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No. 33236-1-II

DIVISION II, COURT OF APPEALS
OF THE STATE OF WASHINGTON

TESORO REFINING AND MARKETING COMPANY,

Plaintiff-Appellant

v.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,

Defendant-Respondent

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ON APPEAL FROM THURSTON COUNTY SUPERIOR COURT
(Hon. Richard D. Hicks)

APPELLANT'S PETITION FOR REVIEW

George C. Mastrodonato
WSBA No. 07483
John B. Schochet
WSBA No. 35869
DORSEY & WHITNEY LLP
Attorneys for Appellant
Tesoro Refining and Marketing
Company

Dorsey & Whitney LLP
1420 Fifth Avenue, Suite 3400
Seattle, Washington 98101
Telephone: (206) 903-8800
Facsimile: (206) 903-8820

Michael B. King
WSBA No. 14405
LANE POWELL PC
Attorneys for Appellant
Tesoro Refining and Marketing
Company

Lane Powell PC
1420 Fifth Avenue, Suite 4100
Seattle, Washington 98101
Telephone: (206) 223-7000
Facsimile: (206) 223-7107

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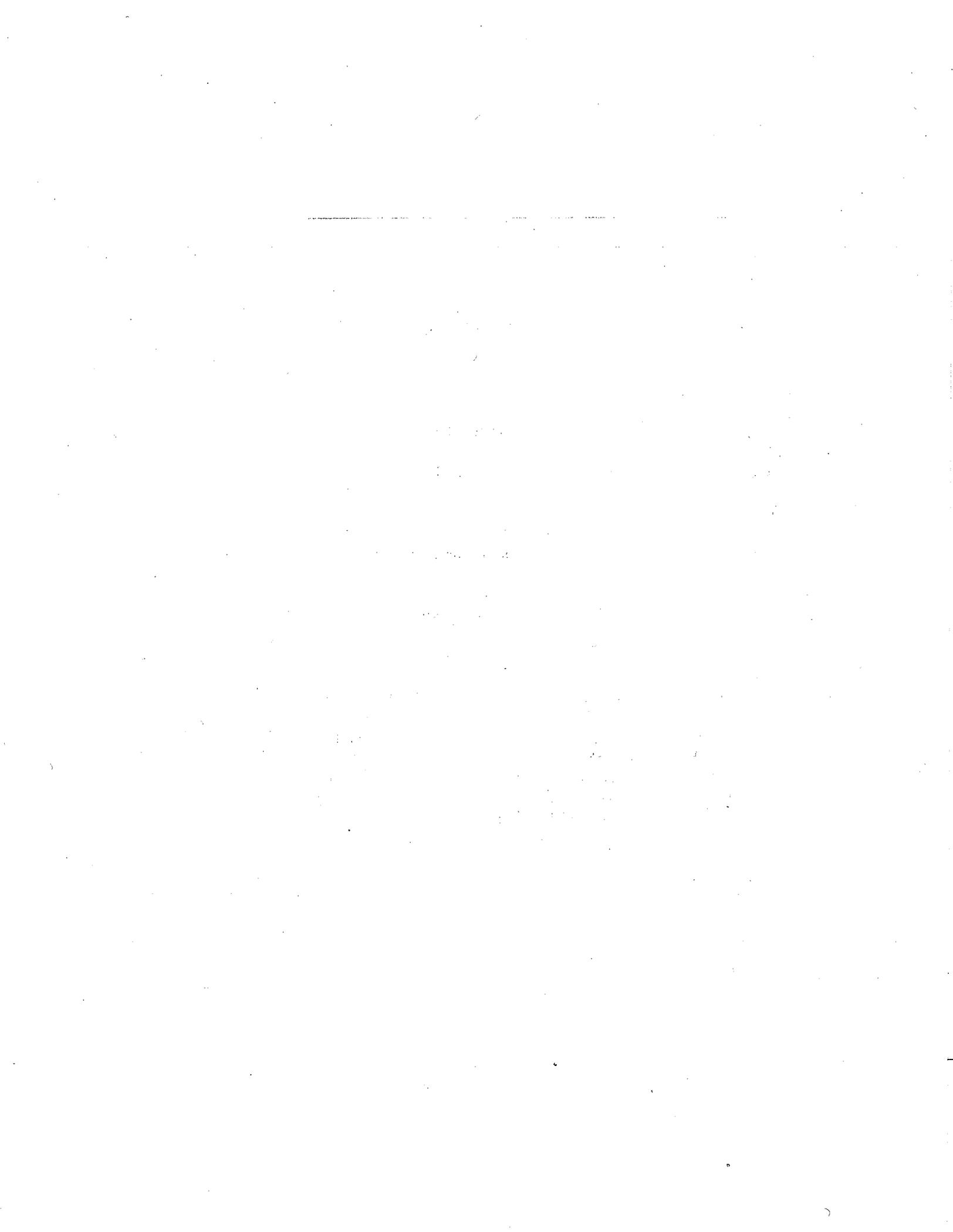


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A. Identity of Petitioner.

Appellant Tesoro Refining and Marketing Company ("Tesoro") petitions for the relief set forth below.

B. Court of Appeals Decision.

Tesoro petitions for review of the published decision terminating review ("the Decision"), entered October 10, 2006, by Division II of the Court of Appeals. A copy of the Decision is attached as Exhibit A of the Appendix to this Petition.¹ Tesoro timely moved for reconsideration of the Decision, which the Court of Appeals denied on November 30, 2006. A copy of the order denying reconsideration is attached as Exhibit B of the Appendix.

C. Statement of Issues Presented for Review.

The Decision raises two issues warranting Supreme Court review:

1. Construing Tax Incidence Statutes in Favor of Taxpayers.

Washington law requires courts to construe ambiguities in tax-imposing statutes against the taxing authority and in favor of the taxpayer. Here, the Hazardous Substance Tax ("HST") statute is ambiguous as to whether it applies to a substance known as "refinery fuel gas." Was it error for the Court of Appeals to construe the HST tax-imposing statute in the Department of Revenue's ("DOR") favor, and uphold the DOR's imposition of HST on refinery fuel gas?

¹The Decision is reported at 135 Wn. App. 411 and 144 P.3d 368. Tesoro will cite to the Decision in the slip opinion form (see Exhibit A) originally issued on October 10, 2006.

2. Compliance With Statutory Requirements for Repealing Administrative Rules. Washington administrative agencies have discretion in adopting administrative rules, and the public is entitled to rely on those rules. Administrative agencies can amend or repeal those rules only through the Administrative Procedure Act's prescribed process. Here, the DOR's administrative rule plainly and unambiguously declares that the HST does not apply to refinery gas, but, at the DOR's urging, the Court of Appeals found the HST rule to be invalid and beyond DOR's administrative authority to adopt. May a state administrative agency retroactively impeach its own administrative rule?

These issues warrant review under RAP 13.4(b)(4), because they involve matters of "substantial public interest that should be determined by the Supreme Court."

D. Nature of the Case and Decision Below.

1. Tesoro's Business and Refinery Gas. Tesoro operates a refinery located near Anacortes, Washington. (CP 40.) The refinery facilities include oil processing equipment, support facilities, and storage tanks for the various products manufactured. (Id.) In the refining process, crude oil is delivered to the refinery, run through the processing equipment, and transformed into various finished products, such as gasoline, diesel and jet fuel, heavy fuel oils, liquefied petroleum gas (propane), and asphalt. (CP 40-41.)

A byproduct produced in the refining process is a substance called "refinery fuel gas." (CP 42.) This gas (also known as "refinery gas") is

continuously created from chemical reactions that occur in several refining process units within the refinery. (CP 42-43.) Refinery gas is not a salable product; it is immediately consumed to provide heat for the refining processes. (Id.) Tesoro's refinery has no facilities that would allow it to store or sell refinery gas. (CP 44, 259.)

Because refinery gas is not a desired yield from crude oil processing, all of the chemical reactions in the refinery are designed to minimize this intermediate byproduct and to dispose of it as quickly as possible, by burning it as fuel within the refinery. See (CP 258.) Any refinery gas not consumed during the manufacturing process (usually within 30 seconds of its creation) is vented to the atmosphere and burned as part of the refinery's "flaring" process. (CP 19, 44.) The processing, flow, and collection of refinery gas does not stop and is not complete until the gas is fully and completely burned in process heaters and boilers, or in the flare. (CP 43.)

2. Tesoro's Payment of Hazardous Substance Tax and Its Refund Application to the Department of Revenue. Tesoro calculates and pays HST on every product produced at the refinery that survives the manufacturing process (except sulfur, which is expressly exempt from HST). (CP 48.) Because the DOR currently requires Tesoro to pay HST on refinery gas, Tesoro also calculates a value for the refinery gas that is produced, created, and consumed at the refinery. (Id.) Since refinery gas is not sold, Tesoro uses a value for a similar (but not identical) product,

fuel oil, in order to value refinery gas for purposes of calculating the HST liability on the gas. (CP 49-50.)

On October 7, 2003, Tesoro submitted a refund petition to the DOR asking for a refund of the \$884,293 in HST Tesoro has paid on refinery gas. (CP 51, 53-58.)² Following discussions and correspondence, the DOR denied Tesoro's refund claim, on February 19, 2004. See (CP 51-52, 59-68).

3. Tesoro's Refund Petition to the Superior Court, and Its Appeal to the Court of Appeals. After the DOR denied Tesoro's refund claim, Tesoro filed suit under RCW 82.32.180 in Thurston County Superior Court, on March 5, 2004. (CP 4-8.) The parties filed cross-motions for summary judgment. The trial court granted the DOR's motion for summary judgment of dismissal and denied Tesoro's summary

²Tesoro acquired the Anacortes Refinery in 1998. Initially, Tesoro did not pay HST on refinery gas, relying on Subsection (7)(b) of WAC 458-20-252 ("Rule 252"). (*Id.*) See discussion of Rule 252, §§ E.1.b and E.2.c, *infra*. This DOR regulation states, and has so stated since the HST was enacted by the legislature in 1987 (effective January 1, 1988) (CP 75-77), and reenacted by the people in 1988 (effective March 1, 1989) through Initiative 97, that:

When any hazardous substance(s) is first produced during and because of any physical combination or chemical reaction which occurs in a manufacturing or processing activity, the intermediate possession of such substance(s) within the manufacturing or processing plant is not considered a taxable possession if the substance(s) becomes a component or ingredient of the product being manufactured or processed or is otherwise consumed during the manufacturing or processing activity.

WAC 458-20-252(7)(b). DOR audited Tesoro in 2001 and made an assessment of HST. Tesoro paid the assessment and then brought this refund claim in 2003.

judgment motion for an HST refund. (CP 316) (VRP 75). The trial court entered its order on April 8, 2005, and Tesoro filed its notice of appeal on May 9, 2005. (CP 317-21, 325-31.) On October 10, 2006, Division II of the Court of Appeals affirmed the trial court's decision in a 2-1 published decision. See Exhibit A. Tesoro filed a motion for reconsideration, which was denied on November 30, 2006. See Exhibit B.

E. Argument Why Review Should Be Accepted.

Whether the "Or" in RCW 82.21.020(3) Should Be Given a Conjunctive or Disjunctive Reading Presents an Issue of Substantial Public Interest.

a. This Is a Tax Incidence Case, and Washington's Longstanding Public Policy Requires That Courts Construe Ambiguities in Tax-imposing Statutes in the Taxpayer's Favor. When a taxpayer challenges a tax's application to a particular activity, Washington courts resolve ambiguities in the taxpayer's favor. See, e.g., First Am. Title Ins. Co. v. Dep't of Revenue, 144 Wn.2d 300, 303, 27 P.3d 604 (2001). When a taxpayer claims an exemption from a tax, however, courts construe the statute strictly and in favor of DOR. See, e.g., Simpson Inv. Co. v. Dep't of Revenue, 141 Wn.2d 139, 149-50, 3 P.3d 741 (2000). Here, all parties and the Court of Appeals agree that Tesoro is challenging a tax sought to be imposed rather than asserting an exemption, so the rule requiring courts to construe ambiguities in Tesoro's favor applies. See Decision at 5.

The interpretive doctrine requiring courts to construe ambiguities in taxing statutes in favor of the taxpayer is longstanding. Just five years

ago, this Court noted that the rule for interpreting tax statutes differs from the approach generally taken when an agency's interpretation of its statutory authority is at issue,³ because of the overarching requirement that ambiguities in the application of tax statutes be resolved in favor of the taxpayer: "We generally defer to the statutory interpretation of the agency charged with implementing a statutory scheme. However, any doubt as to the meaning of a tax statute is construed against the taxing power." First Am. Title, 144 Wn.2d at 303, citing in part Duwamish Warehouse Co. v. Hoppe, 102 Wn.2d 249, 254, 684 P.2d 703 (1984), in turn citing Mac Amusement Co. v. Dep't of Rev., 95 Wn.2d 963, 966, 633 P.2d 68 (1981) ("[i]f there is any doubt as to the meaning of a tax statute, it must be construed against the taxing power" (further citations omitted)).

In 1969, this Court called the taxpayer presumption "a basic rule of construction." Foremost Dairies, Inc. v. Tax Comm'n, 75 Wn.2d 758, 763, 453 P.2d 870 (1969), citing In re Ehlers' Estate, 53 Wn.2d 679, 681, 335 P.2d 823 (1959). And as long ago as 1927, this Court held that, "[i]n case of doubt[, tax statutes] are construed most strongly against the government, and in favor of the citizen." Union Trust Co. of Spokane v. Spokane County, 145 Wash. 193, 196, 259 P. 9 (1927), quoting Gould v. Gould, 245 U.S. 151, 38 S. Ct. 53, 62 L. Ed. 211 (1917), in turn citing American Net & Twine Co. v. Worthington, 141 U.S. 468, 474, 12 S. Ct.

³Tesoro actually agrees with the DOR's interpretation as laid out in the DOR's own Rule 252 (see subsection (7)(b), quoted in footnote 2, supra, at 4). Here, the DOR's current position in this litigation is not only contrary to Tesoro's view of the statute, but also to its own rule. The resulting tax policy conundrum is addressed in Section E.2, infra.

55, 35 L. Ed. 821 (1891), and Benziger v. United States, 192 U.S. 38, 55, 24 S. Ct. 189, 48 L. Ed. 331 (1904).

This fundamental and important taxpayer rights rule should not be discarded lightly. The State has the power to take the people's money by taxation, but the State may do so only when a statute expressly and unambiguously says it may do so. "If there is a doubt as to the liability of an instrument to taxation, the construction is in favor of the exemption, because, in the language of Pollock, C.B., in Girr v. Scudds 'a tax cannot be imposed without clear and express words for that purpose.'" U.S. v. Isham, 84 U.S. (17 Wall.) 496, 504, 21 L. Ed. 728 (1873) (emphasis added). And if there is reasonable doubt, the government bears the burden of clearly and unambiguously erasing that doubt through the legislative process, before being permitted to take the people's money under the authority of a taxing statute.

Abrogation of this longstanding rule by court decisions that honor the rule in form, but drain the rule of all vitality in substance, will upset the balance that, in our system of government, favors the people's right to retain their money over the government's entitlement to take that money by taxation. This Court should grant review whenever a decision of the Court of Appeals threatens to upset that balance. As Tesoro will demonstrate, the Decision of the Court of Appeals in this case does precisely that, and therefore warrants review by this Court.

b. "Or" Should Be Given a Conjunctive Reading if the Statutory Context Demonstrates the Legislature Intended Such a Reading: From the Context of RCW 82.21.020(3), It Is at Least Ambiguous Whether the Legislature Intended "Or" to Be Read in the Conjunctive. The source of the Court of Appeals' effective disregard of the taxpayer presumption in this case lies in the court's treatment of the word "or." While the word "or" typically is read as disjunctive in statutory construction, that is not always the case, and not just in tax incidence cases. "When the term 'or' is used it is presumed to be used in the disjunctive sense, unless the legislative intent is clearly contrary." Childers v. Childers, 89 Wn.2d 592, 595, 575 P.2d 201 (1978) (quoting 1A C. Sands, Sutherland on Statutory Construction § 21.14, n.1 (4th ed. 1972)) (emphasis added).

Here, the "or" at issue comes from the definition of the word "control" in the HST statute: "'Control' means the power to sell or use a hazardous substance or to authorize the sale or use by another." RCW 82.21.020(3) (emphasis added). While the default statutory construction rule would make that "or" disjunctive, the context of the HST demonstrates that this particular "or" was intended to be given a conjunctive reading. Most notably, when the DOR drafted Rule 252, which implements the statutory definition of "control," it adopted a rule providing that any substance initially produced in the manufacturing process that is "consumed during the manufacturing or processing activity" is not subject to HST. WAC 458-20-252(7)(b); see n.2, supra, at 4. In other words: Substances

that a manufacturer or refinery has the power to use, but not to sell, are not subject to HST. Thus, the rule implementing RCW 82.21.020(3) plainly evidences DOR's understanding that the Legislature intended "or" to be given a conjunctive reading, so that a manufacturer must have the ability both to sell and use a substance before it will be subject to the HST. Here, the undisputed evidence is that refinery gas may be used but it cannot be sold (see § D.1, supra); hence, Tesoro does not "control" the substance as contemplated by RCW 82.21.020(3), and therefore should not be required to pay HST on refinery gas.⁴

The Court of Appeals, however, chose to give the "or" used in the definition of control a disjunctive reading, in order to affirm the application of HST to refinery gas. In support of this determination, the court cited to this Court's decision in Agrilink Foods, Inc. v. Dep't of Revenue, 153 Wn.2d 392, 103 P.3d 1226 (2005). See Decision at 10. Yet Agrilink only said exactly what this Court had said before about "or" --

⁴This reading of "or" in RCW 82.21.020(3) is eminently reasonable. The declared purpose of both the original and current versions of the HST law was to tax final products that "present a threat to human health or the environment." See former RCW 82.22.010 and current RCW 82.21.010. A substance that is entirely consumed in the manufacturing process and cannot be sold for use by third parties clearly is not a threat to human health or the environment, and therefore should not be subject to the HST. During oral argument, Judge Penoyer (who later joined Judge Armstrong's majority opinion) suggested that the "theory" behind the HST was to tax all substances that might be "dumped somewhere" because they cannot be sold. See VRP (oral argument to the Court of Appeals, Apr. 3, 2006) 24:15-18 (copy of VRP attached as Ex. C of the Appendix). But as Tesoro's counsel pointed out, the HST was intended to address a specific environmental problem, created by substances whose dual capacity for use or sale gave rise to a particular kind of environmental burden. See VRP (Apr. 3, 2003) 24:2-25:3 (colloquy between counsel and the court).

that it "is commonly understood to allow for a disjunctive reading." Id. at 397 (citing The Chicago Manual of Style and other sources). This Court had already made clear that the disjunctive reading of the word is only a presumption, which applies "unless the legislative intent is clearly contrary." See, e.g., Childers, 89 Wn.2d at 595 (quoting C. Sands, supra). Moreover, the operative term at issue in Agrilink was "and/or," not "or." See Agrilink, 153 Wn.2d at 397.

In short, Agrilink did nothing to make Childers' default presumption an absolute rule. Given the declared purpose of the HST, and the DOR's longstanding interpretation establishing that refinery gas is not subject to the HST,⁵ the "or" at issue in this case should have been read in

⁵The Court of Appeals attempted to avoid the implications of this evidence by characterizing it as "legislative history" that can be ignored, if the meaning of a statute is otherwise clear under our state's "plain meaning" approach to statutory interpretation and construction. See Decision at 9. But neither the evolution of statutory language by amendment, nor an administrative agency's evolving interpretations in response to that amendment, constitutes "legislative history" that can be disregarded under a plain meaning analysis. To the contrary: Such matters are precisely what a court should consider, if it is to effectively carry out its responsibilities to determine statutory meaning from statutory context, which has been the mandate of this Court ever since its clarification of the plain meaning approach set forth in Department of Ecology v. Campbell & Gwinn, L.L.C., 146 Wn.2d 1, 43 P.3d 4 (2002). See, e.g., Cosmopolitan Eng'g Group, Inc. v. Ondeo Degremont, Inc., ___ Wn.2d ___, ___ P.3d ___, slip op. at 12 (Dec. 28, 2006) ("the context of the statutory scheme is important") (citing City of Olympia v. Drebeck, 156 Wn.2d 289, 295, 126 P.3d 802 (2006), cert. denied, 127 S. Ct. 436 (2006); Advanced Silicon Materials, L.L.C. v. Grant County, 156 Wn.2d 84, 89-90, 124 P.3d 294 (2005)). That the Court of Appeals would refer to the evolution of statutory language, or to the promulgation of an agency interpretation responsive to such evolution, as "legislative history," strongly suggests the need for reinforcement by this Court of Campbell & Gwinn's rearticulation of the plain meaning approach to statutory interpretation.

the conjunctive under the principles of statutory construction stated in Childers. And even if not clearly conjunctive, the statute's declared purpose and DOR's longstanding interpretation makes the meaning of "or" in this statutory context at the very least ambiguous, thereby invoking the rule of construction applicable to tax incidence cases, and requiring resolution of the ambiguity in the taxpayer's favor.

c. While Insisting It Was Construing RCW 82.21.020(3)'s Ambiguities in the Taxpayer's Favor, the Court of Appeals Actually Construed the Statute's Ambiguity in the DOR's Favor, Thereby Violating This State's Longstanding Public Policy of Resolving Ambiguities in Tax Incidence Cases in Favor of the Taxpayer. The Court of Appeals purported to apply the longstanding incidence rule by "interpret[ing] any ambiguity in the statute in Tesoro's favor," Decision at 5, citing First Am. Title, 144 Wn.2d at 303; in fact, the court honored the rule only in the breach, and actually interpreted the HST statute's ambiguities in the DOR's favor. As Tesoro has demonstrated, there is significant evidence that the "or" at issue was intended to be read in the conjunctive. The evidence may not be overwhelming -- i.e., a reasonable person could choose to read the "or" in the definition of "control" in the disjunctive rather than the conjunctive. But the issue in this case is not the most reasonable interpretation of "or"; the issue is whether a reasonable person could read the "or" in RCW 82.21.020(3) in the conjunctive. If so, then the use of the word "or" in this context is ambiguous, and Tesoro, as the taxpayer, should be given the benefit of the resulting doubt.

Here, the evidence establishes that a disjunctive reading of the term "or" is a reasonable interpretation of the statute, and Tesoro therefore should have received the benefit of the resulting doubt. The Court of Appeals' effective disregard of this longstanding rule of tax law jurisprudence threatens to undermine the balance between the rights of taxpayers and the government. This Court should grant review to reaffirm the public policy requiring that ambiguities in tax-imposing statutes be interpreted in the taxpayer's favor.

2. Whether the Department of Revenue May Retroactively Refuse to Follow Its Own Rule Presents an Issue of Substantial Public Interest.

a. State Administrative Agencies, Including the DOR, Have Authority to Make Rules Implementing Statutes, and the Public Should Be Entitled to Rely on Those Rules. This Court recognizes that "an agency charged with the administration and enforcement of a statute may interpret ambiguities within the statutory language through the rule making process." Ass'n of Wash. Business v. Dep't of Revenue, 155 Wn.2d 430, 439, 120 P.3d 46 (2005) (internal quotations omitted). The DOR is specifically "charged with enforcing the tax code and hence has the authority to interpret it. Interpreting statutes is consistent with administering and enforcing the statutes." Id. at 440 (internal footnote omitted, citing RCW 82.32.300 and 82.01.060(1)). That rule applies not only to DOR as an administrative agency, but also to other agencies enforcing other statutes. While this particular case is about the DOR's

enforcement of the HST Rule 252, the issue this case raises is far broader, affecting how every administrative agency in the state of Washington handles the task of administering, enforcing, and interpreting statutes.

Interpretive regulations are important, because they make statutes more clear and more predictable. Whether in the area of taxation, environmental standards, employee benefits, transportation contracts, or any number of other regulated fields, the public benefits by knowing specifically what the rules are, so the public can follow the rules. Often, statutory language itself is ambiguous or does not contemplate a particular set of circumstances -- administrative rules can and do provide answers where statutes inevitably raise questions. This Court explained the important benefit of administrative rule-making by quoting the following from a leading administrative law treatise: "Every legislature wants agencies to determine the meaning of the law they must enforce and to inform the public of their interpretations so that members of the public may follow the law." Ass'n of Wash. Business, 155 Wn.2d at 440 (quoting Arthur Earl Bonfield, State Administrative Rule Making § 6.9.1 at 280 (1986)).

Rule-making, however, only benefits the public if the public can rely on an agency's rules. This state's individuals and businesses plan and act based on what the rules are, so rules are not helpful if the public cannot count on a rule being in effect when it is on the books, because of the danger an agency will retroactively impeach its own rule, in order to deprive an individual or business of the benefits of that rule. Of course, an

agency can change or repeal a rule pursuant to the Administrative Procedure Act ("APA"), RCW ch. 34.05, a fair process in that the APA's prescribed procedures ensure that the interested public is notified of, and has an opportunity to comment on, proposed changes in an agency's statutory interpretations embodied in a rule. See RCW 34.05.320, .325. A court may also strike down a rule as invalid, a party attacking the validity of the rule shows that the rule is in conflict with the intent and purpose of underlying legislation. See, e.g., Green River Cmty. Coll. Dist. No. 10 v. Higher Ed. Personnel Bd., 95 Wn.2d 108, 112, 622 P.2d 826 (1980). But a court striking down a rule is still a matter of public record, and interested parties can find out when a rule has been deemed invalid. What is not fair is for an agency to simply stop following its rule without either having the rule deemed invalid by a court or by repealing the rule pursuant to the APA. Such an approach gives the public no notice of rule changes, and defeats the purpose of adoption of the administrative rule in the first instance.⁶

The policy underlying these principles applies with particular force in the tax arena. To begin, tax laws "should . . . be intelligible to those who are expected to obey them." White v. Aronson, 302 U.S. 16, 20-21, 58 S. Ct. 95, 82 L. Ed. 20 (1937). Accordingly, "[t]ax laws should be construed and interpreted as far as possible so as to be susceptible of easy

⁶The APA also allows agencies to amend or repeal rules on an emergency basis, but even this procedure does not permit agencies simply to stop following their rules without taking any formal action, emergency or otherwise. See RCW 34.05.050.

comprehension and not likely to become pitfalls for the unwary." Board of Assessors of Town of Brookline v. Prudential Ins. Co. of America, 38 N.E.2d 145, 154, 310 Mass. 300 (1941) (internal quotations omitted). Moreover, to these concerns one adds in this case the fact of a nearly 20-year-old DOR administrative rule plainly supportive of Tesoro's reading of the HST: "The settled interpretation of a tax statute ought not to be lightly disturbed," because "[s]tability of interpretation is signally desirable in [tax] matters." Comm'r of Revenue v. Oliver, 765 N.E.2d 742, 748, 436 Mass. 467 (2002) (internal quotation omitted).

"Every legislature wants agencies to determine the meaning of the law they must enforce and to inform the public of their interpretations so that members of the public may follow the law." Ass'n of Wash. Business, 155 Wn.2d at 439 (quoting Bonfield, supra, § 6.9.1 at 280) (emphasis added). The DOR's repudiation of its decades-long interpretation of the HST's scope, and the Court of Appeals' affirmation of that repudiation, utterly frustrates this basic purpose of administrative law. Moreover, it does so in a field -- taxation -- in which the need for clarity, certainty, and fair notice is greatest. This Court should grant review to address this important question of administrative law.

b. Administrative Agencies Either Must Follow Their Own Rules or Repeal Them Pursuant to the Requirements of the APA; They May Not Use the Courts to Challenge the Validity of Those Rules. As the language of subsection (7)(b) of Rule 252 makes plain, the HST

does not apply to refinery gas.⁷ While the DOR presented a strained reading of Rule 252 that it claims renders refinery gas subject to HST, see DOR's Brief at 19-21, the DOR also argued that "the rule exceeds the Department's authority and is invalid." DOR's Brief at 25; see also id. at 25-27. The DOR's decision to repudiate its administrative rule without formally repealing it using the APA's established processes jeopardizes the public's ability to rely on an administrative agency's rules.

This Court has explained that administrative agencies are required to follow and support their own rules:

DOR will stick by its rules (whether interpretive, procedural, or legislative) unless and until they are stricken by a court. For interpretive rules in particular, DOR will maintain it interpreted the underlying statutes correctly, and any taxpayer who disagrees will have to persuade a court otherwise. For legislative rules, a taxpayer who thinks the agency went too far in implementing the authorizing statutes will pursue precisely the same course: a lawsuit. Agency rules are de facto authoritative for the public until the public challenges them in court and the court agrees.

Ass'n of Wash. Business, 155 Wn.2d at 447-48 (emphasis added). Here, the DOR is not sticking by its rule; it is attempting to repeal the rule without formal process. Rather than follow APA procedure and rewrite Rule 252 to apply the HST to internally created and consumed substances like refinery gas, the DOR simply claims that, if Rule 252 does not apply

⁷In addition to Rule 252's general statement of the nonapplication of the HST to substances internally created and consumed in the manufacturing process, DOR went further and published Excise Tax Advisory 540.04.22.252 ("ETA 540") (CP 70-73), in which DOR explicitly stated that products derived from refining crude oil including refinery fuel gas are not subject to HST when used in the refinery plant by the refiner to process petroleum. See Tesoro's Opening Brief at 36-38 (citing, quoting, and discussing ETA 540).

the HST to refinery gas, then Rule 252 must be invalid. See DOR's Brief at 25.

As Tesoro has previously recognized, a court can strike down a rule when the rule is shown to conflict with the underlying statute. But an agency should not be allowed to pursue such "relief" from its own rule, because such a procedure allows an agency to disregard the established procedure for repealing a rule the agency truly believes to be invalid.⁸ Validating the approach the DOR has taken in this case would allow administrative agencies to leave rules in place that they have no actual intention of following, and then arguing that those rules are invalid whenever an individual or business seeks to have them enforced. That would make administrative rules less predictable and harder to comprehend. It would reduce both the efficiency and accountability of state government, which was the intent and purpose of the APA in giving the agencies the power to adopt rules.

⁸DOR, in two recent rule proceedings, sought to change its longstanding interpretative position as embodied in administrative regulations by amending the rules. In the first proceeding, current WAC 458-20-185 (tax on tobacco products ("Rule 185")) does not apply the other tobacco products tax to tobacco products sold to federal agencies. WAC 458-20-185(8)(a). DOR proposes to change that interpretation by repealing that part of Rule 185. See WSR 06-20-113, copy attached as Exhibit D of the Appendix to this petition. In the second rule-making proceeding involving WAC 458-20-186 (tax on cigarettes ("Rule 186")), DOR proposes to characterize a "stamping allowance" taken by cigarette wholesalers as income subject to the business and occupation tax. See WSR 06-20-112, copy attached as Exhibit E of the Appendix to this petition. Current Rule 186 treats the stamping allowance as a discount off the price of cigarette stamps. WAC 458-20-186, Part III (301)(b). Tesoro submits these two DOR rule-making proceedings under the APA are proper ways for an agency to change its administrative interpretation.

Administrative rules should be enforced by the agency until they are repealed pursuant to the APA, or a court strikes them down when challenged by the public. By denying Tesoro a refund for the HST tax it has paid, the DOR is seeking to avoid enforcing Rule 252 when it had been neither repealed by APA process nor invalidated by a court. The Decision by the majority of the Court of Appeals to validate this approach warrants review by this Court.

c. WAC 458-20-252(7)(b) Does Not Require Tesoro to Pay Hazardous Substance Tax on Refinery Gas. As Chief Judge Quinn-Brintnall noted in her dissent, subsection (7)(b) of Rule 252 plainly exempts all of Tesoro's refinery gas except the gas that is vented through the flare. See Decision at 17 (Judge Quinn-Brintnall's dissent, calling the rule "clear and unambiguous"). Even the majority acknowledged that Rule 252, "[v]iewed in isolation," does not apply the HST to refinery gas. See Decision at 12. Based on the language of the rule itself, refinery gas is a "hazardous substance . . . first produced during and because of [a] physical combination or chemical reaction which occurs in a manufacturing or processing activity" WAC 458-20-252(7)(b). Tesoro only possesses it on an "intermediate" basis "within the manufacturing or processing plant," and the gas is then entirely "consumed during the manufacturing or processing activity." Id. Therefore, under Rule 252, refinery gas "is not considered a taxable possession." And because Rule 252 unambiguously exempts refinery gas from the HST, this case presents the ideal vehicle for addressing the

substantial public issue of a state agency's ability to ignore its own lawfully promulgated and adopted rule, and the public's right to rely on an administrative agency's compliance with its own rule.

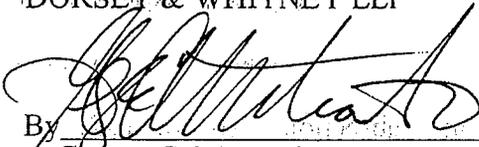
F. Conclusion.

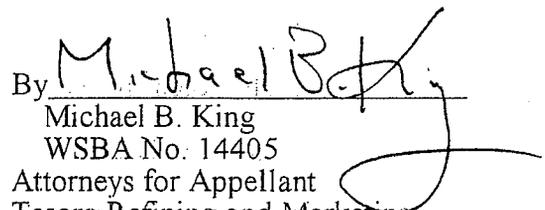
This Court should grant review to address the important tax and administrative law issues raised by the Decision of the Court of Appeals.

RESPECTFULLY SUBMITTED this 2nd day of January, 2007.

DORSEY & WHITNEY LLP

LANE POWELL PC

By 

By 

George C. Mastrodonato
WSBA No. 07483
John B. Schochet
WSBA No. 35869
Attorneys for Appellant
Tesoro Refining and Marketing
Company

Michael B. King
WSBA No. 14405
Attorneys for Appellant
Tesoro Refining and Marketing
Company

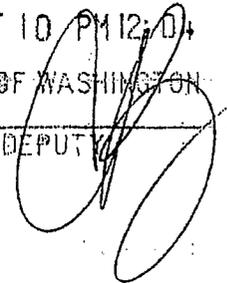
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LANE POWELL PC

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

TESORO REFINING AND MARKETING
COMPANY,

Appellant,

v.

STATE OF WASHINGTON, DEPARTMENT
OF REVENUE,

Respondent.

No. 33236-1-II

PUBLISHED OPINION

ARMSTRONG, J. -- Tesoro Refining and Marketing Company appeals a summary judgment order denying its requested refund of hazardous substance taxes that the Department of Revenue imposed on the Company for possessing a hazardous substance. Tesoro argues that its possession of "refinery gas" was too fleeting to constitute possession under chapter 82.21 RCW. The Company further argues that WAC 458-20-252(7)(b) and WAC 458-20-252(8)(c) support its position that refinery gas is a non-taxable substance when immediately consumed in the refinery's manufacturing processes. We hold that Tesoro possesses refinery gas, a hazardous substance, and that WAC 458-20-252(7)(b) and WAC 458-20-252(8)(c) do not support Tesoro's contention that hazardous substances consumed during the manufacturing process are not subject to the tax. Accordingly, we affirm.

FACTS

Tesoro Refining and Marketing Company's Anacortes Refinery processes crude oil into various consumable products such as gasoline, diesel, jet fuel, heavy fuel oils, propane, and asphalt. Tesoro first preheats the crude oil in large process furnaces before feeding the crude oil to the crude processing unit. The chemical reactions that occur in the several refining process units throughout the refinery produce "refinery gas" as a byproduct.¹ Clerk's Papers (CP) at 42-43. Once extracted, refinery gas is not a desired yield from crude oil processing, and Tesoro manipulates chemical reactions in the refinery to minimize the byproduct. Tesoro cannot and does not sell refinery gas; rather, the processing machinery immediately recovers the gas yielded from the several processes, pipes it to a fuel gas blender,² mixes it, and then burns it to provide heat for the process heaters and boilers. Refinery gas never comes into contact with the contents being processed within a particular unit.

The refinery gas provides 75 percent of the heat needed in the refining manufacturing process. Because the internally produced refinery gas cannot meet all of the refinery's heating needs, Tesoro also obtains natural gas via pipeline to provide supplemental heat. The refinery

¹ Refinery gas is the hazardous substance that the Department taxed and is the subject of this appeal. Refinery gas may contain methane, ethylene, butane, butylenes, propane, hydrogen, and propylene. At Tesoro's Anacortes Refinery, the gas "is immediately reacted with air and completely consumed to provide heat for the manufacturing process." CP at 276.

² The blender is a collection box used to collect "lots of other little streams and make one stream out of it, kind of like downspouts on your house collecting all the rain water, and putting it into one junction box, and then one stream goes to the surface drain." CP at 152. The term "blend" is somewhat misleading. The gases are actually just present together in the same vessel and mixing on their own velocity. No chemical reaction occurs. The fuel gas blender is technically an unnecessary component in the refining process, but it "gives [the refinery gas] a little bit more of a mix." CP at 158.

also purchases other fuels to supplement refinery gas, including liquid fuel oil, liquid propane, and liquid butane. Tesoro stores those fuels for use in an emergency or in special circumstances.

Tesoro's refinery furnaces, heaters, and boilers immediately consume the refinery fuel gas, and its refinery flare burns any excess refining gas.³ On average, Tesoro's refinery consumes the refinery gas 30 seconds after producing it. Refinery fuel gas is in a vapor state, is too volatile to store, and must go immediately to the flare if not consumed.

The Department of Revenue imposes a hazardous substance tax⁴ on the first possessor of hazardous substances, as defined under chapter 82.21 RCW. RCW 82.21.010, .020. Tesoro does not pay the tax on petroleum products that are refining ingredients regardless of which company first possesses those ingredients in Washington. Tesoro pays the tax only on final products.

Tesoro filed for a refund of the \$937,889 it paid in hazardous substance taxes from 1999 to June 2003. The Department denied Tesoro's requested refund, stating that "[w]hile it is true that the refinery fuel is consumed at the plant, it is not consumed in the refining process." CP at 61. The Department also stated that the tax applies to refinery gas because that gas is a petroleum product that is removed from the process and then used at various locations at the plant. Tesoro sought clarification of the Department's ruling, arguing that the Department could not impose the tax because they never stored refinery gas at the plant. The Department

³ The refinery flare is a "permanent safety system" that burns excess gas created from anywhere within the refinery. CP at 160. Tesoro uses the flare as "the ultimate protection against all [of its] refinery vessels so [the company does not] overpressure them." CP at 160. The refinery flare also burns any surplus refinery gas beyond that used for heating.

⁴ While both parties and the trial court refer to the tax as a hazardous substance tax, the legislature refers to chapter 82.21 RCW as the hazardous substance tax and to the individual taxing statute as the pollution tax. RCW 82.21.030.

responded that Tesoro “stored” the gas, for purposes of the tax, when it removed the refinery gas from the refining process and used the gas to help run the refinery. CP at 67.

Tesoro then filed this refund suit under RCW 82.32.180. Both parties moved for summary judgment. The trial court granted the Department’s summary judgment motion, ruling that chapter 82.21 RCW required Tesoro to pay hazardous substance tax for possessing refinery gas.

ANALYSIS

I. STANDARD OF REVIEW

We review issues of statutory interpretation de novo. *City of Olympia v. Drebeck*, 156 Wn.2d 289, 295, 126 P.3d 802 (2006) (citing *Dep’t of Ecology v. Campbell & Gwinn, L.L.C.*, 146 Wn.2d 1, 9, 43 P.3d 4 (2002)). Where a statute’s meaning is plain on its face, we give effect to that plain meaning as an expression of legislative intent. *Drebeck*, 156 Wn.2d at 295 (quoting *Campbell & Gwinn*, 146 Wn.2d at 9-10). We resort to statutory construction aids, including legislative history, only when the statutory language is ambiguous. *Campbell & Gwinn*, 146 Wn.2d at 12.

In reviewing an agency rule, we will hold the rule invalid only if: (1) the rule violates constitutional provisions; (2) the rule exceeds the agency’s statutory authority; (3) the agency adopted the rule without compliance with statutory rule-making procedures; or (4) the rule is arbitrary and capricious. RCW 34.05.570(2)(c).

II. EXEMPTION VS. NON-TAXABLE INCIDENT

Tesoro argues that this case is a “tax incidence” case, as opposed to a “tax exemption” case. Br. of Appellant at 15. It reasons that this distinction is crucial because in a tax incidence case, we must resolve any ambiguity in the taxing statute in favor of the taxpayer; whereas in a

tax exemption case, we resolve any ambiguities in favor of the Department. *See First Am. Title Ins. Co. v. Dep't of Revenue*, 144 Wn.2d 300, 303, 27 P.3d 604 (2001) (any doubt as to the meaning of a tax statute is construed against the taxing power); *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn.2d 139, 149-50, 3 P.3d 741 (2000) (in case of doubt or ambiguity in interpreting exemption or deduction provisions, this court construes those provisions strictly, though fairly, and in keeping with the ordinary meaning of their language against the taxpayer).

Tesoro maintains that the taxing incident does not occur here because it does not possess refinery fuel gas under RCW 82.21.020's definition of possession. The Department agrees with Tesoro's analytical framework but argues that Tesoro possesses refinery gas because it controls the gas and uses it for fuel. Because this is a tax incidence case, we must interpret any ambiguity in the statute in Tesoro's favor. *First Am. Title Ins. Co.*, 144 Wn.2d at 303.

III. APPLICABILITY OF THE HAZARDOUS SUBSTANCE TAX TO REFINERY GAS

An excise tax is a tax that the State of Washington imposes on a taxpayer for exercising a certain right or privilege. 1B K. KUNSCH, WASH. PRAC. § 72.4 (4th ed. 1997). The hazardous substance tax is a tax imposed on the privilege of possessing certain hazardous substances in Washington. RCW 82.21.030(1).

RCW 82.21.020(1)(b) lists "[p]etroleum products" as hazardous substances. The statute defines "[p]etroleum product[s]" as "every . . . product derived from the refining of crude oil" except for crude oil itself. RCW 82.21.020(2). The statute does not define "derived," but Webster's Third New International Dictionary defines "derived" as "formed or developed out of something else." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 608 (1969). The parties agree that refinery gas is formed in the process of refining crude oil. Thus, refinery gas is a petroleum product and a hazardous substance under RCW 82.21.020(1)(b).

The intent of chapter 82.21 RCW is “to impose a tax only once for each hazardous substance possessed in this state and to tax the first possession of all hazardous substances, including substances and products that the department of ecology determines to present a threat to human health or the environment.” RCW 82.21.010. The relevant statutory language is: “Pollution tax. (1) A tax is imposed on the privilege of possession of hazardous substances in this state.” RCW 82.21.030(1). For purposes of this chapter, the legislature defines “[p]ossession” as “the control of a hazardous substance located within this state and includes both actual and constructive possession.” RCW 82.21.020(3). “‘Actual possession’ occurs when the person with control has physical possession” and “‘[c]onstructive possession’ occurs when the person with control does not have physical possession.” RCW 82.21.020(3). The statute defines “[c]ontrol” as “the power to sell or use a hazardous substance or to authorize the sale or use by another.” RCW 82.21.020(3).

Thus, the Department may impose the tax on the first taxpayer who has the power to sell or use a hazardous substance located in Washington, regardless of whether the taxpayer physically possesses the hazardous substance.

A. Tesoro’s Possession and Control of Refinery Gas

Tesoro argues that the Department erroneously imposed the tax because the life span of refinery gas at the refinery is too short for Tesoro to have “any meaningful opportunity for control,” and therefore possess the refinery gas. Br. of Appellant at 17-19. We disagree.

RCW 82.21.030 does not specify a length of time that a taxpayer must possess a hazardous substance before the tax applies. The plain language of RCW 82.21.030(1) mandates that, so long as the taxpayer possesses, i.e., exercises control over the hazardous substance, the tax applies.

Russell Crawford, the manager of Tesoro's Anacortes Refinery's process engineering department, stated that chemical reactions in different units at the refinery yield refinery gas. Tesoro collects the refinery gas from the different units, pipes the gas to a collection box that funnels the gas into one stream, and sends that stream to the refinery's process heaters, boilers, or the refinery flare where the refinery gas is "immediately, 100 percent consumed (burned)." CP at 43.

Tesoro argues that refinery gas is "not an end product," rather, it is an "ephemeral product" that is produced and consumed within the manufacturing process. Br. of Appellant at 38. To support its position, Tesoro contends that refinery gas is "not a desired yield from crude oil processing" and that the statute focuses on only commercially viable hazardous substances. Br. of Appellant at 17. But the company admits that it burns the refinery gas "to recover at least its heating value." Br. of Appellant at 17. Further, by its plain language, the statute applies to all hazardous substances, not just those that are commercially viable. RCW 82.21.030(1). Essentially, Tesoro manufactures a hazardous substance, although not a desired product, and uses that hazardous substance to provide heat for the refining process.

A taxpayer exercises control, either actual or constructive, when it uses a hazardous substance. RCW 82.21.020(3). Thus, Tesoro's argument that refinery gas has too ephemeral a life span for the company to have "any meaningful opportunity for control" fails. Because Tesoro has the power to use the refinery gas to provide heat for the refining process, it controls and therefore possesses a hazardous substance.

Tesoro also argues that it does not exercise control over that portion of the refinery gas that it burns through the refinery flare since the company does not have the power to sell or use that portion of the gas. Crawford testified that the fuel blender sends refinery gas to the refinery

flare when the refinery produces an overabundance of the gas. He stated that when the refinery produces so much refinery gas that the collection box (fuel blender) gets full, a safety device diverts the refinery gas flow to the refinery flare, which ignites the gas and burns it off. Control, as defined in RCW 82.21.020(3), does not require actual use, but only the *power* to use, sell, or authorize another to use or sell a hazardous substance. RCW 82.21.020(3). The fact that Tesoro captures and pipes the refinery gas that eventually burns in the refinery flare evidences its power to use the refinery gas sufficiently enough to establish a taxable possession. As previously mentioned, the taxing statute does not state a specific length of time that a taxpayer must possess the hazardous substance before the tax applies. Because the tax applies to possession, which includes the power to use, the fact that Tesoro does not actually use the refinery gas that burns in the refinery flare is irrelevant.

B. Legislative History

Tesoro argues that the evolution of the tax, from the legislature's original version through the people's amendment by initiative, shows no intent to tax refinery fuel gas. As discussed above, we consider legislative history of a particular statutory provision only if we find a statute ambiguous. *Campbell & Gwinn*, 146 Wn.2d at 12. We apply the same rule to statutes, such as chapter 82.21 RCW, born of initiatives. *Bird-Johnson Corp. v. Dana Corp.*, 119 Wn.2d 423, 426 n.3, 833 P.2d 375 (1992) (citing *Spokane v. Taxpayers*, 111 Wn.2d 91, 97, 758 P.2d 480 (1988)). A statute is ambiguous if it is susceptible to two or more reasonable interpretations. *Agrilink Foods, Inc. v. Dep't of Revenue*, 153 Wn.2d 392, 396, 103 P.3d 1226 (2005). But "a statute is not ambiguous merely because different interpretations are conceivable." *Agrilink Foods, Inc.*, 153 Wn.2d at 396 (quoting *State v. Hahn*, 83 Wn. App. 825, 831, 924 P.2d 392 (1996)).

RCW 82.21.030(1) is plain on its face. It imposes a tax “on the privilege of possession of hazardous substances” within this state. RCW 82.21.030(1). And RCW 82.21.020(3) says that a taxpayer possesses the hazardous substance if it has the power to control it. Tesoro does not point to any ambiguity in the statute; instead, it reasons that the “plain meaning of the statutes [in chapter 82.21 RCW] can . . . be discerned by all that was done by the Legislature, the Department, and voters of the state of Washington, ‘which disclose . . . intent about the provision[s] in question.’” Br. of Appellant at 26 (quoting *Campbell & Gwinn*, 146 Wn.2d at 10). Tesoro urges us to interpret RCW 82.21.030 in light of the remainder of chapter 82.21 RCW and in light of the “evolution” of the tax, including the original version of the tax law, and both former and current versions of WAC 458-20-252.

We ascertain a statutory provision’s plain meaning by examining “the statute in which the provision at issue is found, as well as related statutes or other provisions of the same act in which the provision is found.” *Drebick*, 156 Wn.2d at 295 (quoting *Campbell & Gwinn*, 146 Wn.2d at 10). But that examination does not include reviewing legislative history, as Tesoro asks us to do. See *Campbell & Gwinn*, 146 Wn.2d at 12. Nor does the examination include reviewing regulations that an agency adopts to implement a statute because regulations are not related statutes or provisions within the same act in which a provision can be found. See *Drebick*, 156 Wn.2d at 295. When viewed in the context of chapter 82.21 RCW, the language of RCW 82.21.030 plainly expresses the legislature’s intent to impose a tax on the privilege of possessing a hazardous substance in Washington. And refinery gas is a hazardous substance. Thus, we decline to adopt Tesoro’s theory that the evolution of the tax shows no intent to tax refinery gas.

At oral argument, Tesoro argued that we should read RCW 82.21.020(3)'s definition of "control" to mean that a taxpayer exercises control when the taxpayer has the *choice* to sell or use a hazardous substance. Recently, our Supreme Court addressed the meaning of disjunctive connectors in an excise tax statute. *Agrilink Foods, Inc.*, 153 Wn.2d 397. In *Agrilink*, the court addressed whether Agrilink's processing of perishable meat products into nonperishable canned chile con carne qualified Agrilink for a lower B&O tax rate on that particular processing activity. The statute provided for a reduced B&O tax rate for taxpayers who engaged in the "business of slaughtering, breaking and/or processing perishable meat products and/or selling the same at wholesale only." RCW 82.04.260(4). The court held that because the legislature used the disjunctive term "and/or," the legislature intended that the taxpayer need perform only one of the listed activities to qualify for the lower tax rate. *Agrilink*, 153 Wn.2d at 397 (Agrilink processed perishable meat products). Likewise, in the instant case, when the legislature uses the disjunctive "or" in its definition of control, the legislature intends that a taxpayer has control of a hazardous substance when the taxpayer has the power to sell or use the hazardous substance. See RCW 82.21.020(3); *Agrilink*, 153 Wn.2d at 397. We reject Tesoro's reading of RCW 82.21.020(3).

C. WAC 458-20-252⁵

1. Rule 252(7)(b)

Tesoro argues that rule 252 excludes internally produced and consumed substances from the tax and confirms its reading of the legislature's intended scope of RCW 82.21.030. The Department counters that Tesoro's argument attempts to create new exemptions from the tax that

⁵ The parties refer to this regulation as "[r]ule 252."

are not listed in RCW 82.21.040.⁶ The Department maintains that rule 252 conforms with chapter 82.21 RCW because rule 252 ensures that the tax applies once and only to the first possession of the hazardous substance.

RCW 82.32.300 provides that:

[t]he department of revenue shall make and publish rules and regulations, not inconsistent therewith, necessary to enforce provisions of [chapter 82.21 RCW] . . . which shall have the same force and effect as if specifically included therein, unless declared invalid by the judgment of a court of record not appealed from.

Tesoro argues that rule 252(7)(b) is “clear and unambiguous in its interpretation of [RCW 82.21.010’s⁷] intended scope.” Br. of Appellant at 29. Rule 252(7)(b) states:

(7) Recurrent tax liability. It is the intent of the law that all hazardous substances possessed in this state should incur this tax liability only once unless they are expressly exempt. This is true of hazardous ingredients of products as well as the manufactured end product itself, if designated as a hazardous substance.

(b) When any hazardous substance(s) is first produced during and because of any physical combination or chemical reaction which occurs in a manufacturing or processing activity, the intermediate possession of such substance(s) within the manufacturing or processing plant is not considered a taxable possession if the substance(s) becomes a component or ingredient of the product being manufactured or processed or is otherwise consumed during the manufacturing or processing activity.

⁶ RCW 82.21.040 contains enumerated exemptions from the tax, one of which is natural gas. RCW 82.21.040(4). For this reason, Tesoro does not pay tax on the natural gas it uses to supplement refinery gas to produce heat for the refining process. Refinery gas is not one of RCW 82.21.040(4)’s enumerated exemptions.

⁷ RCW 82.21.010 provides: “It is the intent of this chapter to impose a tax only once for each hazardous substance possessed in this state and to tax the first possession of all hazardous substances, including substances and products that the department of ecology determines to present a threat to human health or the environment.” Tesoro claims that this statute is ambiguous because “on the one hand, the [tax] applies to ‘the first possession of all hazardous substances”, but on the other hand, the tax applies to those ‘substances and products that the department of ecology determines to present a threat to human health or the environment.’” Br. of Appellant at 28. This argument is without merit. The statute’s plain language merely allows the department of ecology to include substances not listed in 42 U.S.C. § 9601(14) within the definition of “hazardous substance.” See RCW 82.21.010, .020(1)(a).

Tesoro argues that because it produces and consumes the refinery gas at the manufacturing plant, the gas is not subject to the tax unless Tesoro takes the gas “outside the refinery gates.” Br. of Appellant at 30. Tesoro maintains that, because it completely burns the refinery gas it produces, rule 252(7)(b) exempts refinery gas from taxation because Tesoro otherwise consumes the gas during the manufacturing activity. See WAC 458-20-252(7)(b).

The Department acknowledges that rule 252(7)(b) exempts a substance from taxation when a chemical reaction forms an intermediate substance that reacts further to create an end product. On the other hand, the Department contends that rule 252(7)(b) imposes a tax on an intermediate substance that is withdrawn from the reaction and does not become part of a later taxed product. The Department maintains that Tesoro withdraws refinery gas from the reaction, thus exposing the gas to taxation as an end product.

Viewed in isolation, rule 252(7)(b) appears to exclude possession of a hazardous substance from the tax if the taxpayer consumes the substance during the manufacturing or processing activity. But as mentioned earlier, RCW 82.32.300 authorizes the Department to adopt rules that are consistent with, chapter 82.21 RCW. And we read statutes pertaining to the same subject matter together to give each effect and to harmonize each with the other. *U.S. West Commc'ns, Inc. v. Utils. & Transp. Comm'n*, 134 Wn.2d 74, 118, 949 P.2d 1337 (1997).

When read together with chapter 82.21 RCW, rule 252(7)(b) is intended to set the timing of the taxing incident and avoid double taxation of a substance that is first created and then consumed in the manufacturing process. Indeed, rule 252(7) is titled “recurrent tax liability.” WAC 458-20-252(7). The underlying statutory authority refers to first possession of a hazardous substance. See RCW 82.21.010, .040. We cannot define the chemical processes that the Department intended to include within rule 252(7)(b)’s “otherwise consumed” language, but

when read in context, the language must refer to multiple possession of a hazardous substance. Rule 252(7)'s title implies that the taxpayer must have at least two possible instances of taxable possession before the rule applies. Tesoro possesses refinery gas only once; therefore, rule 252(7)(b) does not exempt Tesoro's possession of refinery gas from the hazardous substance tax.

If we accept Tesoro's reading of rule 252(7)(b), the regulation would exempt any hazardous substance that Tesoro completely consumed during manufacturing. To the extent the Department intended rule 252(7)(b) to exempt from taxation hazardous substances possessed only once, but completely consumed during the manufacturing process, the rule conflicts with chapter 82.21 RCW and exceeds the Department's statutory rulemaking authority. See *Edelman v. State ex rel. P.D.C.*, 152 Wn.2d 584, 591, 99 P.3d 386 (2004) and *Mayflower Park Hotel, Inc. v. Dep't of Revenue*, 123 Wn. App. 628, 633, 98 P.3d 534 (2004) (citing *Green River Cmty. Coll. v. Higher Educ. Pers. Bd.*, 95 Wn.2d 108, 112, 622 P.2d 826 (1980)) (agencies lack the authority to adopt rules that are inconsistent with statutes; and where statutes and rules conflict, the statute prevails).

Tesoro also contends that rule 252(8)(c) supports its argument that the tax applies only to hazardous substances withdrawn from storage for sale, transfer, manufacture, or consumption.

Rule 252(8)(c) provides:

(8) How and when to pay tax. . . . [The tax] is due for payment together with the timely filing of the return upon which it is reported, covering the tax reporting period during which the hazardous substance(s) is first possessed within this state.

....
(c) Special provision for manufacturers, refiners, and processors. Manufacturers, refiners, and processors who possess hazardous substances are required to report the tax and take any available exemptions and credits only at the time that such hazardous substances are withdrawn from storage for purposes of their sale, transfer, remanufacture, or consumption.

WAC 458-20-252(8)(c). Tesoro argues that it consumes refinery gas but never stores the gas. Tesoro's argument necessarily rests on the assumption that Tesoro is not "storing" refinery gas when it collects the gas from the individual processing units, pipes it to the fuel blender, and then pipes it to the furnaces and boilers that burn the gas to provide heat. But as we earlier discussed, the regulation is silent about how long the taxpayer must "store" the hazardous substance.

And again, we must read rule 252(8)(c) in conjunction with chapter 82.21 RCW. See *U.S. West Commc'ns, Inc.*, 134 Wn.2d at 118. RCW 82.21.030 taxes the first possession of hazardous substances in Washington. Rule 252(8)(c) provides a convenience to refiners with respect to the due date of the possession-based tax. Until a refiner sells or consumes a product, the refiner may not know whether the substance is entitled to an exemption or credit under RCW 82.21.040 or WAC 458-20-252. For instance, if the refiner produces a hazardous substance, stores it, and then later uses it as an ingredient in a taxable end product, the refiner would not have to pay the tax under rule 252(7)(b) on the ingredient. Rule 252(8)(c), titled "how and when to pay tax," relates to timing. If the refiner removed the hazardous substance from storage and failed to put it to a use that qualified for an exemption or credit, the tax would immediately become due. WAC 458-20-252(8)(c).

But when the refiner immediately sells or, in this case, consumes a petroleum product, the refiner knows whether it is entitled to a credit or exemption. Under those circumstances, there is no reason to delay the tax because the refiner knows that the hazardous substance will not eventually become a component or ingredient of another product. Tesoro's rule 252(8) argument fails.

2. Intelligibility of Rule 252

Tesoro argues that the Department's proposed reading of WAC 458-20-252(7)(b) violates the rule that tax laws should be intelligible to those expected to obey them. To support its argument, Tesoro contends that the "Department has for years advised Washington manufacturers that the [tax] did not apply to internally created and consumed hazardous substances." Reply Br. of Appellant at 17-18. Tesoro fails to cite to anything in the record supporting its contention that the Department has advised manufacturers that the tax did not apply. Accordingly, we do not address the argument. RAP 10.3(a)(4).

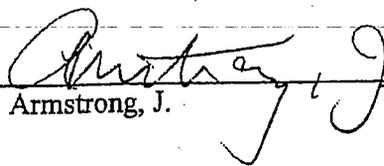
D. Excise Tax Advisory 540.04.22.252 (ETA 540)

The Department published ETA 540 in 1988.⁸ The Department withdrew ETA 540 in May 2005. Tesoro argues that ETA 540 establishes that refinery gas is exempted from the tax. ETA 540 refers only to former chapter 82.22 RCW (1987), the prior version of the tax law, which no longer exists. Former RCW 82.22.040(3)(d) (1987) exempted "liquid fuel or fuel gas used in petroleum processing" from the tax. The current version of the tax does not exempt liquid fuel or fuel gas used in petroleum processing; rather, chapter 82.21 RCW imposes the tax on the first possessor of hazardous substances. RCW 82.21.010; .030(1); .040. Thus, Tesoro's reliance on the repealed excise tax advisory is misplaced.

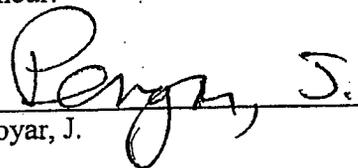
⁸ The Department initially published this document in 1988. When the Department published ETA 540, those publications were called Excise Tax Bulletins. So the Department's initial publication was technically ETB 540. In 1998, the Department converted ETB 540 to ETA 540. Tesoro's contention that the Department "reaffirmed and republished" ETA 540 is somewhat misleading. The Department merely converted ETB 540 into ETA 540.

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Affirmed.


Armstrong, J.

I concur:


Penoyar, J.

QUINN-BRINTNALL, C.J. (concurring in part and dissenting in part) — I agree with that portion of the majority opinion holding that Tesoro Refining and Marketing Company's power to use the hazardous substance created during the refinery process as fuel is a taxable possession under chapter 82.21 RCW.

But I respectfully dissent from that portion of the opinion suggesting that the Department of Revenue exceeded its statutory rulemaking authority by enacting WAC 458-20-252(7)(b) (rule 252) to exempt from taxation hazardous substances created and immediately consumed during the manufacturing process. *See* RCW 34.05.570(2)(c) (an agency rule is invalid if it exceeds the agency's statutory authority). Rule 252(7)(b) is clear and unambiguous. As the majority elaborates, one purpose of chapter 82.21 RCW is to prevent recurrent tax liability, but this purpose is not exclusive and, in my opinion, does not invalidate the plain meaning of rule 252(7)(b). Because the rule furthers the legislature's purpose and intent for the pollution tax (RCW 82.21.030) by exempting from taxation those hazardous substances not released into the environment but created and immediately consumed during the manufacturing process, we can give effect to and harmonize the statute and the rule. *King County v. Cent. Puget Sound Growth Mgmt. Hearings Bd.*, 142 Wn.2d 543, 560, 14 P.3d 133 (2000) (stating the rule that appellate courts should consider and harmonize statutory provisions together to ensure proper construction); *S. Martinelli & Co. v. Dep't of Revenue*, 80 Wn. App. 930, 940 n.6, 912 P.2d 521, review denied, 130 Wn.2d 1004 (1996) (noting that the rule of harmonization applies when the court interprets a tax statute together with an agency rule interpreting the statute). In my opinion, reading rule 252(7)(b) together with chapter 82.21 RCW, Tesoro is responsible for the hazardous substance tax on the gas it flamed off into the atmosphere. But under rule 252(7)(b), Tesoro is

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entitled to a refund of taxes it paid on gas that was created and immediately recycled and consumed during the refining process.

Quinn-Brintnall, C.J.
QUINN-BRINTNALL, C.J.

EXHIBIT B

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

TESORO REFINING and
MARKETING CO,

Appellant,

v.

DEPARTMENT OF REVENUE,

Respondent.

No. 33236-1-II

ORDER DENYING MOTION TO
RECONSIDER

FILED
COURT OF APPEALS
DIVISION II
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STATE OF WASHINGTON
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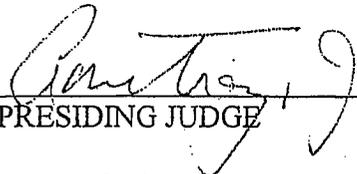
APPELLANT moves for reconsideration of the court's decision terminating review, filed **October 30, 2006**. Upon consideration, the Court denies the motion. Accordingly, it is

SO ORDERED.

PANEL: Jj. Armstrong, Quinn-Brintnall, Penoyar

DATED this 30TH day of November, 2006.

FOR THE COURT:


PRESIDING JUDGE

Michael Barr King
Lane Powell PC
1420 5th Ave Ste 4100
Seattle, WA, 98101-2338

George Carl Mastrodonato
Dorsey & Whitney LLP
1420 5th Ave Ste 3400
Seattle, WA, 98101-4010

Anne Elizabeth Egeler
Atty Generals Ofc/Revenue Division
7141 Clearwater Dr SW
PO Box 40123
Olympia, WA, 98504-0123

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LANE POWELL PC

EXHIBIT C

TRANSCRIPT OF TAPE RECORDING OF PROCEEDINGS

Court of Appeals, Division II

Case No. 33236-I-II

In the Matter of Tesoro Refining

vs.

Department of Revenue

JUDGES: The Hon. Christine J. Quinn-Brintall

The Hon. David Armstrong

The Hon. Joel M. Penoyar

ATTORNEYS: Michael B. King for Tesoro Refining

Anne Ageler for Dept. of Revenue

Date: April 3, 2006

Prepared by: Mindy Suurs, CSR

1 MR. KING: Your Honor, I have some
2 reproductions of some of the things that I'm planning to
3 put up. I'll hand those to the bailiff now, so the court
4 can provide the panel a copy. And I'm going to take a shot
5 at trying to reserve six minutes for rebuttal.

6 May it please the court, my name is Michael
7 King, and along with George Mastrodonato, who is with me at
8 counsel table. I'm from the Lane Powell firm in Seattle.
9 We're here today on behalf of plaintiff and appellant,
10 Tesoro Refining and Marketing Company.

11 Tesoro is the owner of a refinery in
12 Anacortes, Washington, and Tesoro challenges the
13 application of the hazardous substances tax to refinery
14 gas, a by-product of the refining process which is consumed
15 during the course of that process.

16 This is an incidence case.

17 The question before this court is whether
18 the hazardous substance tax applies to the refinery gas
19 produced at Tesoro's Anacortes refinery, and the resolution
20 of this question is governed by the long settled rule in
21 tax cases that a reasonable doubt about whether a tax
22 applies must be resolved in the taxpayer's favor.

23 Now, in addressing this question, I intend
24 to focus on two principal points: Number 1, the language
25 of the statute, and Number 2, the department's rule, Rule

1 252, interpreting the statute. And I will focus on the
2 statute and the rule in light of the uncontroverted facts
3 concerning the production and disposition of refinery gas
4 at the refinery.

5 But first I need to address an ambiguity
6 about the facts which I believe has been raised by a
7 statement in the department's brief. Now, there should be
8 no doubt that Tesoro has only one choice regarding the
9 refinery gas generated by the processes at its refinery in
10 Anacortes: Use the gas as fuel for the refinery boilers or
11 flare the gas as waste. But the department's brief seems
12 to imply that Tesoro has another choice. And I'm referring
13 to a statement that you will find on Page 4 of the brief,
14 right about here, at the end of the statement of the case,
15 where the department says: Although Tesoro uses its
16 refinery gas as a fuel or flares a miniscule amount of it
17 off, there are other uses for refinery gas.

18 And the department goes on to say: Refinery
19 gas can also be sent to a chemical plant for use as a
20 petrochemical feed stock.

21 Now, in support of this statement, the
22 department footnotes, Footnote 15, the clerk's papers 161
23 through 3, which are extracts from Mr. Crawford's
24 deposition -- and Mr. Crawford, of course, is the manager
25 for process engineering at the Anacortes refinery. Well,

1 if you turn to that testimony, you will find no discussion
2 on those pages about petrochemical refinery feed stock.
3 What you do find, however, that does relate to the issue at
4 hand -- and this is clerk's papers Page 161 -- what you do
5 find is this interchange right here: "There's no place to
6 store or sell it. It's a nonsalable product. We have to
7 store or sell it ourselves. So the only exception would be
8 instances where you need to flare it; is that correct?

9 Correct.."

10 Now, at one place elsewhere in the
11 deposition transcript of Mr. Crawford -- and by the way,
12 the entire thing was put in by the department. It is
13 illuminating, and you may want to review it -- and that
14 exchange occurs earlier on in the process. This is clerk's
15 papers Page 147, and there's this one question and answer.
16 Counsel for the department interjects this notion about
17 petrochemical feedstocks right here or so. And in
18 response, Mr. Crawford proceeds to describe, well, if you
19 actually had the additional hardware and facilities, you
20 would then try to further fractionate and process,
21 et cetera, et cetera, et cetera.

22 Here's the point. Yes, I'm sure there are
23 refineries in the country where you have this additional
24 technical capacity that allows you to take refinery gas and
25 sell it as petrochemical feedstock to somebody. But not

1 this refinery. In this refinery, there's one choice: You
2 use the refinery gas as fuel, you burn it up that way, or
3 you flare it as waste.

4 Turning then to the statute and the rule, I
5 would like to invert that order and touch briefly on the
6 rule itself, Rule 252. Because we would submit that the
7 plain import of that rule is pretty straightforward. Now,
8 I've prepared a chart for you labeled Rule 252, and it
9 reproduces the two clauses, 7(b) and 8(c). I can't quite
10 get both of them up there on the screen, but I'm only
11 intending to talk briefly about 7(b), in any case, for
12 purposes of discussion today.

13 7(b), of course, says that: When any
14 hazardous substance is first produced during and because of
15 any physical combination or chemical reaction which occurs
16 in a manufacturing or processing activity -- that's
17 refinery gas -- the intermediate possession of such
18 substance is not considered a taxable possession if the
19 substance -- one of two things happens -- becomes a
20 component or ingredient of the product being manufactured
21 or processed -- doesn't happen here; the record is clear --
22 or is otherwise consumed during a manufacturing or
23 processing activity. Well, that happens here. It's burned
24 up.

25 Now, let's sort of cut to the meaning

1 chase. We couldn't agree more with what Judge Hicks said
2 on this subject. Although he ruled against us, he did say
3 quite clearly -- and this is from the verbatim report of
4 proceedings, Page 71 -- he did say quite clearly right in
5 here, talking about the rule: "I recognize that if I just
6 read Rule 252, that the superior or better interpretation
7 of that rule is exactly as argued by the taxpayer."

8 But he went on to say: "If I put this rule
9 in the context of the statute, then there is a way to read
10 this rule that is not in conflict with the statute and
11 makes the possession taxable, based on there being a
12 possession."

13 So the focal point here has got to be the
14 statute. And let's turn to the statutory language. And
15 there are two provisions that we're worried about, we're
16 concerned with, we're focusing on. One is 030. That's the
17 incidence provision: Are taxes imposed on the privilege of
18 possession of hazardous substances in this state? Well,
19 we're not disputing that the term of art "hazardous
20 substance" is defined such that refinery gas is a hazardous
21 substance. But you're only taxed if you possess it. And
22 what's important is the legislature didn't leave that
23 meaning to idle speculation. The legislature went on and
24 provided definitions. That's 030. That's really what
25 we're -- 020. That's really what we're going to focus on

1 here. Possession means the control of a hazardous
2 substance. And control means the power to sell or use a
3 hazardous substance or to authorize the sale or use by
4 another.

5 Let me illustrate the relationship by
6 this chart. Possession means control. Possession means
7 the control of a hazardous substance, and control means the
8 power to sell or use a hazardous substance or to authorize
9 the sale or use by another.

10 Now, the sticking point here, I submit, is
11 the word "or," as it often is. And Tesoro readily
12 acknowledges that the presumptive meaning of "or" -- the
13 presumption is that the legislature intended "or" to be
14 used in the disjunctive. And that's really the heart of
15 the department's case here. The department is reading
16 "control" to mean, if the taxpayer has the ability to sell
17 or use or authorize the sale or use by another -- if the
18 taxpayer has that ability, that power, to do any one of
19 those things, even if it can't do the other two -- and here
20 we've got the ability to use, but we don't have the ability
21 to do the other two -- then we have possession and we have
22 a taxable possession.

23 Tesoro, on the other hand, would suggest
24 that control means the choice. The power means the choice
25 to sell or use a hazardous substance or to authorize the

1 sale or use by another.

2 Now, although "or" generally, generally, is
3 employed in the disjunctive, if the context suggests
4 otherwise, it will be read otherwise. And I think among
5 the cases that we cited in our reply brief that talk about
6 this point, the Clyde Hill decision really captures the
7 essence of the inquiry. 65 Wn App. 778 at Page 782, we
8 find the following language. There the issue was about
9 warnings concerning tests for drunk driving and whether you
10 had to give a warning about both a breath test or a blood
11 test. And the legislation in question referred to breath
12 or blood test. And in rejecting the notion that you had to
13 warn for both, the court focused on the language about "or"
14 and had this to say: Had the legislature intended to
15 direct law enforcement officers to mention both tests, it
16 could easily have used "and" rather than "or."

17 Well, could the legislature in this case
18 have easily used "and" rather than "or"? This is where the
19 department's case begins to deteriorate. This chart
20 focuses on the "and" alternative, and then we're going to
21 talk about the alternative ways to write this statute so
22 that the department's vision of the statute is clearly and
23 unambiguously expressed, and Tesoro's vision of the statute
24 is clearly and unambiguously expressed. The problem with
25 the "and" alternative is simply this: If you say control

1 means the power to sell and use a hazardous substance, you
2 have a nonsensical implication in the context of hazardous
3 substances. You can't have your hazardous substance cake
4 and eat it too, so to speak. You either use it or you sell
5 it, but if you use it, you can't sell it. That's why it's
6 not an easy thing to use "and" in this context, and the
7 legislature did not use "and."

8 Now, the fundamental problem here -- and it
9 is the problem for the department in this case given that
10 basic default rule about reasonable doubt -- is that the
11 legislature did not write things in a way that clearly and
12 unambiguously expressed either our reading or the
13 department's reading. Tesoro's reading, expressed plainly
14 and unambiguously, would be to have the statute read:
15 Control means the power to choose to sell or to use a
16 hazardous substance. The department's reading, expressed
17 plainly and unambiguously, would be control means the power
18 to sell or the power to use a hazardous substance or the
19 power to authorize the sale or use by another. Of course,
20 the problem is that isn't the way the legislature wrote the
21 statute -- isn't the way.

22 Now let's circle back to the rule because
23 here is where the department's case collapses, I submit, on
24 the fact of its rule. What is its rule? It's an
25 interpretive rule. We have the benefit on appeal of the

1 Supreme Court's unanimous decision in Association of
2 Washington Business, which came down just before we started
3 the briefing in this case. And in that case, Justice
4 Sanders, speaking for a unanimous court, broke out and
5 analyzed and categorized the various kinds of rules:
6 Regulatory rules and interpretive rules. We have an
7 interpretive rule here.

8 And two points were made in Association of
9 Washington Business that I want to flag: One is the point
10 that agencies issue interpretive rules only where there's
11 an ambiguity to interpret. And the second is the why you
12 issue interpretive rules -- to make things clear. And I
13 think it's worth quoting the language from Mr. Bonfield's
14 treatise on state administrative rule making that Justice
15 Sanders, for a unanimous court, quoted with approval. This
16 is from 155 Washington 2d at Page 440: Every legislature
17 wants agencies to determine the meaning of the law they
18 must enforce and to inform the public of their
19 interpretations so that members of the public may follow
20 the law.

21 When the agency, the Department of
22 Revenue -- and by the way, the Association of Washington
23 Business case is all about Department of Revenue
24 interpretive rules, three of them -- when the department
25 confronted this language in 1987, they must have

1 concluded: It's ambiguous. We need an interpretive rule.
2 We need to make clear to taxpayers what's a taxable
3 possession. And so they issued Rule 252, but of course, as
4 Judge Hicks recognized, under Rule 252, refinery gas, the
5 possession of refinery gas, is not a taxable possession.

6 Now, there's one last point I want to
7 underscore here, and that is what happened when the people
8 voted in 1988? Because the suggestion is made to you, oh,
9 well, they changed the statute. They took all sorts of
10 things out. Well, yes, they did narrow the exemption, but
11 contrary to the department's attempt to persuade you that
12 this is an exemption case, we're not arguing for an
13 exemption. We're saying that the tax doesn't apply to us
14 in the first instance. The people didn't change 020 or
15 030.

16 Now, what were the people concerned about?
17 Well, very simply, they were concerned about a very
18 specific phenomenon. The department remarkably quotes the
19 language from the voter's pamphlet, the statement for
20 Initiative 97, and I don't think the department fully
21 recognizes the implication of that language. The critical
22 language is under the heading "Tough Laws, Tough Fines, No
23 Deals." "Washington is the second worst state west of the
24 Mississippi for hazardous waste sites, seeping rain fields,
25 pesticides. Petroleum products can cause cancer and birth

1 defects. The need for tough toxics cleanup law is now
2 clear."

3 Refinery gas doesn't show up in hazardous
4 waste sites or seeping landfills. It's not pesticides.

5 Refinery gas is a by-product of the process that is
6 consumed in the process. The people were concerned about
7 an overly broad exemption that allowed the dispersal of
8 finished products that might also be used as fuel in a
9 facility out where the misuse of the product or the
10 misdisposal of the product would add to an environmental
11 burden. Landfills and toxic waste sites. That's not the
12 situation with refinery gas.

13 Your Honors, the fundamental principle that
14 in cases of reasonable doubt the taxpayer prevails is based
15 on this policy premise, and it is centuries old. It is the
16 people's money, a business's money, an individual's money
17 that we're talking about. The power to tax may be
18 employed, but it must be clearly employed for it to apply.
19 That clarity has not been made out by the department here.
20 This court should reverse, should grant the petition and
21 remand for a determination of the amount of the refund
22 owing to Tesoro. Thank you.

23 JUDGE QUINN-BRINTNALL: Thank you, Mr. King.

24 MS. EGELER: Good morning. My name is Anne
25 Egeler, and I'm an Assistant Attorney General representing

1 the Department of Revenue. The statute at issue in this
2 case is 82.21.030, and it is perhaps the simplest tax
3 statute I have been asked to stand before you and explain.

4 This tax is on the first possession of a
5 hazardous substance in Washington. Hazardous substance is
6 statutorily defined to include petroleum products,
7 including, quote, every product derived from refining crude
8 oil. So there is no limitation based on whether or not
9 this is something that is going to cause a health hazard.
10 So there's no issue there to discuss. Without question,
11 this is a hazardous substance under the statutory
12 definition.

13 As counsel pointed out, we also have a
14 statutory definition of the term "possession" as used in
15 the hazardous substance tax. And possession means the
16 control of a hazardous substance. And control, then, is
17 further defined within that subsection to mean the power to
18 sell or use a hazardous substance. There is no ambiguity
19 there whatsoever. It is quite clear that it means sell or,
20 alternatively, use. There's also no --

21 JUDGE QUINN-BRINTNALL: Ms. Egeler, is it
22 the department's position that, if they could not use and
23 recycle this -- this gas as a fuel and just had to burn it
24 off, that it would then not be a taxable event?

25 MS. EGELER: If there was no use possible --

1 JUDGE QUINN-BRINTNALL: That they just had
2 to burn it off as a -- as a by-product.

3 MS. EGELER: And there was also no way to
4 sell it, so they had no legal authority to sell this, and
5 they -- there was no possible use of it?

6 THE COURT: Well, they're saying right now
7 that they cannot take it and store it and ship it somewhere
8 else and do all of that, that there may be someplaces in
9 the world where that's possible to do, but they can't do it
10 here. But they can recycle it and use it to run the plant
11 itself. If they couldn't do that, if they didn't have the
12 technology and the -- and the ability to do that, and they
13 just had to flare it, I think is the phrase that they use,
14 is it the department's position, then, that that would not
15 be a taxable event?

16 MS. EGELER: If they did not possess
17 something that fell within the statute of something that
18 they had control and the power to sell or use, then no, I
19 don't believe that it would be taxed. In this instance,
20 though, they do use the -- the refinery gas, and the use of
21 that refinery gas is critical. According to Tesoro, they
22 could not operate the refinery without this refinery gas.

23 And it's important to look at the value of
24 this gas. During just the tax period at issue, the value
25 of that refinery gas, if they had had to replace that gas

1 with natural gas, which is what they do when they don't
2 have enough refinery fuel, it would have cost them 133
3 million dollars. This is of tremendous value to them.
4 They use it to heat the burners to go through the refinery
5 process and to heat their steam plant to provide general
6 heat to the refinery. This is a critical product for
7 them. They are deliberately creating the refinery gas by
8 mixing the various byproduct gases and creating a highly
9 valuable fuel source for that refinery.

10 JUDGE PENOYAR: But is it not clearly
11 consumed during the processing activity?

12 MS. EGELER: It is consumed during the
13 processing activity, but Rule 252, as the Superior Court
14 noted, could be read in a way that means that anything
15 consumed during the refining activity is exempt, except for
16 the fact that the Department of Revenue has no ability to
17 write the law. And under the law, there is no exemption
18 for fuel that is used in the refining process. In fact,
19 there used to be exactly such an exemption. There used to
20 be a -- an exemption for fuel gas used in petroleum
21 processing. That exemption was removed by the people in
22 1989.

23 If we read the words "sell" and "use" the
24 way that -- that Tesoro has requested, if we read out the
25 word "or" and replaced it with the word "and" and rewrote

1 statute, that exemption for fuel gas used in petroleum
2 processing would have been meaningless. There would have
3 been no need for that exemption because the use of fuel,
4 under Tesoro's rewriting of the statute, wouldn't have been
5 taxed. Only if they could sell and use it. If they simply
6 use it, as they have testified here is their only ability,
7 is to use the refinery gas, no tax whatsoever. That
8 exemption would be meaningless.

9 JUDGE PENOYAR: Aren't you using the
10 intermediate products that are consumed during the
11 processing activity? Aren't they being used? And wouldn't
12 that come under the definition of -- even your definition
13 of control?

14 MS. EGELER: I'm not sure I'm understanding
15 your question, Your Honor.

16 JUDGE PENOYAR: If, during the manufacturing
17 process, they produced not refinery gas, but some other
18 product that they could then mix back into the oil and get
19 something else out of it, you would say that's not -- that
20 product's not taxable; right?

21 MS. EGELER: If they create a product and
22 then they use it in an entirely different reaction to
23 create another product --

24 JUDGE PENOYAR: No, it's part of the same
25 continuing reaction. They put it back in and it -- it

1 becomes chemically united with whatever else is in there,
2 goes on to make a final product, that's not taxable;
3 right?

4 MS. EGELER: Well, what the department has
5 done in administering the rule has -- has said, as you have
6 pointed out, if there's a single reaction -- if you read
7 part 7(b), when a hazardous substance is first produced
8 during a reaction and then is contained within the final
9 product of that reaction as an ingredient or is created in
10 that reaction and consumed in that reaction, the department
11 is not taxing it. And it's -- it's a matter, frankly, of
12 administrative convenience. When you have a petroleum
13 company or you have a chemical company, fertilizer company,
14 going through a -- a chemical reaction, it's very hard for
15 an auditor to go in and break down every molecule that's
16 created and destroyed in a single reaction.

17 However, there is no -- no exemption for
18 things that are used in the plant. The actual statutory
19 exemptions are contained in 82.21.040. There are six
20 specific exemptions. If you withdraw something from a
21 chemical reaction and you later use it as an ingredient in
22 another reaction, yes, that's going to be taxed because
23 there is no specific statutory exemption. The legislature
24 was exclusive in that list of exemptions. And it comes
25 within --

1 JUDGE PENOYAR: But this refinery gas is
2 being put back into this reaction in the form of heat.

3 MS. EGELER: No, it's not. Refinery gas is
4 created in a physical process where they mix byproduct

5 gases and blend them. They then have a product that

6 they -- they have created: Refinery gas. They take

7 that --

8 JUDGE PENOYAR: And then they immediately
9 burn it to create the product they're actually shooting

10 for.

11 MS. EGELER: And then they use it in another
12 reaction. They use it as an exterior heat source, not as
13 an ingredient or component of what they're making, but as
14 an exterior product. If, however, we were to read the --

15 the rule in the manner that you're suggesting -- that's one
16 possible reading, according to the Superior Court -- it

17 would be inconsistent with the law. And if the rule is

18 inconsistent with the law, it is invalid. If we read this

19 rule as resurrecting the exemption for fuel gas used in the

20 refining process, then the rule is invalid. If we read it

21 in the manner the Supreme Court did, in the manner that the

22 Board of Tax Appeals did in reviewing this very same

23 refinery, as a rule that administers the law and does not

24 attempt to create a new exemption, then the rule stands.

25 But the bottom line is, as this court found

1 in the Fidelity Title case, Fidelity Title vs. the
2 Department of Revenue, the department, quote, cannot enact
3 or amend the law by making rules, and the court went on to
4 cite a number of Supreme Court cases making that very
5 point. The department does not have the ability to make
6 law. The AWB case cited by Tesoro during argument makes
7 this point as well. The court stated that DOR rules must
8 be consistent with statutes. There is no question that
9 this administrative agency does not have the ability to
10 take an exemption that the people deleted and reenact it.

11 It's also interesting to note that these
12 same provisions are in the petroleum products tax, which is
13 almost a mirror image of the hazardous substance tax. In
14 that law, the legislature again used the same definition of
15 possession and control. Looking at this language as a
16 whole and gaining the meaning from the context, as counsel
17 suggests this court should do, it is clear that the
18 legislature knew how to use the word "and" and knew how to
19 use the word "or." They chose to use the word "and" and
20 throughout here they wanted to include both actual and
21 constructive possession. When they wanted to make it
22 disjunctive, they used the word "or," the power to sell or
23 use. And in recognition of that, they originally wrote in
24 the fuel gas exemption for the use of fuel gas in a
25 petroleum process.

1 Under the plain language of the hazardous
2 substance tax, Tesoro's possession of this hazardous
3 substance and its use of this hazardous substance is
4 subject to the tax.

5 And one last point I'd like to make is that
6 there has been a great deal of reference to rules of
7 statutory construction regarding tax imposing statutes.
8 Unless you find ambiguity in the law, in the tax imposing
9 statute, then that rule does not apply. That is a rule
10 that applies only if it is -- is an ambiguous statute. If
11 you find ambiguity, then it is one of the rules of
12 statutory construction to be applied to determine what the
13 legislature's intent was.

14 Since this falls within the definition of a
15 hazardous substance and it is possessed and used by Tesoro,
16 we ask that the Superior Court order be upheld. Thank you.

17 JUDGE QUINN-BRINTNALL: Mr. King.

18 MR. KING: It's 6:06. I don't think I'll
19 take that full amount of time.

20 Your Honors, just a few points. First,
21 counsel says: "This is the simplest statute I've ever
22 addressed." Well, the people who prepare interpretive
23 rules must have viewed things a little differently in 1987
24 or they wouldn't have proffered that interpretive rule
25 since you're only supposed to proffer an interpretive rule

1 to clarify an ambiguity. I guess it wasn't so simple to
2 them in 1987.

3 Second, in response to Judge
4 Quinn-Brintnall's question about what if Tesoro couldn't
5 use this substance at all and just had to flare it entirely
6 as waste gas, would that be a taxable event, there were a
7 couple comments I just want to focus on. One was the
8 acknowledgment, well, no, it would not be taxed. Well,
9 that's a shift of position because the department has
10 previously been taking the position that we ought to pay
11 tax on refinery gas that's flared as well. So now at least
12 we've got the acknowledgment here that refinery gas that
13 has to be flared isn't subject to tax.

14 But in addition, there is this implication
15 that because this is valuable, this is something that we
16 deliberately create. Now, it is certainly true that it is
17 valuable in that we are able to use it -- we are only able
18 to use it -- we can't sell it -- we're able to use it as
19 fuel to heat the boilers. But this suggestion that we
20 deliberately create it is absolutely contrary to the
21 uncontroverted evidence.

22 The testimony from Mr. Crawford -- and it's
23 highlighted in our brief, it's in the declarations, it's in
24 the deposition testimony -- is clear: This is a natural
25 result of a chemical process we can't control. It's a

1 natural result of the breakdown of the crude oil that we're
2 refining. It's yielded. It's not something that we go
3 about creating. We wish it didn't arise. Mr. Crawford's
4 deposition testimony about this was quite specific, but it
5 does get yielded and we have to deal with it.

6 Now, Judge Penoyar, you had an interchange
7 with counsel and you were focusing on the fact that we use
8 the substance by putting it back into the fuel cycle rather
9 promptly and it gets burned up and converted to heat and
10 it's heating the boilers, and the boilers, in turn, are
11 heating the refining process. And again, we have this
12 theme from the department, no, we create it, we blend it.
13 Again, that's simply not consistent with the actual
14 physical facts, the uncontroverted evidence, the actual
15 physical facts.

16 Again, Mr. Crawford's description is -- is
17 quite specific and quite good, and this is in the
18 deposition. He's describing that there are these refinery
19 operations going on and these are light gases that are
20 being produced, various kinds, and they end up being
21 streamed off these various refining centers and brought
22 into this so-called blender.

23 Well, there's nothing chemically that's
24 being done to these refinery gases. When we say "blend,"
25 we simply mean they're all collected and whooshed together

1 and they go out in one stream, off to the boiler. It's
2 kind of like a drain pipe system, as Mr. Crawford describes
3 it, where you're bringing together all these gases. You're
4 not doing a single thing to them chemically. We are not
5 making a new substance. The testimony is clear and
6 uncontroverted. There is no chemical change to any of
7 these distinct streams; they're just being mixed together
8 and they're shot off to the boiler and they're burned and
9 that's it.

10 JUDGE PENOYAR: If you produce a byproduct
11 from this process at the end of the -- that was not
12 commercially viable, a mixture of acids or something that
13 just wasn't something you could sell on the market, would
14 you have to pay a tax on that?

15 MR. KING: No. And I think we now know that
16 we wouldn't have to pay a tax on that because of the
17 department's answer. That would be like waste gas. We've
18 got to flare it, we've got to dispose of it. There are,
19 I'm certain, other taxes that it -- it would be taxed on,
20 for example, first and foremost, the business and
21 occupation tax. We do pay business and occupation tax on
22 refinery gas along with every, you know, other part of the
23 business of the refinery; but we wouldn't be paying on that
24 waste substance. As the department acknowledges, refinery
25 now, refinery gas that's flared shouldn't be taxed, because

1 it's not being used and it's not being sold

2 JUDGE PENOYER: A hazardous substance that's
3 produced in this state is not subject to this tax unless
4 whoever produced it would have the choice of selling it,
5 using it, or authorizing someone else to sell or use it?

6 MR. KING: Yes, and that goes to the purpose
7 of this tax. The purpose of this tax -- and it's very
8 clear -- the purpose of this tax was to create a fund that
9 would then be used to address a specific environmental
10 problem. That environmental problem is that certain
11 substances, over decades, were being dispersed out, used in
12 various ways, and the uses of those substances was
13 generating pollution, the disposal of those substances was
14 generating pollution.

15 JUDGE PENOYER: If you focus on disposal, if
16 you produce something that you couldn't sell, wouldn't the
17 theory behind this tax also say, well, we need to tax that
18 because that's going to get dumped somewhere?

19 MR. KING: No, not the theory behind this
20 particular tax. The theory behind this particular tax is
21 that, if you have a substance that you can use or sell,
22 it's focusing on the particular problem of the creation of
23 substances that either are -- are -- you have a choice of
24 using or you have a choice of selling.

25 JUDGE PENOYER: So it's only focusing on

1 commercially viable substances?

2 MR. KING: I think that's correct. I think
3 that's absolutely correct. But in any event, if we circle
4 back to the department's answer about the waste gas,
5 suppose you -- suppose you change that answer and suppose
6 you conclude, well, it would be subject to some sort of
7 tax. Well, that's .5 percent of the refinery gas that we
8 generate. The issue here is the 99.5 percent that we're
9 using as fuel.

10 Now, it's suggested to you that our
11 definition will render the appeal of the exemption by the
12 people for fuel gas meaningless, and that's not true. Fuel
13 gas is something like butane and propane. That was used as
14 fuel for refinery operations and wasn't taxed. The people
15 eliminated that exemption. We're not talking about that.
16 We're talking about a substance that is generated on-site
17 and burned up on-site. That was not the focal point of the
18 people's actions.

19 Finally, the department says that you can't
20 use a rule to change a statute. We're not adding -- we're
21 not adding or subtracting here. This is really amazing.
22 And I see I did use my time, and if I may, I'll sum up on
23 this point. When have you seen the Department of Revenue
24 run away from one of its interpretive rules? I submit you
25 haven't. This interpretive rule was promulgated because

1 the statute was ambiguous. And it's that ambiguity that
2 means that this tax should not be applied to refinery gas.

3 Thank you, Your Honors.

4 JUDGE QUINN-BRINTNALL: Thank you,
5 Mr. King. Thank you, Counsel.

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EXHIBIT D

EXHIBIT D
PAGE 1 OF 1



PROPOSED RULE MAKING

CR-102 (June 2004)

(Implements RCW 34.05.320)
Do NOT use for expedited rule making

Agency:

- Preproposal Statement of Inquiry was filed as WSR 06-11-169 ; or
- Expedited Rule Making--Proposed notice was filed as WSR ; or
- Proposal is exempt under RCW 34.05.310(4).

- Original Notice
- Supplemental Notice to WSR
- Continuance of WSR

Title of rule and other identifying information: WAC 458-20-185 Tax on tobacco products

Hearing location(s):

Capitol Plaza Building
4th Floor Executive Conference Room
1025 Union Avenue SE
Olympia, Washington 98504

Submit written comments to:

Name: Margaret J. Partlow
Address: Post Office Box 47453
Olympia, Washington
98504-7453
e-mail margaretpa@dor.wa.gov
fax (360) 586-5543
by November 16, 2006

Date: Thursday, November 16, 2006 Time: 10:00 a.m.

Assistance for persons with disabilities: Contact Sandy Davis at (360) 725-7499 no later than 10 days before the hearing date. Deaf and hard of hearing individuals may call 1-800-451-7985 (TTY users).

Date of intended adoption: November 24, 2006
(Note: This is NOT the effective date)

Purpose of the proposal and its anticipated effects, including any changes in existing rules:

WAC 458-20-185 (Rule 185) provides tax-reporting information to persons who sell, use, handle, possess, transport, store, or distribute tobacco products. The proposed changes to the rule update existing information and incorporate significant legislative amendments to Chapter 82.26 RCW.

The current Rule 185 provides that the other tobacco products (OTP) tax "does not apply to tobacco products sold to federal government agencies . . . and a credit may be taken for the amount of tobacco products tax previously paid on such products." The Department has reconsidered these reporting instructions as they relate to tobacco products sold to federal entities and determined that the instructions are not authorized by current statute. These instructions are therefore not included in the proposed rule, and as a result a credit for taxes previously paid on tobacco products sold to federal entities will not be allowed.

Reasons supporting proposal:

Statutory authority for adoption: RCW82.32.300 and 82.01.060(2)

Statute being implemented: Chapter 82.26 RCW

Is rule necessary because of a:

- Federal Law? Yes No
 - Federal Court Decision? Yes No
 - State Court Decision? Yes No
- If yes, CITATION:

Filed: October 4, 2006

Time: 10:42 a.m.

Date

WSR: 06-20-113

Name

Alan R. Lynn

Signature

The above information was input by DOR

Title

Rules Coordinator

Agency comments or recommendations, if any, as to statutory language, implementation, enforcement, and fiscal matters: None.

Name of proponent: Department of Revenue

- Private
- Public
- Governmental

Name of agency personnel responsible for:

Name	Office Location	Phone
Drafting..... Margaret J. Partlow	1025 Union Ave. SE. Ste #544, Olympia , Wa	(360) 570-6123
Implementation.... Alan R. Lynn	1025 Union Ave. SE. Ste #544, Olympia , Wa	(360) 570-6125
Enforcement..... Janis P. Bianchi	1025 Union Ave. SE. Ste #544, Olympia , Wa	(360) 570-6147

Has a small business economic impact statement been prepared under chapter 19.85 RCW?

Yes. Attach copy of small business economic impact statement.

A copy of the statement may be obtained by contacting:

Name:
Address:

phone
fax
e-mail

No. Explain why no statement was prepared. A small business economic impact statement is not required because the rule and the amendments do not impose any requirements or burdens upon small business that are not already required by statute.

Is a cost-benefit analysis required under RCW 34.05.328?

Yes A preliminary cost-benefit analysis may be obtained by contacting:

Name:
Address:

phone
fax
e-mail

No: Please explain: The proposed rule is not a significant legislative rule as defined by RCW 34.05.328.

THIS PROPOSED RULE IS SUBMITTED FOR PUBLIC COMMENTS AFTER INPUT FROM INTERESTED PARTIES AND IS TO BE USED SOLELY FOR DISCUSSION PURPOSES AT THE PUBLIC HEARING ON THE PROPOSED RULE. UNDER NO CIRCUMSTANCES IS THIS PROPOSED RULE TO BE USED TO DETERMINE TAX LIABILITY AND OR EXEMPTIONS.

AMENDATORY SECTION (Amending WSR 03-12-058, filed 6/2/03, effective 7/3/03)

WAC 458-20-185 Tax on tobacco products. ((1))

~~Introduction.~~ This rule explains the tax liabilities of persons engaged in business as a retailer, distributor or subjobber of tobacco products. The tax on tobacco products is in addition to all other taxes owed. For example, retailers, distributors, and subjobbers are liable for business and occupation tax on their retailing or wholesaling activities, use tax on tobacco products distributed as samples, and litter tax on the value of the tobacco products. See WAC 458-20-186 for tax liabilities associated with taxes which apply exclusively to cigarettes.

~~(2) Definitions.~~ The following definitions apply to this rule.

~~(a) "Tobacco products" means all tobacco products except cigarettes as defined in RCW 82.24.010. The term includes:~~

~~(i) Cigars, cheroots, stogies, and periques;~~

~~(ii) Granulated, plug cut, crimp cut, ready rubbed, and other smoking tobacco;~~

~~(iii) Snuff, snuff flour, cavendish, plug and twist tobacco, fine cut, and other chewing tobaccos; and~~

~~(iv) 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.~~

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

~~(c) "Distributor" means:~~

~~(i) 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;~~

~~(ii) Any person who makes, manufactures, or fabricates tobacco products in this state for sale in this state;~~

~~(iii) 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; or~~

~~(iv) 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.

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

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

~~(f) "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 all gifts by persons engaged in the business of selling tobacco products, for advertising, as a means of evading the provisions of chapter 82.26 RCW, or for any other purposes whatsoever.~~

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

~~(i) A wholesale sales price that is an established price must reflect the fair market value of the tobacco products. In the case where a seller and buyer establish a sales price that does not reflect fair market value, such as may occur in certain sales between affiliated companies, the wholesale sales price is the fair market value of the tobacco product and not the sales price established by the seller and buyer.~~

~~(ii) The phrase "discount or other reduction" includes any reduction from the established wholesale sales price made to a specific customer or class of customers.~~

~~**Example.** Pursuant to a half price promotion, a manufacturer sells tobacco products to a distributor. The invoice lists \$100 as the price of the product less a \$50 discount resulting in a net invoice of \$50. The tax is due on \$100 which is the wholesale sales price exclusive of any discount or other reduction.~~

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

~~(i) "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.~~

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

~~(k) "Department" means the department of revenue.~~

~~(l) "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.~~

~~(m) "Indian country" means the same as defined in WAC 458-20-192.~~

~~(3) Rate and measure of tax. The Washington state tobacco products tax is an excise tax levied on the wholesale sales price on all tobacco products sold, used, consumed, handled, or distributed within the state.~~

~~The rate of tax is a combination of statutory percentage rates found in RCW 82.26.020, 82.26.025, and 82.26.028. The total current rate of tax is shown on the current combined excise tax return.~~

~~(4) Imposition of tax. The tax is imposed once on all tobacco products sold, used, consumed, handled, or distributed within this state.~~

~~(a) When tax is imposed. The tax is imposed at the time the distributor:~~

~~(i) Brings, or causes to be brought, into this state from without the state tobacco products for sale; or~~

~~(ii) Makes, manufacturers, or fabricates tobacco products in this state for sale in this state; or~~

~~(iii) Ships or transports tobacco products to retailers in this state, to be sold by those retailers; or~~

~~(iv) Handles for sale any tobacco products that are within this state but upon which tax has not been imposed. For example, a retailer with a place of business in this state purchases for sale tobacco products from an enrolled tribal member of a federally recognized tribe located within Indian country. Because the tax was not imposed on the enrolled tribal member, the retailer must pay the tax.~~

~~(b) Additional occasion when tax may be imposed. Any retailer who fails to keep invoices as required under chapter 82.32 RCW and which invoices do not conform to the requirements set forth in subsection (5)(b) of this rule is liable for the tax on any uninvoiced tobacco product which that retailer handles for sale.~~

~~(c) When an out of state person is a distributor who must pay the tax. A person located out of state who is selling tobacco products to Washington wholesalers from a stock of goods located outside this state is not a distributor and therefore is not liable for the tax.~~

~~(i) On the other hand, a person located out of state who is selling and shipping tobacco products to Washington retailers from an out of state stock of goods is a distributor and is subject to the tax. If the out of state person is not required~~

~~to register and pay taxes in Washington, the retailers to whom it sells must pay the tax. However, such out of state persons may elect to register with the state and pay the tax.~~

~~(ii) A Washington retailer who purchases tobacco from an out of state stock of goods from a person located out of state who is not required to register and pay taxes in Washington may provide to that person a certificate affirming that the Washington retailer will remit to the state the tax due. Both the out of state person and the Washington retailer should retain a copy of such certificate. The certificate should substantially conform to the example shown below:~~

~~Retailer's Certificate of Remittance of Tax~~

~~The undersigned retailer hereby certifies that the undersigned will remit to the state the tax due on the tobacco products specified below purchased from seller. This certificate shall be considered a part of each order which the undersigned may give to the seller, unless otherwise specified, and shall be valid until revoked by the undersigned in writing or until it expires, whichever occurs first. This certificate expires four years from the effective date.~~

~~Name of Seller: _____~~

~~Name of Retailer _____ Effective Date _____~~

~~UBI/Registration # _____~~

~~Address of Retailer _____~~

~~Tobacco products purchased _____~~

~~Agent for Retailer (print) _____~~

~~Signature _____~~

~~(iii) A person who is located out of state and who is required to register and pay taxes in Washington may sell and ship tobacco products to a Washington customer who is both a wholesaler and retailer. Under this circumstance, the person, the customer, and the department may enter into a written agreement that identifies the person who will remit to the state the tax due as to those particular sales. The written agreement will contain such other terms and conditions that are acceptable to the department.~~

~~(iv) When a person located outside Washington distributes samples in this state, that person must pay the tax on those samples.~~

~~(5) Books and records. Since the tobacco products tax is paid on returns as computed by the taxpayer rather than by affixing of stamps or decals, the law contains stringent provisions requiring that accurate and complete records be maintained. The records must include all pertinent papers and~~

~~documents relating to the purchase, sale, or disposition of tobacco products and must be kept for a period of at least five years after the date of the document or the date of the entry appearing in the records.~~

~~(a) Distributors. Distributors must keep at each registered place of business complete and accurate records for that place of business. The records to be kept by distributors include itemized invoices of tobacco products held, purchased, manufactured, brought in or caused to be brought in from without the state or shipped or transported to retailers in this state, and of all sales of tobacco products except retail sales. The itemized invoice for each purchase or sale must be legible and must show the seller's name and address, the purchaser's name and address, the date of sale, and all prices and discounts. Itemized invoices must be preserved for five years from the date of sale.~~

~~(b) Retailers and subjobbers. Retailers and subjobbers must secure itemized invoices of all tobacco products purchased. The itemized invoice for each purchase must be legible and must show the seller's name and address, the purchaser's name and address, the date of sale, and all prices and discounts. Itemized invoices must be preserved for five years from the date of sale.~~

~~(c) Warehouses. Records of all deliveries or shipments (including ownership, quantities) of tobacco products from any public warehouse of first destination in this state must be kept by the warehouse.~~

~~(6) Nonpayment of tax by retailers. If the department finds that any nonpayment of tax by the retailer was willful, penalties and interest shall be assessed in accordance with chapter 82.32 RCW. In the case of a second or plural nonpayment of tax by the retailer, penalties and interest will be assessed in accordance with chapter 82.32 RCW without regard to willfulness.~~

~~(a) Example. In the course of an audit of Retailer, the department determines that on several occasions Retailer failed to pay the tax. The department does not find the nonpayment to be willful. Retailer owes the tax due on all occasions of nonpayment and the penalties and interest is assessed on all but the first occasion of nonpayment. A few years later Retailer is audited again. The department finds one occasion of nonpayment of tax. In addition to the tax due, penalties and interest will be assessed in accordance with chapter 82.32 RCW.~~

~~(b) Example. In the course of an audit of Retailer #2, the department determines that on several occasions Retailer #2 failed to pay the tax. The department determines that the nonpayment of tax was willful. In addition to the tax due on all occasions of nonpayment, Retailer #2 owes penalties and interest on all occasions.~~

~~(7) Reports and returns.~~ The tax is reported on the combined excise tax return to be filed according to the reporting frequency assigned by the department. Detailed instructions for preparation of these returns may be secured from the department.

~~Out of state wholesalers or distributors selling directly to retailers in Washington should apply for a certificate of registration, and the department will furnish returns for reporting the tax.~~

~~Retailers, distributors, and subjobbers may be required to file a report with the department in compliance with the provisions of the National Uniform Tobacco Settlement when purchasing tobacco products from certain manufacturers. Please see WAC 458-20-264 and chapter 70.157 RCW.~~

~~(8) Interstate sales and sales to U.S.~~

~~(a) The tax does not apply to tobacco products sold to federal government agencies, nor to deliveries to retailers outside the state for resale by such retailers, and a credit may be taken for the amount of tobacco products tax previously paid on such products. RCW 82.26.110. The credit is not available for sales made for delivery outside this state other than sales for resale to retailers. For example, no credit may be taken for a sale of tobacco products delivered to a consumer outside the state.~~

~~(b) To document that the tobacco products were sold to a retailer outside the state for resale by such retailer, the person may obtain from the retailer a certificate which substantially conforms to the following:~~

~~Retailer's Certification of Purchase of Tobacco Products for
Resale Outside Washington~~

~~The undersigned buyer/retailer hereby certifies that the tobacco products specified below are purchased for resale outside this state by the undersigned. This certificate shall be considered a part of each order which the undersigned may give to the seller, unless otherwise specified, and shall be valid until revoked in writing by the undersigned or until it expires, whichever occurs first. This certificate expires four years from the effective date.~~

~~Name of Seller _____ Effective Date _____~~

~~UBI/Registration # _____~~

~~Name of Buyer/Retailer Business _____~~

~~Address _____~~

~~Items purchased for resale _____~~

~~Agent for buyer/retailer (print) _____~~

~~Signature _____~~

~~(9) Returned or destroyed goods.~~ A credit may also be taken for tobacco products destroyed or returned to the manufacturer on which tax was previously paid. If the credit is claimed against tax owed by the taxpayer or as a refund of tax paid, taxpayers must retain in their records appropriate documentation, affidavits or certificates conforming to those illustrated below:

~~(a) Certificate of taxpayer.~~

Claim for Credit on Tobacco Products
Tax Merchandise Destroyed

The undersigned certifies under penalty of perjury under the laws of the state of Washington that the following is true and correct to the best of his/her knowledge:

That he/she is (Title) of the (Business Name), a dealer in tobacco products; that the dealer has destroyed merchandise unfit for sale, said tobacco products having a wholesale sales price of \$; that tobacco tax had been paid on such tobacco products; that the tobacco products were destroyed in the following manner and in the presence of an authorized agent of the department of revenue:

.....
(State date and manner of destruction)
.....
.....

Attested to:
Date

By
Signature of Taxpayer or
Authorized Representative:

.....
Position with Dealer

.....
Dealer

.....
Address of Dealer

APPROVED:

.....
Authorized Agent of
Department of Revenue of the
State of Washington.

~~(b) Certificate of manufacturer.~~

Claim for Credit on Tobacco Products
Tax Merchandise Returned:

The undersigned certifies under penalty of perjury under the laws of the state of Washington that the following is true and correct to the best of his/her knowledge:

That he/she is (Title) of the (Business Name), a manufacturer of tobacco products; that the manufacturer has received from (Dealer), (Address), a dealer in tobacco products within the State of Washington, certain tobacco products which were unfit for sale, the tobacco products having a wholesale sales price of \$; that

the tobacco products were destroyed in the following manner:

(Indicate date and manner of destruction)

Credit issued on Memo No. _____
credit approved by: _____

Signature of Taxpayer or
Authorized Representative

on behalf of the Department
of Revenue State of
Washington

Name of Manufacturer

Address

~~(10) Enforcement.~~ Pursuant to RCW 82.26.121 and 66.44.010, enforcement officers of the liquor control board may enforce all provisions of the law with respect to the tax on tobacco products. Retailers, distributors, and subjobbers must allow department personnel and enforcement officers of the liquor control board free access to their premises to inspect the tobacco products contained in the premises and to examine the books and records of the business. Failure to allow free access or to hinder or interfere with department personnel and/or enforcement officers of the liquor control board may result in the revocation of the business license.)) (1) Introduction.

This rule explains the tax liabilities of persons engaged in business as retailers or distributors of tobacco products other than cigarettes. The tax on tobacco products (also called "other tobacco products" or OTP tax) is in addition to all other taxes owed, such as retailing or wholesaling business and occupation tax, sales tax, and litter tax. See WAC 458-20-186 for tax liabilities associated with taxes that apply exclusively to cigarettes.

(2) Organization of rule. The information provided in this rule is divided into five parts:

(a) Part I provides definitions and explains the tax liabilities of persons engaged in the business of selling or distributing tobacco products (excluding cigarettes) in this state.

(b) Part II explains the licensing requirements and responsibilities for persons making wholesale or retail sales of tobacco products in this state.

(c) Part III explains the requirements and responsibilities for persons transporting tobacco in Washington.

(d) Part IV explains the recordkeeping requirements and enforcement of the tobacco tax.

(e) Part V describes the credits for tax paid and the procedures that must be followed to qualify for credit.

Part I - Tax on Tobacco Products (excluding Cigarettes)

(101) In general. The Washington state tobacco products

tax is due and payable by the first distributor who possesses tobacco products in this state. The measure of the tax in most instances is based on the actual price paid by the distributor for the tobacco product, unless the distributor is affiliated with the seller.

(102) **Definitions.** For the purposes of this rule, the following definitions apply:

(a) **"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.

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

(c) **"Board"** means the liquor control board.

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

(e) **"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.

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

(g) **"Department"** means the department of revenue.

(h) **"Distributor"** means:

(i) 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;

(ii) Any person who makes, manufactures, fabricates, or stores tobacco products in this state for sale in this state;

(iii) Any person engaged in the business of selling tobacco products from outside this state who ships or transports tobacco products to retailers in this state, to be sold by those retailers;

(iv) 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. RCW 82.26.010 (3)(a) through (d). (For example, Sunshine Tobacco Shop ("Sunshine") buys cigars from an out-of-state manufacturer for resale to consumers in this state. The cigars are shipped to Sunshine via common carrier. In this instance, Sunshine is a distributor, must have both a retailer's and a distributor's license, and must pay the tobacco products tax on the products it brings into the state. However, if Sunshine bought its merchandise exclusively from in-state distributors that have paid the tobacco products tax on that

merchandise, Sunshine would not be considered a distributor, and would need only a retailer's license.)

(i) "Indian," "Indian country," and "Indian tribe" have the same meaning as defined in chapter 82.24 RCW and WAC 458-20-192.

(j) "Manufacture" means the production, assembly, or creation of new tobacco products. For the purposes of this rule, "manufacture" does not necessarily have the same meaning as provided in RCW 82.04.120.

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

(l) "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.

(m) "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.

(n) "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.

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

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

(q) "Sale" means:

(i) 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.

(ii) 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.

(r) "Sample" and "sampling" have the same meaning as in RCW 70.155.010. Sampling is prohibited in this state. See chapter 70.155 RCW.

(s) "Store," "stores," or "storing" means the holding of tobacco products for later sale or delivery inside or outside this state. For example:

(i) Wilderness Enterprises ships products from out-of-state to its Kent warehouse. All products are intended for future

sale to Alaska. Wilderness Enterprises is a distributor that stores tobacco products in this state. Wilderness Enterprises is liable for tobacco products tax on the products stored in this state. (However, see subsection (401) of this section for credits that may be available to Wilderness Enterprises for out-of-state sales.)

(ii) Cooper Enterprises brings tobacco products into this state for sale. It rents storage space from a third party, Easy Storage. Cooper Enterprises, not Easy Storage, is responsible for the tax and reporting requirements on the stored tobacco products.

(t) "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. For purposes of this subsection, "person" includes both persons as defined in (m) of this subsection 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;

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

For purposes of this subsection, "person" includes both persons as defined in (m) of this subsection 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;

(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 for which 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 (q) (ii) of this subsection, the price, determined as nearly as possible according to the actual price for which 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 (t)(i) through (v) of this subsection do not apply, the price, determined as nearly as possible according to the actual price for which 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.

(u) **"Taxpayer"** means a person liable for the tax imposed by chapter 82.26 RCW.

(v) **"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, including wrapping papers or tubes that contain any amount of tobacco (such as "blunts"), 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.

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

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

(103) **Imposition of tax.** RCW 82.26.030 as amended effective July 1, 2005, states: "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." The tax is imposed at the time the first distributor possesses the product in this state for sale. RCW 82.26.020(2).

Examples. The following examples, while not exhaustive, illustrate some of the circumstances in which the tax is imposed. These examples should be used only as a general guide. The status of each situation must be determined after a review of all of the facts and circumstances.

(a) BET Wholesalers sells and ships tobacco products from Kentucky via common carrier to Surprise Enterprises in Washington. The tax is due from Surprise Enterprises, because it is the first possessor in Washington that holds the product for sale. However, BET Distributors must give the liquor control board (LCB) notice of its intent to ship tobacco products into this state.

(b) BET Wholesalers sells and ships tobacco products in its own trucks from Kentucky to Jamie's Enterprises in Washington.

The tax is due from BET Wholesalers, because it is the first possessor in Washington that holds the product for sale.

(c) Garden State Cigars is located in New Jersey. It ships its products to Washington retailers via National Common Carrier. The retailers must be licensed as distributors and are liable for the tax. However, Garden State Cigars must give the liquor control board (LCB) notice of its intent to ship tobacco products into this state.

(104) **Rates.** The Washington state tobacco tax is an excise tax levied on the taxable sales price as defined in RCW 82.26.010. The rate is a combination of statutory rates found in RCW 82.26.020.

(105) **Promotions.**

(a) Tobacco products sold, provided at a reduced cost, or given away for advertising or any other purpose are taxed in the same manner as if they were sold, used, consumed, handled, possessed, or distributed in this state. RCW 82.26.010 (5)(b). The taxable sales price for the tobacco products is the actual price for which the taxpayer or other distributors sell the same tobacco products, or a maximum of 67 cents each for cigars.

For example, Etta's (an out-of-state manufacturer) gives Joe's Distributing 500 cigars and 200 cans of snuff as a promotion. Etta's and Joe's Distributing are unaffiliated. Joe's Distributing normally sells this brand of cigars for \$1.00 each and the snuff for \$2.50 each to unaffiliated distributors and/or retailers. Joe's Distributing owes tobacco products tax on this merchandise. Because Joe's Distributing normally sells each cigar for more than 67 cents, the tobacco products tax is calculated on the cigars at 50 cents each ($500 \times 0.50 = \$250$). The tobacco products tax on the snuff is calculated at 75% of Joe's normal selling price to unaffiliated buyers ($200 \times \$2.50 = \$500 \times 75\% = \$375$) for a total tobacco products tax of \$625.

(b) If a product is purchased or sold at a discount in a promotion characterized as a "2 for 1" or similar sale, the tax is calculated on the actual prorated consideration the buyer paid to the unaffiliated distributor, or a maximum of 67 cents a cigar.

For example:

(i) Duke Distributing (an out-of-state wholesaler) ships tobacco products via common carrier to Lem's Tobacco Shop (an unaffiliated Washington retailer). Duke invoices Lem's for \$1,500. The sale includes 200 cigars priced "buy one for \$2 and get one free"; the balance of the sale is chewing tobacco priced at \$1,300. Lem's Tobacco Shop is liable for the tax. The tax on the chewing tobacco is \$975 ($\$1,300 \times 75\%$). Each cigar costs Lem's Tobacco Shop \$1 ($\$200/200$ cigars = \$1 per cigar). Because each cigar costs more than 67 cents, the tax on the cigars is capped at \$0.50 each. The tax on the cigars is \$100 (200 cigars

x \$0.50 = \$100). Total tobacco tax due on the invoice is \$1,075.

(ii) Shasta Distributing (an out-of-state wholesaler) ships OTP in its own trucks to Lem's Tobacco Shop (an unaffiliated Washington retailer). Shasta invoices Lem's for \$1,500. The sale includes 200 cigars priced "buy one for \$2 and get one free"; the balance of the sale is chewing tobacco priced at \$1,300. Shasta Distributing owes the tax. Shasta originally purchased the products from an unaffiliated manufacturer for \$300 (\$100 for the cigars and \$200 for the chewing tobacco). The tax on the chewing tobacco is \$150 (\$200 x 75%). The tax on the cigars is \$75 (\$100 x 75% = \$75), because the cigars cost less than 67 cents each (\$100/200 cigars = 50 cents per cigar). Total tobacco tax due on the invoice is \$225.

(iii) Wind Blown Distributing (an out-of-state wholesaler) ships tobacco products in its own trucks to Lem's Tobacco Shop (an unaffiliated retailer located in this state). Wind Blown invoices Lem's for \$1,500. The sale includes 200 cigars priced "buy one for \$2 and get one free"; the balance of the sale is chewing tobacco priced at \$1,300. Wind Blown Distributing owes the tax. Wind Blown originally purchased the products from an affiliated manufacturer for \$100 (\$25 for the cigars and \$75 for the chewing tobacco). The measure of the tax is the actual price for which Wind Blown sells these products to unaffiliated buyers, i.e., Lem's. The tax due on the chewing tobacco is \$975 (\$1,300 x 75%). The tax on the cigars is \$100 (200 cigars x 50 cents). The tax on the cigars is capped at \$0.50 each, because each cigar costs more than 67 cents (\$200/200 cigars = \$1 per cigar). Total tobacco tax due on the invoice is \$1,075.

Part II - Wholesale and Retail Tobacco Products Vendor Licensing Requirements and Responsibilities

(201) License required. No person may engage in the retail or wholesale distribution of tobacco products in this state without a license.

(202) Distributor's license. Prior to selling or distributing tobacco products from a stock of goods in Washington or to retailers in Washington, each distributor must first obtain a tobacco distributor's license from the department of licensing.

(a) Background check. Each distributor must undergo a criminal background check before a license will be issued. Chapter 82.26 RCW. The background check must be completed to the satisfaction of the liquor control board and the department. Failure to provide information sufficient to complete the background check may result in denial of the license. A background check will not be required if the applicant has had a background check for a license issued under chapter 66.24 or 82.24 RCW.

(b) Application. Application for license or renewal of license is made on forms supplied by the department of licensing and must be accompanied by the annual license fee as provided in chapter 82.26 RCW. A distributor's license is valid for one year from the date it is issued. The annual fees will not apply if the licensee pays the corresponding annual distributor cigarette fees under RCW 82.24.510.

(c) Multiple locations. If the distributor sells, intends to sell, or stores tobacco products at more than one place of business, whether temporary or permanent, a separate license with a license fee as provided in chapter 82.26 RCW is required for each additional place of business. Each license must be exhibited in the place of business for which it is issued.

(203) Duties and responsibilities of licensed distributors.

(a) Sales restricted. Wholesalers selling tobacco products in this state may sell tobacco products only to Washington retailers or wholesalers who have a current tobacco license, to other licensed wholesalers, the federal government or its instrumentalities, or to Indian tribal entities authorized to possess untaxed tobacco products.

(b) Manufacturer's representatives. Manufacturers selling tobacco products through manufacturer's representatives must provide the department a current list of the names, addresses and telephone numbers of all such representatives. The list is mailed to: Washington State Department of Revenue, P.O. Box 47477, Olympia, WA 98504. The manufacturer must have a distributor's license and its representatives must carry a copy of the manufacturer's distributor license at all times when selling or distributing the manufacturer's tobacco products.

(204) Retail license. Prior to the retail sale or distribution of tobacco products, each retailer must first be issued a retail tobacco license from the department of licensing. A license is required for each location at which tobacco products are sold at retail. Each license must be exhibited at the place of business for which it is issued.

Application. Applications for license or renewals of license are made on forms supplied by the department of licensing and must be accompanied by the annual license fee as provided in chapter 82.26 RCW. A retail tobacco license is valid for one year from the date it is issued. The annual fees will not apply if the licensee pays the corresponding annual retailer cigarette fees under RCW 82.24.510.

(205) Duties and responsibilities of retailers. A retailer that obtains tobacco products from an unlicensed distributor or any other person that is not licensed under this chapter must be licensed both as a retailer and a distributor and is liable for the tax imposed under RCW 82.26.020 with respect to the tobacco products acquired from the unlicensed person that are held for sale, handling, or distribution in this state. For example, if

a retailer buys tobacco products from an Indian smoke shop or an out-of-state wholesaler who does not have a tobacco distributor license, the retailer must obtain a distributor license and pay the tobacco tax due.

(206) Suspension or revocation of wholesale or retail tobacco licenses.

(a) The department has full power and authority to suspend or revoke the license of any wholesale or retail tobacco dealer in the state upon sufficient showing that the license holder has violated the provisions of chapter 82.26 RCW or this rule. See RCW 82.26.220 and WAC 458-20-10001 for information on the procedures pertaining to suspension or revocation of cigarette licenses.

(b) Any person possessing both a tobacco products license and a cigarette license is subject to suspension and revocation of both licenses for violation of either chapter 82.24 or 82.26 RCW. For example, if a person has both a cigarette license and a tobacco license, revocation of the tobacco license will also result in revocation of the cigarette license.

(c) A person whose license has been suspended or revoked must not sell or permit the sale of tobacco products or cigarettes on premises occupied or controlled by that person during the period of the suspension or revocation.

(d) Any person whose license has been revoked must wait one year following the date of revocation before requesting a hearing for reinstatement. Reinstatement hearings are held pursuant to WAC 458-20-10001.

Part III - Transporting Tobacco Products in Washington

(301) Transportation of tobacco products restricted.

(a) Only licensed distributors or retailers in their own vehicles, or manufacturer's representatives authorized to sell or distribute tobacco products in this state, can transport tobacco products in this state. Individuals transporting the product must have a copy of a valid retailer's or distributor's license in their possession and evidence that they are representatives of the licensees. Individuals transporting tobacco products for sale must also have in their possession invoices or delivery tickets for the tobacco products that show the name and address of the consignor or seller, the name and address of the consignee or purchaser, and the quantity and brands of the tobacco products being transported. It is the duty of the distributor, retailer, or manufacturer responsible for the delivery or transportation of the tobacco products to ensure that all drivers, agents, representatives, or employees have the delivery tickets or invoices in their possession for all such shipments.

(b) All other persons must give notice to the board in advance of transporting or causing tobacco products to be

transported in this state for sale. This includes those transporting tobacco products in this state via common carrier. For example: Peg's Primo Cigars (PPC), a small out-of-state distributor, sells tobacco products to retailers in Washington. PPC ships the products via National Common Carrier. Before placing the product in shipment to Washington, PPC must give notice to the board of the pending shipment. The notice must include the name and address of the consignor or seller, the name and address of the consignee or purchaser, the quantity and brands of the tobacco products being transported, and the shipment date.

Part IV - Recordkeeping and Enforcement

(401) **Books and records.** An accurate set of records showing all transactions related to the purchase, sale, or distribution of tobacco products must be retained. RCW 82.26.060, 82.26.070 and 82.26.080. All records must be preserved for five years from the date of the transaction.

(a) **Distributors.** Distributors must keep at each place of business complete and accurate records for that place of business. The records to be kept by distributors include itemized invoices of tobacco products held, purchased, manufactured, brought in or caused to be brought in from without the state or shipped or transported to retailers in this state, and of all sales of tobacco products. The itemized invoice for each purchase or sale must be legible and must show the seller's name and address, the purchaser's name and address, the date of sale, and all prices and discounts. Itemized invoices must be preserved for five years from the date of sale.

(b) **Retailers.** Retailers must secure itemized invoices of all tobacco products purchased. The itemized invoice for each purchase must be legible and must show the seller's name and address, the purchaser's name and address, the date of sale, and all prices and discounts. Itemized invoices must be preserved for five years from the date of sale. Retailers are responsible for the tax on any tobacco products for which they do not have invoices.

(402) **Reports and returns.** The department may require any person dealing in tobacco products in this state to complete and return forms, as furnished by the department, setting forth sales, inventory, shipments, and other data required by the department to maintain control over trade in tobacco.

(a) **Tax returns.** The tax is reported on the combined excise tax return that must be filed according to the reporting frequency assigned by the department. Detailed instructions for preparation of these returns may be obtained from the department.

(b) **Reports.** Retailers and distributors may be required to file a report with the department in compliance with the

provisions of the National Uniform Tobacco Settlement when purchasing tobacco products (e.g., "roll your own tobacco") from certain manufacturers. Please see WAC 458-20-264 and chapter 70.157 RCW.

(403) **Criminal provisions.** Chapter 82.26 RCW prohibits certain activities with respect to tobacco products. Persons handling tobacco within this state must refer to these statutes.

(404) **Search, seizure, and forfeiture.** Any tobacco products in the possession of a person selling tobacco in this state without a license or transporting tobacco products without the proper invoices or delivery tickets may be seized without a warrant by any agent of the department, agent of the board, or law enforcement officer of this state. In addition, all conveyances, including aircraft, vehicles, or vessels used to transport the illegal tobacco product may be seized and forfeited.

(405) **Enforcement.** Pursuant to RCW 82.26.121 and 66.44.010, enforcement officers of the liquor control board may enforce all provisions of the law with respect to the tax on tobacco products. Retailers and distributors must allow department personnel and enforcement officers of the liquor control board free access to their premises to inspect the tobacco products on the premises and to examine the books and records of the business. If a retailer fails to allow free access, or hinders, or interferes with department personnel and/or enforcement officers of the liquor control board, that retailer's registration certificate issued under RCW 82.32.030 is subject to revocation. Additionally, any licenses issued under chapter 82.26 or 82.24 RCW are subject to suspension or revocation by the department.

(406) **Penalties.** Penalties and interest may be assessed in accordance with chapter 82.32 RCW for nonpayment of tobacco tax.

Part V - Credits

(501) Credits.

(a) **Interstate and foreign sales.** A credit is available to distributors for tobacco products sold to retailers and wholesalers outside the state for resale. This credit may be taken only for the amount of tobacco products tax reported and previously paid on such products. RCW 82.26.110. No credit may be taken for a sale of tobacco products from a stock of goods in this state to a consumer outside the state.

(b) **Returned or destroyed goods.** A credit may be taken for tax previously paid when tobacco products are destroyed or returned to the manufacturer. Credits claimed against tax owed or as a refund of tax paid, must be supported by documentation.

(c) **Documentation.** Credits claimed against tax owed or as a refund of tax paid, must be supported by documentation. Affidavits or certificates are required, and must substantially

conform to those illustrated below. The affidavits or certificates must be completed by the taxpayer prior to claiming the credit, and must be retained with the taxpayer's records as set forth in Part VI of this rule.

**Claim for Credit on Tobacco Products Sold for Resale
Outside Washington**

The undersigned distributor under penalty of perjury under the laws of the state of Washington certifies that the following is true and correct to the best of his/her knowledge:

(Business name), (tax reporting number), purchased the tobacco products specified below for resale outside this state. Tobacco products tax has been paid on such tobacco products as set forth below.

Products were purchased from: (name of business)

.....
Date

Products were sold to: (name of out-of-state buyer)

.....
Address

.....
Date

<u>Product</u>	<u>Taxable sales price</u>	<u>Quantity</u>	<u>Tax paid</u>
<u>Cigars exceeding \$0.67 per cigar</u>	<u>N/A</u>		
<u>Cigars not exceeding \$0.67 per cigar</u>		<u>N/A</u>	
<u>All tobacco products that are not cigars</u>		<u>N/A</u>	

Signature of Taxpayer or Authorized Representative: ...

.....
Name

Title:

**Claim for Credit on Tobacco Products Destroyed
Merchandise**

(i) Certificate of taxpayer.

<u>Product</u>	<u>Taxable sales price</u>	<u>Quantity</u>	<u>Tax paid</u>

Cigars exceeding \$0.67 per cigar	N/A		
Cigars not exceeding \$0.67 per cigar		N/A	
All tobacco products that are not cigars		N/A	

The undersigned certifies under penalty of perjury under the laws of the state of Washington that the following is true and correct to the best of his/her knowledge:

(Business name), (tax reporting number), a dealer in tobacco products, has destroyed tobacco products unfit for sale. Tobacco tax has been paid on such tobacco products as set forth above. The tobacco products were destroyed in the manner set forth below. The destruction occurred either:
 (A) In the presence of an authorized agent of the department of revenue; or

(B) With prior authorization from the department to destroy the product without an agent of the department present.

Date, manner, and place of destruction:

Signature of Taxpayer or Authorized Representative:

Name:

Title:

Witnessed or approved:

Authorized Agent, Department of Revenue

**Claim for Credit on Tobacco Products Returned
Merchandise**

(ii) Certificate of manufacturer.

<u>Product</u>	<u>Taxable sales price</u>	<u>Quantity</u>	<u>Tax paid</u>
Cigars exceeding \$0.67 per cigar	N/A		
Cigars not exceeding \$0.67 per cigar		N/A	
All tobacco products that are not cigars		N/A	

The undersigned certifies under penalty of perjury under the laws of the state of Washington that the following is true and correct to the best of his/her knowledge:

(Business name), (tax reporting number), a dealer in tobacco products, has returned merchandise unfit for sale. Tobacco tax has been paid on such tobacco products as set forth above.

Returned to:

Date:

Method of transport:

Manufacturer's credit issued on:

Credit memo number:

Signature of Taxpayer or Authorized Representative:

.....

Name:

Title:

EXHIBIT E



PROPOSED RULE MAKING

CR-102 (June 2004)

(Implements RCW 34.05.320)

Do NOT use for expedited rule making

Agency:

- Preproposal Statement of Inquiry was filed as WSR 06-11-170 ; or
- Expedited Rule Making--Proposed notice was filed as WSR ; or
- Proposal is exempt under RCW 34.05.310(4).

- Original Notice
- Supplemental Notice to WSR
- Continuance of WSR

Title of rule and other identifying information: WAC 458-20-186 Tax on Cigarettes

Hearing location(s):

Capitol Plaza Building
4th Floor Executive Conference Room
1025 Union Avenue SE
Olympia, Washington 98504

Submit written comments to:

Name: Margaret J. Partlow
Address: Post Office Box 47453
Olympia, Washington
98504-7453
e-mail margaretpa@dor.wa.gov
fax (360) 586-5543
by November 16, 2006

Date: Thursday, November 16, 2006 Time: 10:00 a.m.

Assistance for persons with disabilities: Contact Sandy Davis at (360) 725-7499 no later than 10 days before the hearing date. Deaf and hard of hearing individuals may call 1-800-451-7985 (TTY users).

Date of intended adoption: November 24, 2006
(Note: This is NOT the effective date)

Purpose of the proposal and its anticipated effects, including any changes in existing rules: WAC 458-20-186 (Rule 186) provides tax-reporting information to persons who sell, use, consume, handle, possess, or distribute cigarettes. The rule explains who is liable for the tax, how and when the cigarette tax imposed by Chapter 82.24 is to be paid, and the record keeping requirements. It also explains the application process for wholesale and retail cigarette vendor licenses, and the responsibilities of persons making "delivery sales" into this state. It includes references to statutory fees, bonding requirements, and explains the conditions for and process of application for reinstatement of a license following a revocation under the Administrative Procedure Act.

The proposed changes to the rule update existing information, incorporate recent legislative changes, and clarify that the "stamping allowance" for wholesalers is income, not merely a discount on the price of the stamps; accordingly, the stamping allowance is subject to business and occupation tax.

Reasons supporting proposal:

Statutory authority for adoption: RCW 82.32.300, 82.01.060(2), and 82.24.235.

Statute being implemented:
Chapter 82.24 RCW

Is rule necessary because of a:

- Federal Law? Yes No
 - Federal Court Decision? Yes No
 - State Court Decision? Yes No
- If yes, CITATION:

Filed: October 4, 2006

Time: 10:41 a.m.

Date

WSR: 06-20-112

Name

Alan R. Lynn

Signature

The above information was input by DOR

Title

Rules Coordinator

Agency comments or recommendations, if any, as to statutory language, implementation, enforcement, and fiscal matters: None.

Name of proponent: Department of Revenue

- Private
- Public
- Governmental

Name of agency personnel responsible for:

Name	Office Location	Phone
Drafting.....Margaret J. Partlow	1025 Union Ave. SE. Ste #544, Olympia , Wa	(360) 570-6123
Implementation.... Alan R. Lynn	1025 Union Ave. SE. Ste #544, Olympia , Wa	(360) 570-6125
Enforcement..... Janis P. Bianchi	1025 Union Ave. SE. Ste #544, Olympia , Wa	(360) 570-6147

Has a small business economic impact statement been prepared under chapter 19.85 RCW?

Yes: Attach copy of small business economic impact statement.

A copy of the statement may be obtained by contacting:

Name:

Address:

- phone
- fax
- e-mail

No. Explain why no statement was prepared. A small business economic impact statement is not required because the rule and the amendments do not impose any requirements or burdens upon small business that are not already required by statute.

Is a cost-benefit analysis required under RCW 34.05.328?

Yes A preliminary cost-benefit analysis may be obtained by contacting:

Name:

Address:

- phone
- fax
- e-mail

No: Please explain: The proposed rule is not a significant legislative rule as defined by RCW 34.05.328.

THIS PROPOSED RULE IS SUBMITTED FOR PUBLIC COMMENTS AFTER INPUT FROM INTERESTED PARTIES AND IS TO BE USED SOLELY FOR DISCUSSION PURPOSES AT THE PUBLIC HEARING ON THE PROPOSED RULE. UNDER NO CIRCUMSTANCES IS THIS PROPOSED RULE TO BE USED TO DETERMINE TAX LIABILITY AND OR EXEMPTIONS.

AMENDATORY SECTION (Amending WSR 05-02-035, filed 12/30/04, effective 1/30/05)

WAC 458-20-186 Tax on cigarettes. (1) **Introduction.** This rule addresses those taxes and licensing activities that apply exclusively to cigarettes as defined by RCW 82.24.010. See WAC 458-20-185 for tax liabilities and registration requirements associated with tobacco products other than cigarettes. The tax on cigarettes is in addition to all other taxes owed. For example, retailers and wholesalers are liable for business and occupation tax on their retailing or wholesaling activities, and must collect and remit sales tax on retail sales of cigarettes. Consumers pay the cigarette tax in addition to sales or use tax on purchases of cigarettes for consumption within this state. (Wholesalers not licensed in the state of Washington who are making sales of cigarettes to Indians in accordance with a cigarette tax contract authorized by RCW 43.06.455 must comply with the specific terms of their individual contracts. See also WAC 458-20-192 regarding sales in Indian country.)

(2) **Organization of rule.** The information provided in this rule is divided into seven parts:

(a) Part I explains the tax liabilities of persons who sell, use, consume, handle, possess, or distribute cigarettes in this state.

(b) Part II explains the licensing requirements and responsibilities for persons making wholesale or retail sales of cigarettes in this state.

(c) Part III explains the stamping requirements and how the cigarette tax rates are calculated.

(d) Part IV describes the exemptions from the tax and the procedures that must be followed to qualify for exemption.

(e) Part V explains the requirements and responsibilities for persons transporting cigarettes in Washington.

(f) Part VI explains the requirements and responsibilities for persons engaged in making delivery sales of cigarettes into this state.

(g) Part VII explains the enforcement and administration of the cigarette tax.

Part I - Tax on Cigarettes

(101) **In general.** The Washington state cigarette tax is due and payable by the first person who sells, uses, consumes, handles, possesses, or distributes the cigarettes in this state.

(a) **Possession.** For the purpose of this rule, a "possessor" of cigarettes is anyone who personally or through an agent, employee, or designee, has possession of cigarettes in this state.

(b) **Payment.** Payment of the cigarette tax is made through the purchase of stamps from banks authorized by the department of revenue (department) to sell the stamps. Only licensed wholesalers may purchase or obtain cigarette stamps. Except as specifically provided in Part IV of this rule, it is unlawful for any person other than a licensed wholesaler to possess unstamped cigarettes in this state. However, as explained in subsection (102)(b) of this rule, certain consumers may possess unstamped cigarettes for personal consumption if they pay the tax as provided in this rule.

(c) **Imposition of tax.** Ordinarily, the tax obligation is imposed on and collected from the first possessor of unstamped cigarettes. However, failure of an exempt entity with an obligation to collect and remit the tax does not relieve a subsequent nonexempt possessor of unstamped cigarettes from liability for the tax.

(d) **Promotions.** Cigarettes given away for advertising or any other purpose are taxed in the same manner as if they were sold, used, consumed, handled, possessed, or distributed in this state, but are not required to have the stamp affixed. Instead, the manufacturer of the cigarettes must pay the tax on a monthly return filed with the department. See subsection (702) of this rule.

(102) **Possession of cigarettes in Washington state.**

(a) Every person who is (i) in possession of unstamped cigarettes in this state, and (ii) is not specifically exempt by law, is liable for payment of the cigarette tax as provided in chapter 82.24 RCW and this rule.

(b) Consumers who buy unstamped cigarettes or who purchase cigarettes from sources other than licensed retailers in this state must pay the cigarette tax as provided in subsection (702) of this rule when they first bring the cigarettes into this state or first possess them in this state. This requirement includes, but is not limited to, delivery sales as described in Part VI of this rule.

(c) **Cigarettes purchased from Indian retailers.** Special rules apply to cigarettes purchased from Indian retailers.

(i) Indians purchasing cigarettes in Indian country are exempt from the state cigarette tax; however, these sales must comply with WAC 458-20-192. Other consumers may purchase cigarettes for their personal consumption from "qualified Indian retailers" without incurring liability for state cigarette tax.

A "qualified Indian retailer" is one who is subject to the terms of a valid cigarette tax contract with the state pursuant to RCW 43.06.455.

(ii) Consumers who purchase cigarettes from Indian retailers who are not subject to a cigarette tax contract with the state must comply with the reporting requirements and remit the cigarette tax as explained in subsection (702) of this rule. These consumers are also liable for the use tax on their purchases. See WAC 458-20-178.

(iii) It is the duty of the consumer in each instance to ascertain his or her responsibilities with respect to such purchases.

(d) **Cigarettes purchased on military reservations.** Active duty or retired military personnel, and their dependants, may purchase cigarettes for their own consumption on military reservations without paying the state tax (see Part IV). However, such persons are not permitted to give or resell those cigarettes to others.

(e) **Counterfeit cigarettes.** It is unlawful for any person to manufacture, sell, or possess counterfeit cigarettes. A cigarette is counterfeit if (i) it or its packaging bears any logo or marking used by a manufacturer to identify its own cigarettes, and (ii) the cigarette was not manufactured by the owner of that logo or trademark or by any authorized licensee of the manufacturer. RCW 82.24.570.

(f) Possession of unstamped and untaxed cigarettes, and possession of counterfeit cigarettes, are criminal offenses in this state. See Part VII.

Part II - Wholesale and Retail Cigarette Vendor Licensing Requirements and Responsibilities

(201) **License required.** No person, other than a government instrumentality or an Indian retailer as set forth in Part IV of this rule, may engage in the retail or wholesale distribution of cigarettes in this state without a license. No person may engage in the business of sampling within this state unless that person has first obtained a sampler's license. Failure to obtain the required license prior to sampling or selling cigarettes at wholesale or retail is a criminal act. RCW 70.155.050.

(202) **Definitions.** For the purposes of this rule, the following definitions apply:

(a) **"Place of business"** means any location where business is transacted with, or sales are made to, customers. The term includes, but is not limited to, any vehicle, truck, vessel, or the like at which sales are made.

(b) **"Retailer"** means every person, other than a wholesaler, who purchases, sells, offers for sale, or distributes

cigarettes, regardless of quantity or amount, or the number of sales, and all persons operating under a retailer's registration certificate.

(c) **"Retail selling price"** means the ordinary, customary, or usual price paid by the consumer for each package of cigarettes, less the tax levied by the state.

(d) **"Sample" and "sampling"** have the same meaning as in RCW 70.155.010.

(e) **"Wholesaler"** means every person who purchases, sells, or distributes cigarettes, as defined in chapter 82.24 RCW, to retailers for the purpose of resale only.

(203) **Wholesale license.** Prior to the sale or distribution of cigarettes at wholesale, each wholesaler must first obtain a wholesale cigarette license from the department of licensing.

(a) **Background check.** Each wholesaler must undergo a criminal background check before a license will be issued. RCW 82.24.510. The background check must be completed to the satisfaction of the liquor control board and the department. Failure to provide information sufficient to complete the background check may, in the department's discretion, result in denial of the license.

(b) **Application.** Application for license or renewal of license is made on forms supplied by the department of licensing and must be accompanied by the annual license fee as provided in chapter 82.24 RCW. A wholesale cigarette license is valid for one year from the date it is issued.

(c) **Multiple locations.** If the wholesaler sells, or intends to sell, cigarettes at more than one place of business, whether temporary or permanent, a separate license with a license fee as provided in chapter 82.24 RCW is required for each additional place of business. Each license must be exhibited in the place of business for which it is issued.

(d) **Bond required.** Each licensed wholesaler must file a bond with the department in an amount determined by the department, but not less than \$5,000.00. The bond must be executed by the wholesaler as principal, and by a corporation approved by the department of licensing and authorized to engage in business as a surety company in this state, as surety. The bond must run concurrently with the wholesaler's license.

(204) **Duties and responsibilities of licensed wholesalers.**

(a) **Stamps.** Only licensed wholesalers may purchase or obtain cigarette stamps. Wholesalers are prohibited by law from selling or providing stamps to any other wholesaler or person.

(b) **Numbering.** Each roll of stamps, or group of sheets, has a separate serial number. The department keeps records of which wholesaler purchases each roll or group of sheets. Wholesalers are prohibited from possessing stamps other than those specifically issued to them.

(c) **Sales restricted.** Wholesalers selling cigarettes in

this state may sell cigarettes only to Washington retailers who have a current retail cigarette license, to other licensed wholesalers, or to Indian tribal entities authorized to possess cigarettes that are not taxed by the state.

(d) **Unstamped cigarettes.** Except as explained in Part IV of this rule, no person other than a licensed wholesaler may possess unstamped cigarettes in this state. (For the purpose of this rule, the term "unstamped cigarette" means any cigarette that does not bear a Washington state cigarette stamp as described in Part III of this rule.) Licensed wholesalers may possess unstamped cigarettes in this state only in the following circumstances:

(i) Licensed wholesalers may possess unstamped cigarettes for up to 72 hours after receipt; however, the cigarettes must be stamped on or before sale or transfer to any other party other than another licensed wholesaler. Licensed wholesalers may possess unstamped cigarettes for more than 72 hours after receipt if they receive prior written permission from the department to do so.

(ii) Licensed wholesalers who have furnished a surety bond in an amount determined by the department may set aside, without stamping, that portion of their stock reasonably necessary for conducting sales to persons outside this state or to instrumentalities of the federal government. All unstamped stock must be kept separate and apart from stamped stock.

(e) **Transfers.** Wholesalers in possession of unstamped cigarettes under subsection (204)(d) of this rule that are transferred by the wholesaler to another facility within this state must be transferred in compliance with RCW 82.24.250.

(205) **Retail license.** Prior to the retail sale or distribution of cigarettes, each retailer must first be issued a retail cigarette license from the department of licensing. A license is required for each location at which cigarettes are sold at retail. Each license must be exhibited at the place of business for which it is issued.

(a) **Application.** Applications for license or renewal of license are made on forms supplied by the department of licensing and must be accompanied by the annual license fee as provided in chapter 82.24 RCW. A retail cigarette license is valid for one year from the date it is issued.

(b) **Vending machines.** Retailers operating cigarette vending machines are required to pay an additional annual fee as set forth in chapter 82.24 RCW for each vending machine.

(206) **Duties and responsibilities of retailers.**

(a) No retailer in this state may possess unstamped cigarettes unless he or she is also a licensed wholesaler.

(b) Retailers may obtain cigarettes only from cigarette wholesalers licensed by this state.

(207) **Additional requirements for manufacturers,**

wholesalers, retailers, and samplers. Persons making wholesale or retail sales or engaged in the business of sampling of cigarettes in this state must comply with all the provisions of chapters 70.155 and 70.158 RCW. All cigarettes sold, delivered, or attempted to be delivered, in violation of RCW 70.155.105 are subject to seizure and forfeiture. RCW 82.24.130.

(208) Suspension or revocation of wholesale or retail cigarette licenses.

(a) The department has full power and authority to revoke or suspend the license of any wholesale or retail cigarette dealer in the state upon sufficient showing that the license holder has violated the provisions of chapter 82.24 RCW or this rule. See RCW 82.24.550 and WAC 458-20-10001 for information on the procedures pertaining to suspension or revocation of cigarette licenses.

(b) Any person possessing both a cigarette license and a tobacco products license is subject to suspension and revocation of both licenses for violation of either chapter 82.24 or 82.26 RCW. For example, if a person has both a cigarette license and a tobacco license, revocation of the cigarette license will also result in revocation of the tobacco license.

(c) A person whose license has been suspended or revoked must not sell or permit the sale of cigarettes or tobacco products on premises occupied or controlled by that person during the period of the suspension or revocation.

(d) For the purposes of this rule, "tobacco products" has the same meaning as in RCW 82.26.010.

(e) Any person whose license has been revoked must wait one year following the date of revocation before requesting a hearing for reinstatement. Reinstatement hearings are held pursuant to WAC 458-20-10001.

Part III - Stamping and Rates

(301) Cigarette stamps.

(a) Stamps indicating payment of the cigarette tax must be affixed prior to any sale, use, consumption, handling, possession, or distribution of all cigarettes other than those specifically exempted as explained in Part IV of this rule. The stamp must be applied to the smallest container or package, unless the department, in its sole discretion, determines that it is impractical to do so. Stamps must be of the type authorized by the department and affixed in such a manner that they cannot be removed from the package or container without being mutilated or destroyed.

(b) Licensed wholesalers may purchase state-approved cigarette stamps from authorized banks. Payment for stamps must be made at the time of purchase unless the wholesaler has prior approval of the department to defer payment and furnishes a

surety bond equal to the proposed monthly credit limit. Payments under a deferred plan are due within 30 days following purchase. Licensed wholesalers are ~~((allowed a discount))~~ compensated for affixing the stamps at the rate of \$6.00 per thousand stamps affixed ("stamping allowance") ~~((, which amount is offset against the purchase price))~~. (The stamping allowance is subject to business and occupation tax under the service and other business activities classification.)

(302) Rates.

(a) The Washington state cigarette tax is imposed on a per cigarette basis. The rate of the tax is a combination of statutory rates found in RCW 82.24.020, 82.24.027, and 82.24.028.

(b) When the rate of tax increases, the first person who sells, uses, consumes, handles, possesses, or distributes previously taxed cigarettes after the rate increase is liable for the additional tax.

(303) Refunds. Any person may request a refund of the face value of the stamps when the tax is not applicable and the stamps are returned to the department. Documentation supporting the claim must be provided at the time the claim for refund is made.

(a) Refunds for stamped untaxed cigarettes sold to Indian tribal members or tribal entities ~~((will include the stamping allowance and))~~ in the full value of the stamps affixed will be approved by an agent of the department.

(b) Refunds for stamped cigarettes will not include the stamping allowance if the stamps are:

- (i) Damaged, or unfit for sale, and as a result are destroyed or returned to the manufacturer or distributor; or
- (ii) Improperly or partially affixed through burns, jams, double stamps, stamped on carton flaps, or improperly removed from the stamp roll.

(c) The claim for refund must be filed on a form provided by the department. An affidavit or a certificate from the manufacturer for stamped cigarettes returned to the manufacturer for destruction or by an agent of the department verifying the voiding of stamps and authorizing the refund must accompany the claim for refund.

Part IV - Exemptions

(401) In general. There are limited exemptions from the cigarette tax provided by law. This part discusses exemptions and the procedures that must be followed to qualify for an exemption.

(402) Government sales. The cigarette tax does not apply to the sale of cigarettes to:

- (a) The United States Army, Navy, Air Force, Marine Corps,

or Coast Guard exchanges and commissaries and Navy or Coast Guard ships' stores;

(b) The United States Veteran's Administration; or

(c) Any person authorized to purchase from the federal instrumentalities named in (a) or (b) above, if the cigarettes are purchased from the instrumentality for personal consumption.

(403) Sales in Indian country.

(a) The definitions of "Indian," "Indian country," and "Indian tribe," in WAC 458-20-192 apply to this rule. "Cigarette contract" means an agreement under RCW 43.06.450 through 43.06.460.

(b) The cigarette tax does not apply to cigarettes taxed by an Indian tribe in accordance with a cigarette contract under RCW 43.06.450 through 43.06.460.

(c) The cigarette tax does not apply to cigarettes sold to an Indian in Indian country for personal consumption; however, those sales must comply with the allocation provisions of WAC 458-20-192. Sales made by an Indian cigarette outlet to nontribal members are subject to the tax, except as provided in (b) above.

(d) See WAC 458-20-192 for information on making wholesale sales of cigarettes to Indians and Indian tribes.

(404) Interstate commerce. The cigarette tax does not apply to cigarettes sold to persons licensed as cigarette distributors in other states when, as a condition of the sale, the seller either delivers the cigarettes to the buyer at a point outside this state, or delivers the same to a common carrier with the shipment consigned by the seller to the buyer at a location outside this state. Any person engaged in making sales to licensed distributors in other states or making export sales or in making sales to the federal government must furnish a surety bond in a sum equal to twice the amount of tax that would be affixed to the cigarettes that are set aside for the conduct of such business without affixing cigarette stamps. The unstamped stock must be kept separate and apart from any stamped stock.

Part V - Transporting Cigarettes in Washington

(501) Transportation of cigarettes restricted. No person other than a licensed wholesaler may transport unstamped cigarettes in this state except as specifically set forth in RCW 82.24.250 and this rule, or as may be allowed under a cigarette tax contract subject to the provisions of RCW 43.06.455. Licensed wholesalers transporting unstamped cigarettes in this state must do so only in their own vehicles unless they have given prior notice to the liquor control board of their intent to transport unstamped cigarettes in a vehicle belonging to another person.

(502) **Notice required.** Persons other than licensed wholesalers intending to transport unstamped cigarettes in this state must first give notice to the liquor control board of their intent to do so.

(503) **Transportation of unstamped cigarettes.** All persons transporting unstamped cigarettes must have in their actual possession invoices or delivery tickets for such cigarettes. The invoices or delivery tickets must show the true name and address of the consignor or seller, the true name and address of the consignee or purchaser, and the quantity and brands of the cigarettes transported. It is the duty of the person responsible for the delivery or transport of the cigarettes to ensure that all drivers, agents, or employees have the delivery tickets or invoices in their actual possession for all such shipments.

(504) **Consignment.** If the cigarettes transported pursuant to subsection (501), (502), or (503) of this rule are consigned to or purchased by any person in this state, that purchaser or consignee must be a person who is authorized by chapter 82.24 RCW to possess unstamped cigarettes in this state.

(505) **Out-of-state shipments.** Licensed wholesalers shipping cigarettes to a point outside Washington or to a federal instrumentality must, at the time of shipping or delivery, report the transaction to the department. The report must show both (a) complete details of the sale or delivery, and (b) whether stamps have been affixed to the cigarettes.

The report may be made either by submitting a duplicate invoice or by completing a form provided by the department, and must be filed with the department as set forth in subsection (702) of this rule.

(506) **Compliance required.** No person may possess or transport cigarettes in this state unless the cigarettes have been properly stamped or that person has fully complied with the requirements of RCW 82.24.250 and this rule. Failure to comply with the requirements of RCW 82.24.250 is a criminal act. Cigarettes in the possession of persons who have failed to comply are deemed contraband and are subject to seizure and forfeiture under RCW 82.24.130.

Part VI - Delivery Sales of Cigarettes

(601) **Definitions.** The definitions in this subsection apply throughout this rule.

(a) **"Delivery sale"** means any sale of cigarettes to a consumer in the state where either: (i) The purchaser submits an order for a sale by means of a telephonic or other method of voice transmission, mail delivery, any other delivery service, or the internet or other online service; or (ii) the cigarettes are delivered by use of mail delivery or any other delivery

service. A sale of cigarettes made in this manner is a delivery sale regardless of whether the seller is located within or outside the state. (For example, "Royal Tax-free Smokes," located in the state of Vermont, offers sales via the internet and a toll-free telephone number, and ships its products to consumers in this state. These transactions are delivery sales.) A sale of cigarettes not for personal consumption to a person who is a wholesaler licensed under chapter 82.24 RCW or a retailer licensed under chapter 82.24 RCW is not a delivery sale.

(b) **"Delivery service"** means any private carrier engaged in the commercial delivery of letters, packages, or other containers, that requires the recipient of that letter, package, or container to sign to accept delivery.

(602) **Tax liability.** Cigarettes delivered in this state pursuant to a delivery sale are subject to tax as provided in Part I of this rule. Persons making delivery sales in this state are required to provide prospective consumers with notice that the sales are subject to tax pursuant to chapters 82.24 and 82.12 RCW, with an explanation of how the tax has been or is to be paid with respect to such sales.

(603) **Additional requirements.** Persons making delivery sales of cigarettes in this state must comply with all the provisions of chapter 70.155 RCW. All cigarettes sold, delivered, or attempted to be delivered, in violation of RCW 70.155.105 are subject to seizure and forfeiture. RCW 82.24.130.

Part VII - Enforcement and Administration

(701) **Books and records.** An accurate set of records showing all transactions related to the purchase, sale, or distribution of cigarettes must be retained. RCW 82.24.090. These records may be combined with those required in connection with the tobacco products tax (see WAC 458-20-185), if there is a segregation therein of the amounts involved. All records must be preserved for five years from the date of the transaction.

(702) **Reports and returns.** The department may require any person dealing with cigarettes in this state to complete and return forms, as furnished by the department, setting forth sales, inventory, and other data required by the department to maintain control over trade in cigarettes.

(a) Manufacturers and wholesalers selling stamped, unstamped, or untaxed cigarettes must submit a complete record of sales of cigarettes in this state monthly. This report is due no later than the 15th day of the calendar month and must include all transactions occurring in the previous month.

(b) Persons making sales of tax-exempt cigarettes to Indian tribes or Indian retailers pursuant to WAC 458-20-192 (9)(a)

must transmit a copy of the invoice for each such sale to the special programs division of the department prior to shipment.

(c) Wholesalers selling stamped cigarettes manufactured by nonparticipating manufacturers as defined in WAC 458-20-264 must report all such sales to the special programs division no later than the 25th day of the calendar month and must include all transactions occurring in the previous month.

(d) Persons making sales of cigarettes into this state to other than a licensed wholesaler or retailer must file a report as required under Title 15, Chapter 10A, section 376 of the U.S. Code (commonly referred to as the "Jenkins Act" report). This report is due no later than the 10th day of each calendar month and must include all transactions occurring in the previous month.

(e) Persons shipping or delivering any cigarettes to a point outside of this state must submit a report showing full and complete details of the interstate sale or delivery as set forth in Part V of this rule. This report is due no later than the 15th day of the calendar month immediately following the shipment or delivery.

(f) Persons giving away unstamped cigarettes for advertising, promotional, or any other purpose, must report and pay the tax on the number of cigarettes distributed in this state.

(g) Consumers who buy unstamped cigarettes or who purchase cigarettes from sources other than licensed retailers in this state must pay the tax when they first bring the cigarettes into this state or first possess them in this state. The tax is paid with a "Tax Declaration for Cigarettes," which may be obtained from the department.

(703) **Criminal provisions.** Chapter 82.24 RCW prohibits certain activities with respect to cigarettes. Persons handling cigarettes within this state must refer to these statutes. The prohibited activities include, but are not limited to, the following:

(a) **Transportation or possession of 60,000 or fewer cigarettes.** Transportation or possession of 60,000 or fewer unstamped cigarettes is prohibited unless the notice requirements set forth in RCW 82.24.250 have been met; failure to meet those notice requirements is a gross misdemeanor. RCW 82.24.110 (1)(m).

(b) **Transportation or possession of more than 60,000 cigarettes.** Transportation or possession of more than 60,000 unstamped cigarettes is prohibited unless the notice requirements set forth in RCW 82.24.250 have been met; failure to meet those notice requirements is a felony. RCW 82.24.110(2).

(c) **Forgery or counterfeiting of stamps.** Alteration, fabrication, forgery, and counterfeiting of stamps are felonies.

RCW 82.24.100.

(d) **Counterfeit cigarettes.** The manufacture, sale, or possession of counterfeit cigarettes in this state is a felony. RCW 82.24.570.

(704) **Search, seizure, and forfeiture.** The department or the liquor control board may search for, seize, and subsequently dispose of unstamped cigarette packages and containers, counterfeit cigarettes, conveyances of all kinds (including aircraft, vehicles, and vessels) used for the transportation of unstamped and/or counterfeit cigarettes, and vending machines used for the sale of unstamped and/or counterfeit cigarettes. See RCW 82.24.130, et seq., for provisions relating to search, seizure, and forfeiture of property, possible redemption of property, and for treatment of such property in the absence of redemption.

(705) **Penalties.** RCW 82.24.120 provides a penalty for failure to affix the cigarette stamps or to cause the stamps to be affixed as required, or to pay any tax due under chapter 82.24 RCW. In addition to the tax deemed due, a penalty equal to the greater of \$10.00 per package of unstamped cigarettes or \$250.00 will be assessed. Interest is also assessed on the amount of the tax at the rate as computed under RCW 82.32.050(2) from the date the tax became due until the date of payment. The department may, in its sole discretion, cancel all or part of the penalty for good cause.

No. 33236-1-II

DIVISION II, COURT OF APPEALS
OF THE STATE OF WASHINGTON

TESORO REFINING AND MARKETING COMPANY,

Plaintiff-Appellant

v.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,

Defendant-Respondent

ON APPEAL FROM THURSTON COUNTY SUPERIOR COURT
(Hon. Richard D. Hicks)

DECLARATION OF SERVICE

George C. Mastrodonato
WSBA No. 07483
John B. Schochet
WSBA No. 35869
DORSEY & WHITNEY LLP
Attorneys for Appellant
Tesoro Refining and Marketing
Company

Dorsey & Whitney LLP
1420 Fifth Avenue, Suite 3400
Seattle, Washington 98101
Telephone: (206) 903-8800
Facsimile: (206) 903-8820

Michael B. King
WSBA No. 14405
LANE POWELL PC
Attorneys for Appellant
Tesoro Refining and Marketing
Company

Lane Powell PC
1420 Fifth Avenue, Suite 4100
Seattle, Washington 98101
Telephone: (206) 223-7000
Facsimile: (206) 223-7107

I, Kathryn Savaria, the undersigned, hereby certify and declare under penalty of perjury as follows:

I am a citizen of the United States and a resident of Snohomish County, Washington. I am over the age of 18 years and am not a party to the within cause. My business mailing address is 1420 Fifth Avenue, Suite 4100, Seattle, Washington 98101-2338.

On the 2nd day of January, 2007, I caused true and correct copies of Petition for Review, Letter to Court of Appeals and this Declaration of Service to be served upon the following counsel in the manner described below:

Anne E. Egeler, Esq.
Attorney General's Office
7141 Cleanwater Drive S.W.
Post Office Box 40123
Olympia, Washington 98504-0123

- U.S. Mail, postage prepaid
- Hand Delivered via Messenger Service
- Overnight Courier
- Facsimile: (360) 664-2023

George C. Mastrodonato, Esq.
John B. Schochet, Esq.
Dorsey & Whitney LLP
1420 Fifth Avenue, Suite 3400
Seattle, WA 98101

- U.S. Mail, postage prepaid
- Hand Delivered via Messenger Service
- Overnight Courier
- Facsimile: (360) 664-2023

DATED this 2nd day of January, 2007, at Seattle, Washington.

Kathryn Savaria
Kathryn Savaria

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STATE OF WASHINGTON
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