

FILED

JUL 12 2016

WASHINGTON STATE
SUPREME COURT

Supreme Court No. 93356-1
Court of Appeals No. 73606-0-1

**IN THE SUPREME COURT
OF THE STATE OF WASHINGTON**

UNITED AIRLINES, INC.,

Petitioner,

v.

WASHINGTON STATE DEPARTMENT OF REVENUE, ET AL,

Respondents.

**ON APPEAL FROM THE SUPERIOR COURT OF THE
STATE OF WASHINGTON FOR KING COUNTY**

The Honorable Monica Benton

PETITION FOR REVIEW

Christopher L. Thayer, WSBA #23609
Attorney for Petitioner

Christopher L. Thayer, WSBA #23609
PIVOTAL LAW GROUP, PLLC
IBM Building
1200 5th Avenue, Suite 1217
Seattle, Washington 98101
(206) 340-2008 telephone
(206) 340-1962 fax
CThayer@PivotalLawGroup.com

2016 JUL -5 PM 1:11
FILED
COURT OF APPEALS DIV 1
STATE OF WASHINGTON
CF

TABLE OF CONTENTS

I. IDENTITY OF PETITIONER AND INTRODUCTION..... 1

II. COURT OF APPEALS DECISION 2

III. ISSUES PRESENTED FOR REVIEW..... 3

IV. STATEMENT OF THE CASE..... 3

A. UAL leases property at SeaTac Airport subject to a possessory interest property tax..... 3

B. From 2006-2011, DOR changed its methodology for assessing possessory interests in Airport Properties, resulting in taxation of the Port's tax-exempt reversionary interest. 4

C. DOR's methodology assessed taxes against UAL for the Port's tax-exempt reversionary interest. 6

D. Trial Court..... 6

E. Court of Appeals ruling. 8

V. ARGUMENT 9

A. Standard of Review. 9

B. RCW 84.69.020(2) requires a refund for property taxes paid as a result of a "manifest error in description," which includes assessments against tax-exempt property like the Port's reversionary interest..... 10

C. Under *Pier 67* and *Duwamish Warehouse*, DOR was required to account for the tax-exempt reversionary interest of the government owner, and was not permitted to ignore the term of the lease, when calculating UAL's possessory interest..... 13

VI. CONCLUSION 18

TABLE OF AUTHORITIES

Cases

| | |
|--|--------|
| <i>Duwamish Warehouse v. Hoppe</i> , 102 Wn.2d 249, 684 P.2d 703 (1984)..... | passim |
| <i>Fairbanks v. J.B. McLoughlin Co., Inc.</i> , 131 Wn.2d 96, 929 P.2d 433 (1997)..... | 9, 12 |
| <i>J.N. v. Bellingham Sch. Dist. No. 501</i> , 74 Wn. App. 49, 871 P.2d 1106 (1994)..... | 10, 12 |
| <i>Keates v. City of Vancouver</i> , 73 Wn. App. 257, 869 P.2d 88 (1994)..... | 9 |
| <i>Lamon v. McDonnell Douglas Corp.</i> , 91 Wn.2d 345, 588 P.2d 1346 (1979)..... | 10, 12 |
| <i>Lybbert v. Grant County, State of Wash.</i> , 141 Wn.2d 29, 1 P.3d 1124 (2000)..... | 9 |
| <i>Millikan v. Bd of Directors of Everett Sch. Dist. No. 2</i> , 93 Wn.2d 522, 611 P.2d 414 (1980)..... | 9, 12 |
| <i>Pier 67 II, Inc. v. King County</i> , 78 Wn.2d 48, 469 P.2d 902 (1970)..... | passim |
| <i>State ex rel. Murray v. Shanks</i> , 27 Wn. App. 363, 618 P.2d 102 (1980)..... | 10 |

Statutes

| | |
|----------------------------|--------|
| RCW 84.40.010(1) | 4 |
| RCW 84.69.020..... | 1, 3 |
| RCW 84.69.020(2) | 10, 18 |
| WAC 458-14-005(14) | 11, 18 |
| WAC 458-14-005(14)(h)..... | 1, 3 |

I. IDENTITY OF PETITIONER AND INTRODUCTION

Petitioner United Airlines, Inc. (“UAL”) respectfully requests this Court to review the Court of Appeals’ opinion below.

This matter arises out of Department of Revenue’s (“DOR”) assessment of possessory interest taxes on airport property leased by UAL at SeaTac Airport for tax-assessed years 2009-2011. During this period, UAL leased airport property from the Port of Seattle, a tax-exempt entity (“Port”), under a six-year lease with no option to renew. For those tax years, DOR assessed taxes against UAL for the Port’s tax-exempt reversionary property interest. UAL challenged those assessments under the “manifest error” provisions of **RCW 84.69.020**. A “manifest error” occurs when taxes are assessed against “property exempted by law from taxation.” **WAC 458-14-005(14)(h)**. UAL presented sworn statements from experts to the trial court below, confirming DOR assessed taxes against UAL for the tax-exempt Port-owned property.

The Court of Appeals mischaracterized the issue as one of “valuation” requiring the exercise of “appraisal judgment,” not correctable under RCW 84.69, and disregarded UAL’s expert’s testimony. The Court of Appeals erred when it accepted DOR’s position that the reversionary interest of the Port was “nil.” This is

not allowed by the Washington Supreme Court holdings of *Pier 67 II, Inc. v. King County*, 78 Wn. 2d 48, 469 P.2d 902 (1970) (actual lease term must be taken into account), or *Duwamish Warehouse v. Hoppe*, 102 Wn.2d 249, 684 P.2d 703 (1984) (reversionary interest of public entity must be accounted for and backed out of any appraisal of publicly owned property).

As *Pier 67* required DOR to use the actual term of the lease, it was impossible for the reversionary interest of the Port to be “nil” when UAL had a six-year lease of Airport Property. The reversionary interest of the Port had to have some value, which must be accounted for (and not taxed) pursuant to *Duwamish*.

This Court should accept review and confirm it was manifest error for DOR to have assessed taxes against UAL for the Port of Seattle’s tax-exempt reversionary interest.

II. COURT OF APPEALS DECISION

UAL asks this Court to review the June 6, 2016 opinion of the Court of Appeals in this matter (the “Opinion”). The Opinion upheld DOR’s assessment of taxes against UAL for the Port’s tax-exempt reversionary property interest by affirming the trial court’s grant of summary judgment in favor of DOR and against UAL. A copy of the Opinion is attached as **Appendix A**.

III. ISSUES PRESENTED FOR REVIEW

1. Did the Court of Appeals err when it characterized UAL's dispute as one of "valuation" requiring the exercise of "appraisal judgment," rather than one regarding the "manifest error" of assessing taxes against tax-exempt property under **RCW 84.69.020**, despite the definition of "manifest error" including "[t]he assessment of property exempted by law from taxation," **WAC 458-14-005(14)(h)**, and UAL's expert testimony confirming the methodology used by DOR improperly assessed taxes against UAL for tax-exempt Port-owned property?

2. Did the Court of Appeals err when it refused to apply controlling Washington State Supreme Court precedent, **Pier 67 II, Inc. v. King County**, 78 Wn.2d 48, 469 P.2d 902 (1970), and **Duwamish Warehouse v. Hoppe**, 102 Wn.2d 249, 684 P.2d 703 (1984), which require DOR to consider the actual term of the applicable lease and to take into account any tax-exempt reversionary interest when assessing taxes against a possessory interest?

IV. STATEMENT OF THE CASE

A. UAL leases property at SeaTac Airport subject to a possessory interest property tax.

UAL operates a commercial airline, including operations at

SeaTac International Airport in King County, Washington (the “Airline Property”). SeaTac Airport is owned by the Port - a public entity exempt from real estate tax. **RCW 84.40.010(1)**. Airlines like UAL are subject to a “possessory interest” tax, which is not defined by Washington statute or code.

A “possessory interest” is a private party’s right of possession and use of real property owned by a tax-exempt public entity for a period of time. DOR Property Tax Bulletin #70-14 specifically defines it as “a portion of the bundle of rights that would normally be included in fee simple ownership,” making it an ownership interest “for some time less than perpetuity,” with a value “normally something less than the value in perpetuity of the whole bundle.” **CP 259** (emphasis added).

On January 1, 2006, UAL entered into a six-year lease (no renewal option) with the Port for the use of certain defined Airport Property. **CP 574-578; CP 579-693**.

B. From 2006-2011, DOR changed its methodology for assessing possessory interests in Airport Properties, resulting in taxation of the Port’s tax-exempt reversionary interest.

Before 2006, DOR assessed Airport Properties using an assumed lease term of seven years. **CP 299-302**. Starting in 2006,

DOR adopted an assessment methodology, which assessed possessory interests as if the tenant owned the property in fee. DOR assumed a hypothetical perpetual lease term. **CP 228-249; CP 306; CP 309; CP 320-321; CP 452.** This change in methodology increased the assessed value of Airport Properties significantly. **CP 452.**

After receiving complaints from other airlines, including Alaska and Southwest, DOR admitted its 2006-2011 methodology resulted in taxation of the Port's tax-exempt ownership interests. Kathy Beith, DOR's Assistant Director of Property Tax Division, admitted, "[t]he possessory leases of Alaska Airlines are assessed in the same manner as if they owned the property." **CP 304-305.**

Ms. Beith testified in her April 9, 2015 deposition:

- A possessory interest is valued at something less than the entire bundle of rights associated with fee ownership. **CP 328.**
- A possessory interest is the right of ownership of property for some time less than perpetuity. **CP 328-329.**
- In assessing the Airport Properties, DOR is attempting to assess the possessory interest of the airline company, which is "something less than the fee interest in the property." **CP 319.**
- DOR's 2006-2011 methodology valued the possessory interests of the airline airport properties as if they owned the fee interest in the property. **CP 333.**

- DOR's 2006-2011 methodology assumed the value for the reversionary interests of the Port to be "zero" or "nil". **CP 330-331**.
- DOR's 2006-2011 methodology resulted in an increased assessed value of at least three times the previously assessed value of the same properties. **CP 320-321**.

C. DOR's methodology assessed taxes against UAL for the Port's tax-exempt reversionary interest.

For 2009-2011, DOR assessed UAL Airline Property assuming a perpetual lease term for Airport Property leased from the Port and a zero value for the Port's reversionary interest, even though UAL's actual lease expired in 2012. **CP 451-453; CP 576; CP 581**. Upon discovering DOR's error, UAL filed a claim under RCW 84.69.020 requesting a refund of taxes paid as a result of a "manifest error". **CP 454; CP 581-582; CP 576**. On February 19, 2013, King County denied UAL's refund claim. **CP 530**.

The total tax refund due UAL for assessed years 2009, 2010 and 2011 is: 2009 (2010 taxes) \$555,906; 2010 (2011 taxes) \$473,594; 2011 (2012 taxes) \$548,165. **CP 455**.

D. Trial Court.

This matter came up on appeal before the Court of Appeals after the Trial Court, on cross motions for summary judgment, dismissed UAL's claims. In support of its motion and in opposition to DOR's motion, UAL's expert, David Hunnicutt, an MAI certified

commercial real estate appraiser, offered expert opinions, on a more probable than not basis, and to a reasonable degree of certainty in his profession as follows:

- (1) The methodology used by the DOR to value and assess UAL leasehold possessory interests at SeaTac for 2009, 2010, and 2011, failed to account for the reversionary interest of the Port of Seattle.
- (2) As a result, the calculations relied upon by DOR for value, improperly took into account the value of the tax exempt interest of the Port.
- (3) The DOR when assessing taxes for UAL's possessory interests in airport properties, effectively taxed UAL as if it owned the airport properties in fee simple.
- (4) UAL was assessed taxes for exempt Port-owned property.

CP 228-249.

Neal Cook, DOR's appraisal expert, offered the following

contradictory opinions:

- (1) The methodology used by the DOR from 2006 – 2011 “produced an accurate estimate of the value of the property rights transferred to a lessee....”
- (2) The methodology used by DOR from 2006 – 2011 to assess possessory interests “did not include the value estimate of the lessor's reversionary interest”.
- (3) The methodology used did not value the fee simple interest of the subject property.

CP 170-200.

Mr. Cook claimed DOR engaged in a two-step process to calculate UAL's possessory interest, as follows:

In the first step of the two-step calculation the value of the beneficial rights transferred to the lessee of the property was computed by capitalizing the net annual lease payments for a single year using a capitalization rate...

In the second step of the calculation, the present value of the government owner's reversionary interest in the beneficial rights was estimated and subtracted to arrive at the estimated market value of the non-government lessee's beneficial rights.

CP 170-200. However, DOR never calculated the value of the reversionary interest owned by the tax-exempt Port as required by step two. Mr. Cook further claimed DOR's methodology did not assess taxes on the Port's exempt interest, but Cook and DOR failed to explain how the Port's interest was accounted for or excluded from the assessment. **CP 170-200; CP 29-92; CP 813-821.** As a result, Port-owned exempt property was valued and assessed against UAL. **CP 446-573; CP 813-821; CP 228-249.**

Notwithstanding conflicting expert opinions on a material issue, the trial court granted summary judgment in favor of DOR and against UAL. **CP 839.** UAL filed the underlying appeal. **CP 845.**

E. Court of Appeals ruling.

The Court of Appeals affirmed the trial court's decision, characterizing the issue as one of "valuation" requiring the exercise of "appraisal judgment," which is not correctable under RCW 84.69.

Appendix A.

The Court of Appeals refused to apply controlling state precedent of *Pier 67 II, Inc. v. King County*, 78 Wn.2d 48, 469 P.2d 902 (1970), and *Duwamish Warehouse v. Hoppe*, 102 Wn.2d 249, 684 P.2d 703 (1984), which require DOR to take into account the actual lease term, and the value of the tax-exempt reversionary interest when assessing leasehold/possessory interest taxes.

V. ARGUMENT

A. Standard of Review.

On appeal, a trial court's summary judgment ruling is reviewed *de novo*. See *Keates v. City of Vancouver*, 73 Wn. App. 257, 263, 869 P.2d 88 (1994). The appellate court engages in the same inquiry as the trial court in determining whether summary judgment is appropriate. *Lybbert v. Grant County, State of Wash.*, 141 Wn.2d 29, 34, 1 P.3d 1124 (2000). All material evidence and all reasonable inferences therefrom must be viewed in favor of the nonmoving party; if reasonable persons might reach different conclusions, the motion must be denied. *Millikan v. Bd of Directors of Everett Sch. Dist. No. 2*, 93 Wn.2d 522, 531, 611 P.2d 414 (1980); *Fairbanks v. J.B. McLoughlin Co., Inc.*, 131 Wn.2d 96, 102, 929 P.2d 433 (1997).

Affidavits and other testimonial documents of the party moving for summary judgment must be scrutinized with care, and all reasonable inferences from the evidence must be resolved against him/her, while affidavits of nonmoving party are to be afforded leniency. ***State ex rel. Murray v. Shanks***, 27 Wn. App. 363, 618 P.2d 102 (1980). “In general, an affidavit containing admissible expert opinion on an ultimate issue of fact is sufficient to create a genuine issue as to that fact, precluding summary judgment.” ***J.N. v. Bellingham Sch. Dist. No. 501***, 74 Wn. App. 49, 60-61, 871 P.2d 1106 (1994) (reversing summary judgment where the trial court “discounted the sworn testimony of J.N.’s experts”). ***See also Lamon v. McDonnell Douglas Corp.***, 91 Wn.2d 345, 351-53, 588 P.2d 1346 (1979) (reversing summary judgment where the plaintiff’s expert affidavit created at least one genuine issue of material fact).

B. RCW 84.69.020(2) requires a refund for property taxes paid as a result of a “manifest error in description,” which includes assessments against tax-exempt property like the Port’s reversionary interest.

Under RCW 84.69.020, *ad valorem* taxes shall be refunded if paid as a result of “manifest error in description.” ***RCW 84.69.020(2)***. WAC 458-14-005 defines “manifest error” as “an error in listing or assessment, which does not involve a revaluation of property,” and

further provides a list of items that constitute a “manifest error,” including:

(h) The assessment of property exempted by law from taxation;

... or

(j) Any other error which can be corrected by reference to the records and valuation methods applied to similarly situated properties, without exercising appraisal judgment.

WAC 458-14-005(14).

Each item is disjunctive, meaning an error warrants correction if it qualifies under just one of the definitions. Regardless, the present case falls under both subparts (h) and (j). First, DOR’s assessments taxed exempt property owned by the Port. The methodology utilized by DOR from 2006-2011 assumed a lease term into perpetuity, ignoring the terms of the parties’ actual lease and treating the Port’s tax-exempt reversionary interest as “nil”. This is confirmed by DOR documentation, testimony of DOR Assistant Director Beith, and UAL expert Hunnicutt. At a bare minimum, there was a disputed issue of material fact on this issue presented to the Trial Court which precluded summary judgment, and the Court of Appeals erred when it failed to reverse the Trial Court. Second, correction of this error can be made based upon information DOR

already has and does not require any appraisal judgment – all DOR needs to do is recalculate the amount of taxes that should have been assessed utilizing the existing lease term instead of a hypothetical perpetual lease term.

The Court of Appeals ignored the definition of “manifest error” under Washington law as including “the assessment of property exempted by law from taxation” – which is exactly what DOR did when it taxed UAL. The Court also failed to accord the proper weight and deference to the evidence. **See Fairbanks**, 131 Wn.2d at 102 and **Millikan**, 93 Wn.2d at 531 (all material evidence and all reasonable inferences therefrom must be viewed in favor of the nonmoving party; if reasonable persons might reach different conclusions, the motion must be denied); **Lamon**, 91 Wn.2d at 351-53 and **J.N.**, 75 Wn. App at 60-61 (summary judgment is precluded where an expert affidavit creates even one genuine issue of material fact). The Court of Appeals should have at minimum reversed the grant of summary judgment to DOR and remanded to the Trial Court for further proceedings.

///

///

///

C. Under Pier 67 and Duwamish Warehouse, DOR was required to account for the tax-exempt reversionary interest of the government owner, and was not permitted to ignore the term of the lease, when calculating UAL's possessory interest.

In *Pier 67 II, Inc. v. King County*, 78 Wn.2d 48, 469 P.2d 902 (1970), this Court set forth the factors DOR must consider when valuing a leasehold possessory interest. In *Pier 67*, a taxpayer challenged the validity of valuations for a leasehold interest and improvements on state-owned land. *Id.* at 48-49. The Court found that in determining the taxable value of a leasehold interest “the value to be taxed is the value of the right to use the property over the period of the lease.” *Id.* at 56-57 (emphasis added). The Court in *Pier 67* also noted that a leasehold interest “cannot be valued without reasonable knowledge of its probable remaining life.” *Id.* at 58.

In *Duwamish Warehouse v. Hoppe*, 102 Wn.2d 249, 684 P.2d 703 (1984), Duwamish Warehouse appealed the valuation of its leasehold interest on lands owned by the Port of Seattle. The assessor valued the warehouse at its full market value, without considering the Port of Seattle’s tax-exempt reversionary interest. The Court noted where “fee interest is privately owned” the assessor may impose a single tax on the entire estate; but where the fee interest is owned by the government (and therefore tax-exempt), the

possessory interest must be taxed separately from the reversionary interest. *Id.* at 253. The Court noted the statute required the assessor to tax the property at “full and fair value” and where there is “any doubt as to the meaning of a tax statute, it must be construed against the taxing power.” *Id.* at 254 (emphasis added).

Ordinarily, full and fair value means the amount a willing buyer would pay a seller who is willing but not obligated to sell.... Where private land is leased, the willing buyer is contemplated to be purchasing the entire fee, including leasehold and improvements.... In the circumstances of state-owned interests in the land, however, the State’s ownership interest cannot be purchased. Thus, a willing buyer would not logically pay a price for the entire fee....

Id. at 254. The Court concluded the reversionary interest must be considered in determining the value of a leasehold interest:

To disregard the fact that this building reverts to the Port at the end of the lease term, long before its useful life is up, would be to disregard a factor which plainly would affect the price negotiations between a willing buyer and a willing seller.

Id. at 256-57.

Washington requires the assessment of leasehold possessory interests to account for the period of the actual lease (*Pier 67*), as well as the tax-exempt reversionary interest (*Duwamish*). Here, DOR chose to ignore both of these mandates and used a methodology that assumed a perpetual lease and per se

set the Port's tax-exempt reversionary interest as zero – thereby imposing taxes assessed on the Port's exempt interest against UAL.

The Court of Appeals disregarded *Pier 67* and *Duwamish* because they involved challenges to valuation, not requests for administrative refunds. **Appendix A, pp.7-8**. However, nothing in *Pier 67* or *Duwamish* supports such a limitation of their reasoning or application.

DOR argued “where the evidence suggested that the lease would continue to be renewed into the foreseeable future, the government owner’s reversionary interest was considered minimal.” **CP 29-92**. However, *Pier 67* does not allow for this speculation. UAL’s lease with the Port was a six-year lease with no renewal options, set to expire on December 21, 2012. **CP 579-693; CP 574-578**. The fact that airline companies may enter into new leases at the conclusion of each lease term does not mean the airlines occupy the same property in each consecutive lease. **CP 737-740**. The lease provides UAL’s right to use portions of the airport may change from time to time. **CP 579-693**. The only property UAL has a right to possess at any given time is expressly stated in the lease in effect at the time. It is absurd for DOR to assume a hypothetical perpetual term whereby the taxable property is greater than that which is

granted under the terms of a lease, or for the Court of Appeals to approve such an assumption as an exercise in “valuation” or “appraisal judgment.”

The Court of Appeals found:

The use of an appraisal method that assigned a nil value to the port’s reversionary interest after consideration of all the circumstances cannot be characterized as the manifest error of assessing property exempted by law from taxation.” **Appendix A, p.10.**

The Court of Appeals also disregarded the expert testimony of Mr. Hunnicutt. Instead, the Court of Appeals sided with the moving party (DOR), characterizing the dispute and the expert testimony as relating only to “valuation.”

However, Hunnicutt did not need to perform a separate appraisal of the property. He merely reviewed the calculation to determine that a perpetuity model such as the direct capitalization approach incorrectly assessed value to the exempt reversionary interest. No appraisal judgment was required to identify the error.

Ordering DOR to correct its mistake falls within the intent of the “manifest error” provisions and does not require valuation judgment or a separate appraisal. Correcting a calculation does not require valuation judgment or a new appraisal. An example

commonly used to describe the intent of the provision is to say that the county's appraisal included an element that did not exist, such as additional square footage, a fireplace, a pool, etc. The DOR erred in its description of the exempt reversionary interest by asserting that it did not exist or the value was "nil." This disagreement is a factual issue that does not require appraisal judgement. Under *Duwamish* and *Pier 67*, either there was or was not a stated lease term, and either there is or is not a reversionary interest. DOR was required to account for these factors and failed to do so. The Court of Appeals erred in affirming the Trial Court's dismissal of UAL's claim. UAL's tax assessment can be readily recalculated after accounting for the actual lease term, just as a similar correction would be required if the county or assessing jurisdiction was ordered to correct for square footage, fireplace, pool, or other erroneous character of the assessed property.

Pursuant to *Pier 67* and *Duwamish*, DOR did not have the legal right to ignore the actual lease and erred when it assumed the taxable lessee's interest would continue to perpetuity. And, to the extent DOR claimed it somehow accounted for the port's reversionary interest but deemed it "nominal," this characterization fails because: (1) it is contradicted by admissions in its own internal

documents where it acknowledges that the methodology assume the reversionary interest is “nil” (vs. “nominal”); and (2) even if it were legally permissible to assume the reversionary interest were even “nominal,” there would still be some value which had to be accounted for, to ensure DOR was not assessing and imposing possessory interest taxes on UAL for the Port’s tax-exempt property.

VI. CONCLUSION

By upholding the trial court’s summary judgment, the Court of Appeals erroneously disregarded Washington Supreme Court precedent of *Pier 67* and *Duwamish*, and allowed to stand DOR’s taxation of non-taxable property interests, in violation of RCW 84.69.020(2) and WAC 458-14-005(14).

DOR’s own witnesses and internal documents admit the Port’s tax-exempt reversionary interest was treated as “nil” under the assessment model utilized from 2006-2011. By treating the reversionary interest as zero, DOR taxed the full fee interest, including the tax-exempt reversionary interest, when it assessed and taxed UAL’s Airline Properties in 2009, 2010 and 2011. This was a “manifest error.” **RCW 84.69.020(2); WAC 458-14-005(14).**

DOR was further obligated by Washington case law to account for the actual lease term (*Pier 67*), and the Port’s tax-exempt

reversionary interest (*Duwamish*). It did neither.

At a bare minimum, in the face of expert testimony from UAL and the various admissions and statements against interest by DOR representatives, there were disputed issues of material fact that precluded the entry of summary judgment in favor of DOR.

UAL thus respectfully requests this Court to grant its Petition for Review and reverse the Court of Appeals' error.

Respectfully submitted this 5th day of July, 2016.

PIVOTAL LAW GROUP PLLC



Christopher L. Thayer, WSBA #23649
Attorneys for Petitioner

CERTIFICATE OF SERVICE

The undersigned certifies under penalty of perjury under the laws of the State of Washington that on the below date a true copy of this Petition for Review was served on counsel of record as indicated below:

Via Regular Mail

Charles E. Zalesky
Attorney General of Washington
PO Box 40123
Olympia, WA 98504-0123

Via E-mail

Attorney General of Washington
Charles Zalesky
Email: ChuckZ@atg.wa.gov

Via E-mail

Assistant Attorney General
Andrew Krawczyk
Email: AndrewK1@atg.wa.gov

Copies Sent Via Email to:

CandyZ@atg.wa.gov
REVOlyEF@atg.wa.gov

Dated this 5th day of July, 2016, at Seattle, Washington.



Kathleen Martens

APPENDIX A

Appendix A – Petition for Review
United Airlines v. Washington State Department of Revenue
Court of Appeals No. 73606-0-1

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

| | | |
|---|---|---------------------|
| UNITED AIRLINES, INC., a Delaware corporation, |) | No. 73606-0-1 |
| |) | |
| Appellant, |) | DIVISION ONE |
| |) | |
| v. |) | |
| |) | |
| KING COUNTY, a governmental entity, and WASHINGTON STATE DEPARTMENT OF REVENUE, |) | PUBLISHED OPINION |
| |) | |
| Respondents. |) | FILED: June 6, 2016 |

FILED
COURT OF APPEALS DIV I
STATE OF WASHINGTON
2016 JUN -6 AM 9:05

BECKER, J. — An administrative refund of taxes under chapter 84.69 RCW is not available as an avenue for challenging an alleged error in determining the valuation of property. To challenge a tax as unlawful or excessive, a taxpayer must pay the tax under written protest and then file suit under RCW 84.68.020. Because the appellant in the present case attempted to use the administrative refund process to challenge the appraisal method by which appellant's property interest was valued, the trial court properly dismissed the action on summary judgment.

Summary judgment rulings are reviewed de novo. Summary judgment is authorized when no genuine issue of material fact exists and the moving party is entitled to judgment as a matter of law. A material fact is one upon which the

No. 73606-0-1/2

outcome of the litigation depends in whole or in part. Samis Land Co. v. City of Soap Lake, 143 Wn.2d 798, 803, 23 P.3d 477 (2001).

Appellant United Airlines is a commercial air carrier that flies in and out of SeaTac International Airport, which is located in King County. United has leased property at SeaTac since the airport opened in the 1940's. Several of the leases have been short in nature, but they have always been renewed. In January 2006, United and the Port of Seattle agreed to a six-year lease.

The port, as a municipal corporation, is exempt from taxation on property it owns at SeaTac. RCW 84.36.451(1)(a). This exemption does not apply to United's leasehold. RCW 84.36.451(2)(a). A nongovernment entity leasing government-owned property has a taxable possessory interest. Clark-Kunzl Co. v. Williams, 78 Wn.2d 59, 64, 469 P.2d 874 (1970).¹

The basis of valuation of a taxable leasehold estate is established by statute. "Taxable leasehold estates must be valued at such price as they would bring at a fair, voluntary sale for cash without any deductions for any indebtedness owed including rentals to be paid." RCW 84.40.030(2). The parties agree that the value of a taxable possessory interest "is normally something less" than the value of a fee ownership. See GEORGE KINNEAR &

¹United, an "airplane company," RCW 84.12.200(1)-(2), is subject to assessment by the Department of Revenue, rather than by the county in which it operates. RCW 84.12.270; see also RCW 82.29A.130(1) (exempting such companies from paying the leasehold excise tax).

CLYDE B. ROSE, WASH. DEP'T OF REVENUE, PROCEDURE GUIDE FOR THE APPRAISAL OF POSSESSORY INTERESTS 2 (Nov. 1970),² which provides as follow:

1. DEFINITIONS AND NATURE OF POSSESSORY INTERESTS

Taxable possessory interests are private interests in property owned by a tax exempt body, usually a public agency.

A taxable possessory interest constitutes a private right to the possession, and use of such property for a period of time. It constitutes the ownership of property for some time less than perpetuity. It is a portion of the bundle of rights that would normally be included in a fee ownership, and its value therefore is normally something less than the value in perpetuity of the whole bundle.

Before 2006, the department employed an imputed return approach to valuing possessory interests in airline leaseholds at SeaTac. The value was computed using a discounted cash-flow model that capitalized the net annual lease payments assuming a seven-year remaining life.³

In 2006, the department decided to change to a variation of what is known as a residual approach for valuing possessory interests. The residual approach first computes the present value of the leasehold by capitalizing the net amount of lease payments for a single year using a capitalization rate determined from a review of rate studies. The second step is to consider the present value of the government-owned reversionary interest and to subtract it if it has any material value. Using the residual approach, the department "looked for evidence suggesting that the lease would not be renewed at the end of its express term." Where the evidence suggested that the lease would continue to be renewed into the foreseeable future, the port's reversionary interest "was

² Clerk's Papers at 45 (Exhibit 1, declaration of Kathy Beith, assistant director of the property tax division for the Washington State Department of Revenue).

³ Clerk's Papers at 33 (declaration of Kathy Beith).

considered to be minimal.” According to the department, a significant difference is that the residual approach used a direct capitalization method, whereas the imputed return approach used limited-life yield capitalization.⁴

The residual approach resulted in valuations that were significantly higher than the valuations calculated under the imputed return approach.⁵ Using the residual approach, the department, at least in some cases, calculated the value of the government-owned reversionary interest at “nil” or “zero.”⁶

After receiving objections from airline companies, and after internal study and discussion, the department agreed to change from the residual approach to a modified version of the earlier imputed return approach. This methodology used the actual lease term rather than a hypothetical perpetual lease.⁷

United requested an administrative refund of taxes paid to King County from 2009 through 2011. For each year, the department had valued United's possessory interest by using the residual approach and assuming a hypothetical perpetual lease. The county denied the request.

United brought this action in superior court in December 2013. The department intervened to defend the county and to protect its own interests. The department moved for summary judgment seeking affirmance of the county's denial of United's refund claim. United filed a cross motion for summary judgment. The court granted the department's motion. United appeals.

⁴ Clerk's Papers at 34 (declaration of Kathy Beith).

⁵ Clerk's Papers at 320-21 (declaration of Kathy Beith).

⁶ Clerk's Papers at 331 (deposition testimony of Kathy Beith).

⁷ Clerk's Papers at 35 (declaration of Kathy Beith).

At the outset, it is important to understand that requesting an administrative refund of taxes is different from filing suit to challenge a tax as unlawful or excessive. To challenge a tax as unlawful or excessive, a taxpayer must pay the tax under written protest. The protest must set forth all of the grounds upon which such tax is claimed to be unlawful or excessive. RCW 84.68.020. The next step, which must be taken within a short window of time, is to bring an action in court to recover the tax. RCW 84.68.060. United paid the taxes, but not under protest. United did not file suit to challenge the tax as unlawful or excessive. United is proceeding under the administrative refund statute, RCW 84.69.020.

A request for an administrative refund is directed to the county treasurer rather than to a court. RCW 84.69.030(1)(b).⁸ A refund request may be filed within three years after the due date of the payment to be refunded. RCW 84.69.030(1). Payment under protest is not required. RCW 84.69.170. With some exceptions not relevant here, a request for an administrative refund will not be granted if the basis for the request is a claimed error in the valuation of the property. RCW 84.69.020.

Upon receiving a request for an administrative refund of ad valorem taxes, the county treasurer determines whether the request fits any of the limited statutory circumstances set forth in 16 subsections of RCW 84.69.020. If the county treasurer rejects the request, an action may be brought in superior court to contest the treasurer's decision. RCW 84.69.120.

⁸ In King County, the responsibility for handling such requests has been delegated to the county assessor.

The 16 subsections are, in general, readily recognizable as situations in which there has been an administrative mistake in the collection of taxes that can be corrected without a reappraisal of the property. For example, taxes may be refunded if they were paid more than once, paid as a result of a clerical error in extending the tax rolls, paid with respect to an improvement which did not exist on the assessment date, or paid under levies or statutes adjudicated to be illegal or unconstitutional. RCW 84.69.020(1), (3), (5)-(6).

United based its request for a refund on RCW 84.69.020(2). Under this subsection, taxes must be refunded if they were paid “as a result of manifest error in description.” Manifest error means “an error in listing or assessment, which does not involve a revaluation of property.” WAC 458-14-005(14). A manifest error may be, for example, an error in the legal description, a clerical or posting error, double assessments, misapplication of statistical data, incorrect characteristic data, incorrect placement of improvements, or erroneous measurements. WAC 458-14-005(14)(a)-(g).

Relevant here, a “manifest error” includes “the assessment of property exempted by law from taxation.” WAC 458-14-005(14)(h). United claims it was taxed on the port’s reversionary interest, which is tax-exempt. According to United, the department’s use of the residual approach violated the legal requirements of Washington law for valuing a possessory interest because it determined the value of the port’s reversionary interest to be nominal or nil.

The value to be taxed in a leasehold over tax-exempt public property is the “value of the right to use the property *over the period of the lease.*” Pier 67,

No. 73606-0-1/7

Inc. v. King County, 78 Wn.2d 48, 55-56, 469 P.2d 902 (1970) (emphasis added), cert. denied, 401 U.S. 911 (1971). United relies on Pier 67, and particularly the above-quoted statement, as authority demonstrating that it was manifest error for the department to use a methodology that assumes a hypothetical perpetual lease term. But the suit in Pier 67 was brought as a challenge to valuation of taxes paid under protest, not as a challenge to the denial of a request for an administrative refund. Pier 67, 78 Wn.2d at 49. The court discussed the standards to be used in *valuing* leaseholds under RCW 84.40.030(2). The court recognized that the statute makes no particular method of appraisal mandatory so long as the assessor fulfills his ultimate responsibility “to determine the true cash *value* of the property.” Pier 67, 78 Wn.2d at 58 (emphasis added). Because the court was concerned with the standards and methods for valuation of property, the reasoning in Pier 67 is not on point in this case.

United also relies on Duwamish Warehouse Co. v. Hoppe, 102 Wn.2d 249, 684 P.2d 703 (1984). But that case also involved a challenge to valuation, not a request for an administrative refund. A warehouse was built on land leased from the port. The assessor valued the warehouse at its full market value, even though the lease provided that ownership of the structure would automatically be transferred to the port at the end of the lease term. The Supreme Court held that the assessor was obliged to consider the port’s reversionary interest. “To disregard the fact that this building reverts to the Port at the end of the lease term, long before its useful life is up, would be to disregard a factor which plainly would affect the price negotiations between a willing buyer and a willing seller.

No. 73606-0-1/8

The result is a nonuniform valuation much higher than the true and fair market value in money which the statute commands.” Duwamish Warehouse Co., 102 Wn.2d at 256.

United argues that in this case, the department similarly disregarded the port's reversionary interest. The facts here are not necessarily similar. Unlike in Duwamish Warehouse Co., the department's methodology for valuing airline leaseholds did not fail to consider the port's reversionary interest; rather, the department considered the port's reversionary interest and assigned it a value of nil if it was reasonable to assume that the airline would continue to renew its lease into the foreseeable future. But in any event, what United is challenging is the department's use of a particular appraisal methodology to determine the amount a willing buyer would pay a willing seller for United's possessory interest. If the department erred by determining that the value of the port's reversionary interest was negligible under the circumstances, it was an error in *valuing* the port's reversionary interest, not an error in *describing* United's possessory interest. As discussed above, an error in valuation is not allowed as a basis for an administrative refund. RCW 84.69.020. An error in valuation can be redressed only if the taxpayer pays the tax under protest and brings suit under chapter 84.68 RCW.

A manifest error that will justify an administrative refund must be an error that “can be corrected by reference to the records and valuation methods applied to similarly situated properties, without exercising appraisal judgment.” WAC 458-14-005(14)(j). United contends the county assessor could have easily

corrected the alleged error without exercising appraisal judgment. "All that is necessary is to determine the remaining life of the lease and capitalize the lease income over the remaining life of the lease."

It is not obvious that capitalizing the lease income over the remaining life of United's lease would yield the true cash value of United's possessory interest. The department contends that United's proposed approach is flawed because it uses a direct capitalization rate in a yield capitalization model without any analytical data to support that choice. United does not refute this contention. And even if United's proposed approach is an acceptable method of appraisal, it is not the only one. No rule of thumb can be formulated to fit every situation. Pier 67, 78 Wn.2d at 58. Appraisal judgment is required.

United offers a California case as authority for the proposition that taxation of an airline's possessory interest must be based on the remaining term of its lease. Am. Airlines v. County of Los Angeles, 65 Cal. App. 3d 325, 135 Cal. Rptr. 261 (1976). To the extent that Am. Airlines holds it is illegal to anticipate that an airline lease will be renewed when it does not include a renewal option, it does not change our conclusion that United is alleging an error in valuation. Under Washington's statutory scheme, an error in valuation is not a proper subject for a request for an administrative refund.

United contends a trial is necessary because the expert witnesses in the case offered contradictory opinions. An appraiser testifying on behalf of United opined that the department effectively taxed the airline as if it owned the leasehold property in fee simple. An expert witness testifying on behalf of the

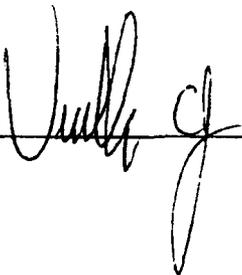
No. 73606-0-1/10

department disagreed. These disagreements do not create a material issue of fact because they relate to a dispute over how to arrive at a fair and accurate *valuation* of United's property.

In summary, the use of an appraisal method that assigned a nil value to the port's reversionary interest after consideration of all the circumstances cannot be characterized as the manifest error of assessing property exempted by law from taxation. The trial court did not err in dismissing United's suit on summary judgment.

Affirmed.

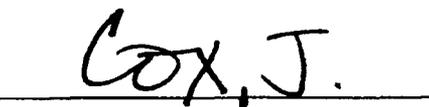
WE CONCUR:



A handwritten signature in cursive script, appearing to be "V. J. G.", written over a horizontal line.



A handwritten signature in cursive script, reading "Becker, J.", written over a horizontal line.



A handwritten signature in cursive script, reading "Cox, J.", written over a horizontal line.