbed, and other smoking tobacco, snuff, snuff flour, cavendish, plug and twist tobacco, fine-cut and other chewing tobaccos, shorts, refuse scraps, clippings, cuttings and sweepings of tobacco, and other kinds and forms of tobacco, prepared in such manner as to be suitable for chewing or smoking in a pipe or otherwise, or both for chewing and smoking, but shall not include cigarettes as defined in RCW 82.24.010.

(2) "Manufacturer" means a person who manufactures and sells tobacco products.

(3) "Distributor" means (a) any person engaged in the business of selling tobacco products in this state who brings, or causes to be brought, into this state from without the state any tobacco products for sale, (b) any person who makes, manufactures, fabricates, or stores tobacco products in this state for sale in this state, (c) any person engaged in the business of selling tobacco products without this state who ships or transports tobacco products to retailers in this state, to be sold by those retailers, (d) any person engaged in the business of selling tobacco products in this state who handles for sale any tobacco products that are within this state but upon which tax has not been imposed.

(4) "Retailer" means any person engaged in the business of selling tobacco products to ultimate consumers.

(5)(a) "Sale" means any transfer, exchange, or barter, in any manner or by any means whatsoever, for a consideration, and includes and means all sales made by any person.

(b) The term "sale" includes a gift by a person engaged in the business of selling tobacco products, for advertising, promoting, or as a means of evading the provisions of this chapter.

(6) "Business" means any trade, occupation, activity, or enterprise engaged in for the purpose of selling or distributing tobacco products in this state.

(7) "Place of business" means any place where tobacco products are sold or where tobacco products are manufactured, stored, or kept for the purpose of sale, including any vessel, vehicle, airplane, train, or vending machine.

(8) "Retail outlet" means each place of business from which tobacco products are sold to consumers.

(9) "Department" means the department of revenue.

82.26.010 Definitions.

(10) "Person" means any individual, receiver, administrator, executor, assignee, trustee in bankruptcy, trust, estate, firm, copartnership, joint venture, club, company, joint stock company, business trust, municipal corporation, the state and its departments and institutions, political subdivision of the state of Washington, corporation, limited liability company, association, society, any group of individuals acting as a unit, whether mutual, cooperative, fraternal, nonprofit, or otherwise. The term excludes any person immune from state taxation, including the United States or its instrumentalities, and federally recognized Indian tribes and enrolled tribal members, conducting business within Indian country.

(11) "Indian country" means the same as defined in chapter 82.24 RCW.

(12) "Actual price" means the total amount of consideration for which tobacco products are sold, valued in money, whether received in money or otherwise, including any charges by the seller necessary to complete the sale such as charges for delivery, freight, transportation, or handling.

(13) "Affiliated" means related in any way by virtue of any form or amount of common ownership, control, operation, or management.

(14) "Board" means the liquor control board.

(15) "Cigar" means a roll for smoking that is of any size or shape and that is made wholly or in part of tobacco, irrespective of whether the tobacco is pure or flavored, adulterated or mixed with any other ingredient, if the roll has a wrapper made wholly or in greater part of tobacco. "Cigar" does not include a cigarette.

(16) "Cigarette" has the same meaning as in RCW 82.24.010.

(17) "Manufacturer's representative" means a person hired by a manufacturer to sell or distribute the manufacturer's tobacco products, and includes employees and independent contractors.

(18)(a) "Taxable sales price" means:

(i) In the case of a taxpayer that is not affiliated with the manufacturer, distributor, or other person from whom the taxpayer purchased tobacco products, the actual price for which the taxpayer purchased the tobacco products;

(ii) In the case of a taxpayer that purchases tobacco products from an affiliated manufacturer, affiliated distributor, or other affiliated person, and that sells those tobacco products to unaffiliated distributors, unaffiliated retailers, or ultimate consumers, the

82.26.010 Definitions.

actual price for which that taxpayer sells those tobacco products to unaffiliated distributors, unaffiliated retailers, or ultimate consumers;

(iii) In the case of a taxpayer that sells tobacco products only to affiliated distributors or affiliated retailers, the price, determined as nearly as possible according to the actual price, that other distributors sell similar tobacco products of like quality and character to unaffiliated distributors, unaffiliated retailers, or ultimate consumers;

(iv) In the case of a taxpayer that is a manufacturer selling tobacco products directly to ultimate consumers, the actual price for which the taxpayer sells those tobacco products to ultimate consumers;

(v) In the case of a taxpayer that has acquired tobacco products under a sale as defined in subsection (5)(b) of this section, the price, determined as nearly as possible according to the actual price, that the taxpayer or other distributors sell the same tobacco products or similar tobacco products of like quality and character to unaffiliated distributors, unaffiliated retailers, or ultimate consumers; or

(vi) In any case where (a)(i) through (v) of this subsection do not apply, the price, determined as nearly as possible according to the actual price, that the taxpayer or other distributors sell the same tobacco products or similar tobacco products of like quality and character to unaffiliated distributors, unaffiliated retailers, or ultimate consumers.

(b) For purposes of (a)(i) and (ii) of this subsection only, "person" includes both persons as defined in subsection (10) of this section and any person immune from state taxation, including the United States or its instrumentalities, and federally recognized Indian tribes and enrolled tribal members, conducting business within Indian country.

(c) The department may adopt rules regarding the determination of taxable sales price under this subsection.

(19) "Taxpayer" means a person liable for the tax imposed by this chapter.

(20) "Unaffiliated distributor" means a distributor that is not affiliated with the manufacturer, distributor, or other person from whom the distributor has purchased tobacco products.

(21) "Unaffiliated retailer" means a retailer that is not affiliated with the manufacturer, distributor, or other person from whom the retailer has purchased tobacco products.

[2005 c 180 § 2; 2002 c 325 § 1; 1995 c 278 § 16; 1975 1st ex.s. c 278 § 70; 1961 c 15 § 82.26.010. Prior: 1959 ex.s. c 5 § 11.]

82.26.020 Tax imposed -- Deposit of tax revenue.

(1) There is levied and there shall be collected a tax upon the sale, handling, or distribution of all tobacco products in this state at the following rate:

(a) Seventy-five percent of the taxable sales price of cigars, not to exceed fifty cents per cigar; or

(b) Seventy-five percent of the taxable sales price of all tobacco products that are not cigars.

(2) Taxes under this section shall be imposed at the time the distributor (a) brings, or causes to be brought, into this state from without the state tobacco products for sale, (b) makes, manufactures, fabricates, or stores tobacco products in this state for sale in this state, (c) ships or transports tobacco products to retailers in this state, to be sold by those retailers, or (d) handles for sale any tobacco products that are within this state but upon which tax has not been imposed.

(3) The moneys collected under this section shall be deposited as follows:

(a) Thirty-seven percent in the general fund;

(b) Fifty percent in the health services account created under RCW 43.72.900; and

(c) Thirteen percent in the water quality account under RCW 70.146.030 for the period beginning July 1, 2005, through June 30, 2021, and in the general fund for the period beginning July 1, 2021.

[2005 c 180 § 3; 2002 c 325 § 2; 1993 c 492 § 309; 1983 2nd ex.s. c 3 § 16; 1982 1st ex.s. c 35 § 9; 1975 1st ex.s. c 278 § 71; 1971 ex.s. c 299 § 77; 1965 ex.s. c 173 § 25; 1961 c 15 §82.26.020 . Prior: 1959 ex.s. c 5 § 12.]

82.26.030 Legislative intent -- Purpose.

It is the intent and purpose of this chapter to levy a tax on all tobacco products sold, used, consumed, handled, or distributed within this state and to collect the tax from the distributor as defined in RCW 82.26.010. It is the further intent and purpose of this chapter to impose the tax once, and only once, on all tobacco products for sale in this state, but nothing in this chapter shall be construed to exempt any person taxable under any other law or under any other tax imposed under Title 82 RCW. It is the further intent and purpose of this chapter that the distributor who first possesses the tobacco product in this state shall be the distributor liable for the tax and that in most instances the tax will be based on the actual price that the distributor paid for the tobacco product, unless the distributor is affiliated with the seller.

[2005 c 180 § 1; 2002 c 325 § 4; 1961 c 15 §82.26.030 . Prior: 1959 ex.s. c 5 § 13.]

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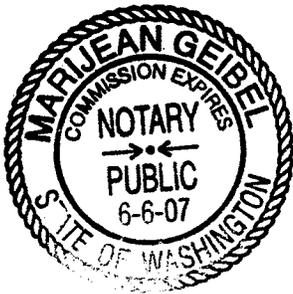
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SIGNED and SWORN to before me, this 14th day of July, 2006.



Marijean Geibel
Signature of Notary Public

Marijean Geibel
Printed Name

NOTARY Public in and for the
State of Washington, residing at

Olympia

Commission expires 6-6-07