Cite as Det. No. 91-184, 11 WTD 367 (1992).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In The Matter of the Petition For Refund of	)	D E T E R M I N A T I O N
	)	No. 91-184
. . .	)	Registration No. . . .

[1] RCW 82.32.060: CONSTITUTIONAL LAW--EQUAL PROTECTION--TAXES--INTEREST RATE. In tax cases, the proper test to apply to equal protection cases is the "rational basis" or "minimal scrutiny" test expressed in the Associated Grocers case. The 3% interest rate on tax refunds does not violate that test. Associated Grocers, Inc. v. Washington, 114 Wn.2d 182 (1990); GTE v. Department of Rev., 49 Wn. App. 532, 536-7, (1987).

[2] RCW 82.32.060: DUE PROCESS--EMINENT DOMAIN--TAXING POWERS. In determining whether governmental action constitutes the exercise of the power of taxation or the exercise of the power of eminent domain, one must show that the imposition of the tax was not just illegal, but so arbitrary as to compel the conclusion that the state had proceeded under the power of eminent domain rather than the power of taxation. Magnano Co. v. Hamilton, 292 U.S. 40, 78 L.Ed. 1109, 54 S.Ct. 599 (1934), City of Pittsburgh v. Alco Parking Corporation, 417 U.S. 369, 373, 41 L.Ed. 2d 132, 94 S.Ct. 2291 (1974).

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

TAXPAYER REPRESENTED BY: . . .

NATURE OF ACTION:

Taxpayer petitions for a "reasonable rate of interest" on the taxes refunded or credited to taxpayer as a result of the above-captioned audit.

FACTS AND ISSUES:

Hesselholt, Chief A.L.J. -- Taxpayer was audited for the period July 1, 1987 through December 31, 1989. As a result of the audit, it was found that taxpayer had overpaid B&O taxes in the amount of $ . . . . The amount was refunded to the taxpayer with 3% interest. Taxpayer argues that the interest is constitutionally insufficient and that reasonable interest should be paid on the refund.

Taxpayer argues that limiting interest on tax refunds to 3% violates the constitutional guarantees of equal protection and due process, and that sovereign immunity is not a defense to such a violation. Taxpayer asserts that under Washington case law, having waived sovereign immunity as a defense to paying interest, the state may not justify the discriminatory interest rate scheme by claiming sovereign immunity. Taxpayer cites Jenkins v. State, 85 Wn.2d 883, 890, 540 P.2d 1363 (1975), for the proposition that

> Once sovereign immunity has been waived, even partially, any legislative classifications made with reference thereto will be constitutional only if they conform to the equal protection guarantees of the state and federal constitutions.

Under due process, taxpayer argues that the state has taken property in the form of money from it for its own use in the performance of a planned action in its sovereign capacity. Pursuant to Article 1, §16, taxpayer asserts, it is entitled to recover just compensation for the full value of the property so taken. Taxpayer cites Deaconess Hospital v. State, 10 Wn.App. 475, 518 P.2d 216 (1974), review denied, 84 Wn.2d 1001.

Finally, taxpayer argues that principles of common justice require equitable treatment before the law and at the hands of the sovereign. Here, taxpayer cites the eloquent Judge Learned Hand in Procter & Gamble Distributing Co. v. Sherman, 2 F.2d 165, 166, (S.D.N.Y. 1924):

> [I]t seems to me plain that it is not an adequate remedy, after taking away a man's money as a condition of allowing him to contest his tax, merely to hand it back, when, no matter how long after, he establishes that he ought never to have been required to pay at all. Whatever may have been our archaic notions about

> interest, in modern financial communities a dollar today is worth more than a dollar next year, and to ignore the interval as immaterial is to contradict well-settled beliefs about value. The present use of my money is itself a thing of value, and, if I get no compensation for its loss, a remedy does not altogether right my wrong.

Taxpayer concludes its petition as follows:

> Citizens of a state have a right to expect that the state, in dealing with them, will apply the same rules of justice as it applies in actions between them. Certainly if A sues B to recover money wrongfully obtained, the successful A is entitled not merely to the principal sum paid, but also to interest at the judgment rate from the date of payment. In logic and fairness, when Washington compels its citizens to pay a tax which is later determined to be illegal the same principle of common justice requires that the State make the citizen whole by repaying not merely the sum illegally obtained, but reasonable interest as well. Anything less fails to restore the "involuntary lender" to the status quo prior to the state's illegal collection.
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> The 3% interest rate for refunds is unfair not only because it fails to justly compensate the taxpayer, but also because it unjustly enriches the State. When the State determines that a taxpayer owes back taxes, the State assesses interest on those additional taxes at the rate of 9%. Thus the State charges its citizens 9% for the use of "its" tax money while paying its citizens only one-third that rate if the money turns out to have been "theirs" all along. By raising the rate it charges taxpayers from 6% to 9% in 1971, the State implicitly acknowledged that even 6% was not adequate compensation for the overpayments of illegally assessed taxes and then, years later, to pay interest on refunds at the 1979 rate of 3%, amounts to nothing less than extortion perpetrated by the government on those it serves. Such exploitation is unconscionable and indefensible in equity, as well as unconstitutional as a matter of law.

(Footnote omitted.)

DISCUSSION:

RCW 82.32.060 provides that

> . . . interest at the rate of three percent per annum shall be allowed by the department and by any court on the amount of any refund or recovery allowed to a taxpayer for taxes, penalties, or interest paid by the taxpayer.

Interest is charged on unpaid taxes at the rate of 9% per annum. RCW 82.32.050. Taxpayer argues that this difference in rate is a violation of equal protection and due process. Taxpayer has cited a number of cases to support this argument. Jenkins, supra, involved a claim for damages against King County for negligent injury. The equal protection issue presented in that case was the difference in the time allowed for commencement of actions for tortious conduct against counties as opposed to all other government entities. The equal protection concerns here are not the same.

[1] In Associated Grocers, Inc. v. Washington, 114 Wn.2d 182 (1990), the Washington Supreme Court held, that in tax cases, the proper test to apply to equal protection cases was the "rational basis" or "minimal scrutiny" test:

> (1) whether the classification applies alike to all members within the designated class; (2) whether some basis in reality exists for reasonably distinguishing between those within and without the class; and, (3) whether the challenged classification bears any rational relation to the purposes of the challenged statute. . .

Associated Grocers, at 187.

The Washington Appellate Court, in a case not cited by the taxpayer, directly addressed the exact question presented by this taxpayer.

> GTE also contends that the disparity in interest rates between RCW 82.32.050 and RCW 82.32.060 violates the equal protection guaranties of Const. art. 1, § 12 and U.S. Const. amend. 14. We disagree.
>
> GTE has no fundamental right to a given interest rate either as to refunds or delinquencies, nor is a suspect class--such as race, nationality or alienage--involved. Therefore, the minimum scrutiny analysis applies to GTE's constitutional challenge. Bellevue Sch. Dist. 405 v. Brazier Constr. Co., 100 Wn.2d 776, 675 P.2d 232, aff'd on rehearing, 103 Wn.2d 111, 691 P.2d 178 (1984). Our inquiry is whether (1) the legislation applies alike to all members within the designated class; (2)

> there are reasonable grounds to distinguish between those within and those without the class; and (3) the classification has a rational relationship to the purpose of the legislation. The statute is presumed constitutional and GTE must overcome a heavy burden to persuade us otherwise. Bellevue Sch. Dist. 405, 100 Wn.2d at 781-82. Plainly, each statute applies alike to all members of the designated class, and obviously it is reasonable to distinguish between those within and without each class. The remaining question is whether the classifications bear a rational relationship to the purposes of the legislation. We hold that they do.
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> The rationale of the differing rates can be summed up in one word: incentive. One faced with a high interest rate on delinquent taxes is given incentive not to be delinquent in the first place and, if delinquent, to abbreviate the period of interest by prompt payment. One faced with low interest on refunds is similarly encouraged: to be accurate in making payments in the first instance, and promptly to seek a refund should there be an overpayment. Thus, the classifications of these statutes bear a rational relationship to the orderly and efficient administration of the tax laws, certainly among the purposes of the legislation.

GTE v. Department of Rev., 49 Wn. App. 532, 536-7, (1987). The Washington courts have already rejected equal protection challenges to the interest rate differential. We likewise reject taxpayer's equal protection arguments.

[2] Taxpayer next argues that under the Washington Constitution, Article 1, §16, that it is entitled to just compensation for the taking of its property (money.) Article 1, §16 provides, in part, that

> Eminent Domain. . . . No private property shall be taken or damaged for public or private use without just compensation having been first made, or paid into court for the owner, and no right-of-way shall be appropriated to the use of any corporation other than municipal until full compensation therefor be first made in money, or ascertained and paid into court for the owner. . . .

Taxpayer argues that its money is private property which has been taken by the state in the form of taxes not actually due, and that the 3% interest allowed by statute does not constitute "just compensation" under the constitution. We cannot find a

Washington case in which the power of eminent domain has been applied to anything other than real property, and believe that the state's exercise of the power of taxation does not constitute an exercise of the powers of eminent domain. According to one commentator:

> When the state has need of the property of citizens for its sovereign purposes, it may lawfully appropriate it against the will of the owner either under the power to tax or the right of eminent domain. There is a difference in the two cases which is vital. When property is appropriated under the right of eminent domain, a particular item or parcel is taken, because for public purposes there is a special need for it, and the state takes it under proceedings which amount, so far as the owner is concerned, to a forced sale. But taxation is based upon the idea of calling upon the people for equal and proportional contributions to the public wants, that the burdens of government may fall ratably upon all who in justice should bear them. So the proceeding by which a municipality condemns property is distinct in character from the proceeding by which it raises money, under the power of taxation, to make compensation for property so taken.

Cooley and Nichols, 1 Cooley the Law of Taxation §30 (4th ed. 1924). Emphasis added. Also see 26 Am.Jur. 2d Eminent Domain §4 (1966).

The powers of taxation and eminent domain are separate and distinct. In determining whether governmental action constitutes the exercise of the power of taxation or the exercise of the power of eminent domain, one must show more than the payment of taxes subsequently determined to be illegal. Essentially, one must prove that the imposition was not just illegal, but so arbitrary as to compel the conclusion that the state had proceeded under the power of eminent domain rather than the power of taxation.

This test was stated in Magnano Co. v. Hamilton, 292 U.S. 40, 78 L.Ed. 1109, 54 S.Ct. 599 (1934), where the Court prescribed the standard for judging whether state action has contravened the limitations of the due process clause as follows:

> That clause [Amendment XIV, §1] is applicable to a taxing statute such as the one here assailed only if the act be so arbitrary as to compel the conclusion that it does not involve an exertion of the taxing power, but constitutes, in substance and effect, the

> direct exertion of a different and forbidden power, as, for example, the confiscation of property.

292 U.S. at 44. This standard has been affirmed more recently in City of Pittsburgh v. Alco Parking Corporation, 417 U.S. 369, 373, 41 L.Ed. 2d 132, 94 S.Ct. 2291 (1974).

While both decisions upheld taxes against the charge that their burdens were confiscatory, the showing of arbitrary or capricious action by a taxing authority is also required where a tax earlier imposed is subsequently invalidated. A recent New York decision, where the issue was similar to the one presented here, makes this point.

In Aco Realty Corporation v. Srogi, 105 A.D.2d 1083, 482 N.Y.S. 2d 598 (1984), the appellate court refused to redefine the statutory interest rate of 3% payable on property tax refunds where an unconstitutional taking was not shown to have occurred. While the taxpayer had established an overassessment, the court, invoking the language found in the U.S. Supreme Court's opinion in Magnano Co., held that the taxpayer must demonstrate that the city had engaged in a "systematic and deliberate scheme" to confiscate their property (i.e., the tax payment) and combine that course of action with a conscious effort at delaying litigation to take advantage of the "forced loan" represented by the overassessment. Only upon that kind of showing would the taxpayer be entitled to challenge the presumption of reasonableness in the statutory interest rate for purposes of securing just compensation. There is nothing in this case that remotely approaches such conduct.

Finally, taxpayer argues that as a matter of fairness and equity, the state should pay a reasonable rate of interest on its "illegally" collected taxes, and that its failure to do so constitutes unjust enrichment to the state. Taxpayer does not define what a "reasonable" rate of interest is, but implies in a footnote that it should be the amount the state it receives on its investments. The legislature has provided, in statute, for payment of 3% interest on refunded taxes.[1] Taxpayer cited Procter & Gamble to support its argument that the state must pay "reasonable" interest on tax refunds. That case holds that the unavailability of interest on tax refunds, under state law, did not provide the type of adequate remedy that would justify a federal court in withholding its jurisdiction over a tax

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[1]ESHB 1401 amends RCW 82.04.060 by providing that the rate of interest paid on refunds will be 1% lower than the rate of interest charged on unpaid taxes. This statutory change takes effect January 1, 1992, for refunds of taxes paid after December 31, 1991.

controversy. It did not hold that a failure in state law, either to pay any interest or to award interest in some market equivalent, is a per se violation of due process or some other right. Thus the case does not support taxpayer's contention.

Taxpayer argues that the 3% interest rate unjustly enriches the state. Without in any way conceding that the concept of unjust enrichment is applicable to a situation such as this, in order to recover under the theory of unjust enrichment, the taxpayer must show that its money has been given to the state in such a manner that in "equity and good conscience" the state should not retain it. Lynch v. Deaconess Med. Center, 113 Wn.2d 152, (1989), at 166. In this case, the monies paid to the state have been returned to the taxpayer, alone with interest at the statutorily authorized rate of 3%. We cannot say that in "equity and good conscience" the state cannot retain any difference between the interest rate paid to the taxpayer and whatever interest rate the state receives on its investments. The state is not required to provide a good investment opportunity to its taxpayers.

As an administrative agency, the Department of Revenue is charged to administer the statutes adopted by the Legislature. It has no authority to violate a clear statutory enactment by providing a different rate of interest than the one provided in RCW 82.32.060.

DECISION:

Taxpayer's petition is denied.

DATED this 15th day of July 1991.