

No. 71932-7-I

DIVISION I, COURT OF APPEALS
OF THE STATE OF WASHINGTON

WEDBUSH SECURITIES, INC., a California corporation,

Petitioner-Appellant

v.

THE CITY OF SEATTLE, WASHINGTON,

Respondent-Respondent.

2019 FEB 23 PM 4:33
COURT OF APPEALS
DIVISION I
SEATTLE, WA 98101

ON APPEAL FROM KING COUNTY SUPERIOR COURT
No. 13-2-22355-4 SEA
(Hon. Monica J. Benton)

REPLY BRIEF OF APPELLANT

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I. INTRODUCTION

Seattle does not dispute that the sole issue on appeal is the proper interpretation of the term “customer location” in RCW 35.102.130. Wedbush interprets the statute according to its plain language—where Wedbush’s customers are located. Seattle, in contrast, seeks to add a “physical contact” requirement to the statute to conclude that there is “no” customer location because Wedbush primarily does business with customers by phone, fax, or email. Resp. Br. at 3. As discussed in Wedbush’s opening brief, Seattle’s interpretation violates numerous principles of statutory construction. Op. Br. at 8-10. Seattle does not argue otherwise.

Instead, Seattle largely ignores the text of RCW 35.102.130 and argues that ambiguity in the statute requires this Court to accept its interpretation. Resp. Br. at 12-13. Seattle’s arguments are without merit. The statute is not ambiguous, nor did the legislature delegate enforcement of the statute to Seattle. And, even if RCW 35.102.130 were ambiguous, any ambiguity must be construed in Wedbush’s favor. The judgment below must be reversed.

II. ARGUMENT

A. **RCW 35.102.130 is not ambiguous, and even if it were ambiguous, it must be construed in favor of Wedbush.**

The Washington legislature has mandated that in order to impose a local B&O tax, cities “must” apportion taxpayers’ gross income according to a statutory two-factor formula in RCW 35.102.130. Seattle concedes that “[t]he City is required under state law to use this two factor apportionment formula.” Resp. Br. at 2. The statutory formula apportions income to a taxing city by multiplying a company’s total income by the average percentage of two factors—a payroll factor and a service income factor. There is no dispute regarding Wedbush’s total income or calculation of the payroll factor. Rather, the parties’ sole dispute relates to assignment of income to the numerator of the service income factor.

RCW 35.102.130(3)(b) assigns income to the numerator of the service income factor based on “customer location.” Thus, when filing its Seattle tax returns, Wedbush assigned income for those customers located in Seattle, regardless of where Wedbush’s account representative assisting that customer was located. BR 000092; CP 39-40. In contrast, Seattle would assign income for those customers located in Seattle only if they had “physical” contact with a Wedbush representative in Seattle, concluding that customers who communicate with Wedbush by phone,

fax, or email have “no” customer location. CP 120. Because Wedbush did not (and could not) undertake such an artificial “physical” contact inquiry, Seattle purported to assign income based on the statute’s alternative test, according to the “greater proportion of the costs of performance,” though Seattle only considered the location of Seattle-based Wedbush account representative in doing so. BR 000023-000043.

Seattle points to RCW 35.102.130’s reference to “contacts” in the definition of “customer location” to justify its injection of a “physical” contact requirement into the statute. RCW 35.102.130(4)(d). Resp. Br. at 13. It claims that the term “contacts” is ambiguous, and that this Court may resolve that ambiguity in its favor. As explained in Wedbush’s opening brief and below, the statute is not ambiguous and, even if it were, this Court cannot simply defer to Seattle’s strained interpretation. Instead, the Court must resolve any ambiguity in a tax statute strictly in favor of the taxpayer, Wedbush.

1. The only reasonable interpretation of “contacts” in RCW 35.102.130 includes email, fax, and telephone communications.

This Court must reject Seattle’s request that it ignore the common and ordinary meaning of the term “contacts” in order to find ambiguity. *HomeStreet, Inc. v. Dep’t of Revenue*, 166 Wn.2d 444, 451, 210 P.3d 297 (2009) (words in a statute must be given their common and ordinary

meaning). “A statute is ambiguous if susceptible to two or more reasonable interpretations, but a statute is not ambiguous merely because different interpretations are conceivable.” *Agrilink Foods, Inc. v. Dep't of Revenue*, 153 Wn.2d 392, 396, 103 P.3d 1226 (2005). Seattle argues that the term “contacts” is ambiguous solely on the grounds that “several definitions are found in Webster’s Third New International Dictionary 490 (1986), including ‘union or junction of body surfaces.’” Resp. Br. at 13.

Yet, Seattle does not and cannot explain how its cherry-picked definition creates ambiguity. Indeed, as Seattle acknowledges, statutory terms must be interpreted in the context of the statute, not in isolation. *Id.* at 15-16. To be sure, the term “contacts” is not ordinarily understood as being limited solely to a “junction of body surfaces,” and the context of the statute—a customer’s *business contacts* with a taxpayer—dispels any such construction. The more common meaning of the term, especially given its context, is reflected in another portion of the definition quoted by Seattle: an “instance of meeting, connecting or communicating.” *Id.* at 13. Of course, business communications between a taxpayer and its customers can, and often do, occur through contacts “by mail, telephone, computer, or fax.” Op. Br. at 10 (quoting Webster’s Third New International Dictionary (1981) at 490 and American Heritage Dictionary

of the English Language (4th ed. 2007)). The term “contacts” is not ambiguous. It includes all methods of communication.

2. The addition of a “physical” contacts requirement is not required to give meaning to RCW 35.102.130(3)(b)(ii).

By the same token, there is no merit to Seattle’s claim that the term “customer location” has to be construed to imply a “physical contact” requirement in order to give meaning to RCW 35.102.130(3)(b)(ii). Resp. Br. at 16. Indeed, Seattle’s interpretation of the statute, if accepted, would violate the very principle of statutory construction it relies upon. Specifically, if an implicit physical contact requirement is impressed onto the statute, the phrase “not taxable at the customer location”—and the entire service income factor—would be rendered superfluous.

Following its strained interpretation of the statute, Seattle ignored “customer location” under RCW 35.102.130(3)(b)(i), and instead purported to assign that income according to “costs of performance” under RCW 35.102.130(3)(b)(ii). The “costs of performance” test, however, *only* applies when the taxpayer is “*not taxable* at the customer location”:

(b) . . . Service income is in the city [i.e., Seattle] if:

(i) The customer location is in the city; or

(ii) The income-producing activity is performed in more than one location and a greater proportion of the service-income-producing activity is performed in the city than in any other location, based on costs of performance, *and* the taxpayer is *not taxable at the customer location*

RCW 35.102.130(3)(b) (emphasis added). Where, as here, the taxpayer *is* taxable at the customer location, then subsection (ii) is never triggered.

Subsection (ii) of RCW 35.102.130 is a “throwback” provision. Throwback provisions allow a city to “throw” a taxpayer’s income “back” to a taxing jurisdiction other than the jurisdiction of the customer’s location, but *only* if the taxpayer is “not taxable at the customer location” (*i.e.*, where the taxpayer has no nexus with the city). Hellerstein & Hellerstein, *State Taxation* ¶ 9.18(l)(b)(vi) (3d ed. 2001 & Supp. 2014-1). Throwback provisions are “designed to avoid the existence of so-called nowhere income—income assigned to a state where the taxpayer is not taxable.” *Id.* This undercuts Seattle’s position that applying the plain language of the statute would render subsection (ii) meaningless, as that subsection has meaning as throwback provisions. It is simply inapplicable here because Wedbush is taxable in Seattle and therefore is “taxable at the customer location.”

Moreover, Seattle’s erroneous interpretation of “customer location” effectively renders the service income factor superfluous by conflating the two-factor test in RCW 35.102.130 into a single-factor test. Because, according to Seattle, there is “no customer location” absent “physical” contact, Seattle turned to the service income factor’s throwback provisions to source income based solely on the location of Wedbush’s

Seattle account representatives. But, as Wedbush explained in its opening brief and Seattle does not dispute, commissions earned by Wedbush’s Seattle account representatives are already picked up in the first factor of the two-factor test: payroll. Op. Br. at 13-14.

The payroll factor, which is not at issue in this case, is designed to “assign a taxpayer’s income to the states in which it employs labor to generate income”—*i.e.*, the location where the taxpayer’s employees work. Hellerstein, *supra*, ¶ 9.17(1). In contrast, the second factor—the service income factor—is designed to “reflect the contribution of the ‘market’ state to the taxpayer’s income.” *Id.* ¶ 9.18(5)(c). Seattle’s refusal to apply that second factor’s “customer location” test when determining the service income factor allows Seattle to source income based solely on the location of Wedbush’s employees—and ignore income derived from Wedbush’s *market*. In effect, Seattle’s interpretation improperly “double counts” the payroll factor and renders the service income factor meaningless. *Homestreet*, 166 Wn.2d at 452 (“statutes are to be construed so no clause, sentence or word shall be superfluous, void, or insignificant”).¹

¹ Grasping at straws, Seattle points to RCW 82.04.462 to help explain its strained interpretation of RCW 35.102.130. But RCW 82.04.462 has nothing to do with local B&O tax, it uses entirely different statutory language (the term “customer location” is not used), and it was enacted two years after RCW 35.102.130 became effective. There is (continued)

3. Seattle’s “physical” contacts requirement is unworkable and unreasonable.

The absurdity of Seattle’s “physical” contact requirement is further illustrated by what it would mean in application. *Broughton Lumber Co. v. BNSF Ry. Co.*, 174 Wn.2d 619, 635, 278 P.3d 173 (2012) (courts must avoid interpreting statutes in a way that would “yield unlikely, absurd or strained consequences.”). According to Seattle’s interpretation of “customer location,” Wedbush—and every other B&O taxpayer—must “track” every single one of its “physical”² contacts with each of its customers to determine whether the “majority” of those contacts took place in Seattle or somewhere else. Resp. Br. at 7, 14. Nothing in RCW 35.102.130 imposes such a tracking requirement, and Seattle offers no suggestion on how to make such a burdensome requirement workable.

Suppose, for example, that a Wedbush account representative from Seattle takes a 60-minute plane ride to Spokane for a 90-minute face-to-face meeting at her customer’s Spokane office. Later that tax year, the same customer drives four hours to Seattle, meeting with Wedbush

nothing in the text or the history of RCW 82.04.462 to suggest that the legislature intended the two separate statutes to be construed similarly, and basic rules of statutory interpretation prevent any such endeavor. *Agrilink*, 153 Wn.2d at 397 (“where the Legislature uses certain statutory language in one instance, and different language in another, there is a difference in legislative intent”).

² By “physical” contact, Seattle does not contend there is a requirement for a “junction of body surfaces,” as suggested by the dictionary definition it cites to claim ambiguity. Rather, Seattle apparently means in-person or face-to-face meetings with customers.

representatives three different times on three different days, but only for a total of 75 minutes. In tracking those contacts for purposes of determining “customer location,” should Wedbush compare the *quantity* of the contacts (one meeting in Spokane versus three in Seattle) such that the “customer location” would be in Seattle? Or should it compare the *length* of the contacts (90 minutes in Spokane versus 75 in Seattle), which would place the “customer location” in Spokane? The difficulty in ascertaining “customer location” based on “physical contacts” only gets worse when considering Wedbush’s thousands of account representatives and customers world-wide.

The only workable construction of RCW 35.102.130 is to give “customer location” its plain meaning. The legislature defined “customer location” as the location where the “majority of contacts” take place in order to properly source income to the Seattle market for customers with multiple locations. Op. Br. at 12. Applying Seattle’s own Bellevue CPA example, if the CPA performs work for a company with its corporate headquarters in California, but the CPA interacts primarily with the customer’s tax department in Seattle, then the “customer location” is Seattle. After all, it is the location where the “majority of the contacts” take place. In sum, only Wedbush has interpreted the term “customer location” in a way that is faithful to its text, context, and purpose. This

Court should reject Seattle's effort to add a "physical" contact requirement to the statute as a means of generating unauthorized tax revenue.

4. Deference to Seattle is not warranted; any ambiguity requires construction in favor of Wedbush.

Because RCW 35.102.130 is not ambiguous, this Court can reject Seattle's request that it be construed in its favor. *See Dot Foods, Inc. v. Dep't of Revenue*, 166 Wn.2d 912, 921, 215 P.3d 185 (2009) ("deference is not afforded when the statute in question is unambiguous"). But even if the statute were ambiguous, it would not help Seattle. There is no merit in Seattle's claim that its interpretation is entitled deference because it is "an agency charged with administering and enforcing" the statute. Resp. Br. at 12-13. Put simply, if an ambiguity existed in the statute, it must be construed in Wedbush's favor as the taxpayer.

Seattle is not "charged with administering and enforcing" RCW 35.102.130. Rather, Seattle and all other cities that desire to impose a local B&O tax are *regulated* by the statute. By its terms, RCW 35.102.130 specifically restricts every city's authority to impose B&O tax, stating that *if* Seattle or any other Washington city "imposes a business and occupation tax," then the city doing so "*must* provide for the allocation and apportionment of a person's gross income" in accordance

with the statute. RCW 35.102.130 (emphasis added). In short, Seattle must *comply* with RCW 35.102.130.

In contrast, as the cases cited by Seattle show, deference is only appropriate where the legislature expressly delegates enforcement authority to a state agency—such as where a statute grants a particular agency authority to adopt rules. *See, e.g., Newschwander v. Bd. of Trustees of Wash. St. Teachers Ret. Sys.*, 94 Wn.2d 701, 710-11, 620 P.2d 88 (1980) (statute provided that agency shall “establish rules and regulations” administering statute); *Stroh Brewery Co. v. Dep’t of Revenue*, 104 Wn. App. 235, 242-43, 15 P.3d 692 (2001) (statute required the agency director to “[m]ake, adopt and publish such rules as he or she may deem necessary or desirable” to carry out duties imposed by the legislature”); *Boeing Co. v. Doss*, 180 Wn. App. 427, 429-37, 321 P.3d 1270 (2014), *review granted*, 181 Wn. 2d 1001, 332 P.3d 984 (2014) (statute granted agency authority to “adopt rules,” but the court declined to defer to the agency’s interpretation because the statute was unambiguous). The legislature delegated no such authority to Seattle or any other city desiring to exercise the local taxing authority granted to cities by the statute.³

³ Based on its erroneous position that the legislature delegated Seattle authority to enforce RCW 35.102.130, Seattle argues that the legislature “silently acquiesced” in the City’s (continued)

Moreover, if there is an ambiguity in the statute, the Court must construe that ambiguity in Wedbush's favor as the taxpayer. *Agrilink Foods, Inc. v. Dept. of Revenue*, 153 Wn.2d 392, 396-97, 103 P.3d 1226 (2005) ("if any doubt exists as to the meaning of a taxation statute, the statute **must** be construed most strongly against the taxing power and **in favor of the taxpayer**") (emphasis added) (quoting *Ski Acres, Inc. v. Kittitas County*, 118 Wash.2d 852, 857, 827 P.2d 1000 (1992) (collecting cases)). Thus, even if Seattle's interpretation were reasonable, the term "contacts" in the definition of "customer location" cannot be construed to mean only "physical" contacts, but must be construed to include telephone, email, fax, and all other forms of communication. Reversal is required for this reason as well.

interpretation by declining to amend the statute to overturn Seattle's "physical contact" interpretation. Resp. Br. at 12-13. Not true. For instance, Seattle has never included its purported interpretation in the text of its ordinance or the rule it enacted to administer the ordinance. SMC 5.45.081(G)(4); Seattle Business Tax Rule 5-032(b)(iv)(D). Rather, Seattle points to an undated photocopy of a purported webpage print-out as evidence of its allegedly public position on the issue. BR 000067. But nothing in the record shows if or when this webpage was published, much less that the legislature was even aware of it or accepted it as a proper interpretation of RCW 35.102.130. Indeed, approximately 40 Washington cities have similar ordinances imposing a B&O tax pursuant to RCW 35.102.130. Seattle has made no showing that any other city interprets the statute the same way Seattle does.

B. Even if a greater proportion of the costs of performance standard were applicable, none of Wedbush's commission income would be in the numerator under the service income factor.

As explained above, a “costs of performance” standard does not apply here because it requires a finding that Wedbush is “not taxable at the customer location,” and Wedbush is undeniably taxable in Seattle. *See* Section A.2, *supra*. Regardless, even if a “greater proportion of the costs of performance” standard were applicable, *none* of Wedbush’s income at issue would be sourced to Seattle under the service income factor in RCW 35.102.130(3)(b)(ii).

Under subsection (ii), income can only be sourced to Seattle if the taxpayer is not taxable in the customer location and “a greater proportion of the service-income-producing activity” is performed in Seattle than in any other location “based on costs of performance.” RCW 35.102.130(3)(b)(ii). Seattle continues to argue that commission income from stock trade orders placed with Wedbush account representatives officed in Seattle must be sourced to Seattle, regardless of where the customer is located. *Resp. Br.* at 18-19. Yet Seattle has *never* compared the costs of performance inside and outside Seattle. In fact, the Seattle auditor testified that she considered *only* the entry of the stock trade orders

Seattle cannot simply ignore Wedbush’s activities in other states to source additional income to Seattle. It is clear from the plain language that in order to determine where the “greater proportion” of a business’ “costs of performance” are incurred “the income producing activity in all states ha[s] to be ascertained to find the ‘greater proportion.’” Hellerstein, *supra*, ¶ 9.18(3)(a).

Here, Seattle disregarded the undisputed evidence in the record that the majority of Wedbush’s activities performed to earn the commission income at issue are conducted *outside* Seattle. The Seattle account representatives who take the customer’s trading orders play a relatively minor role in executing the stock trades—merely receiving stock trade orders from customers over the phone (or by fax) and forwarding those orders to Wisconsin or other non-Seattle locations for processing.⁴ Tr. at 5:9-6:10, 9:10-16, 17:25-27. The processed orders are then sent to floor brokers in New York, Los Angeles, or other non-Seattle locations for the actual execution of the stock trades. Tr. at 5:9-6:10, 17:25-27. Other non-Seattle Wedbush departments also assist in the execution of customers trades, including the company’s margin department and back office operations in Los Angeles. Tr. at 5:27-6:1.

⁴ Seattle’s statement that Wedbush’s Seattle account representatives “execute” the stock trades in Seattle is contrary to the undisputed facts in the record. Resp. Br. at 9.

In short, even if a “costs of performance” standard applied, the evidence shows that the majority of performance costs associated with stock trade orders taken by Seattle account representatives are actually incurred *outside* of Seattle. Tr. at 16:4-14, 19:27-20:2. Therefore, even under Seattle’s erroneous standard, Seattle’s assessment is incorrect and must be reversed.

III. CONCLUSION

“Customer location” under RCW 35.102.130 means the location of Wedbush’s customer. Seattle cannot disregard the plain language and substitute taxpayer location by arguing that the term “contacts” is ambiguous and then using that purported ambiguity to plead with the Court for deference. Seattle’s addition of an extra-statutory “physical” contact requirement violates multiple principles of statutory construction. The Superior Court’s order should be reversed and the case remanded for entry of summary judgment in favor of Wedbush.

RESPECTFULLY SUBMITTED this 23rd day of February,
2015.

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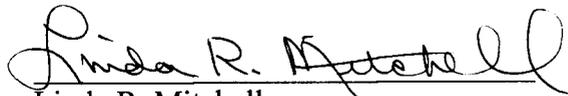
CERTIFICATE OF SERVICE

I hereby certify under penalty of perjury that on February 23, 2015,
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