Cite as Det. No. 00-085, 21 WTD 48 (2002)

BEFORE THE 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. 00-085
. . .	)	Registration No. . . .
	)	Refund Request

[1] RULE 100; RCW 82.01.060(4), RCW 82.32.160, RCW 82.32.170: REVIEW OF DEPARTMENTAL ACTIONS – ASSESSMENTS AND REFUNDS – EXHAUSTION OF ADMINISTRATIVE REMEDIES. The review procedures authorized by RCW 82.01.060(4), 82.32.160, 82.32.170, and Rule 100 may be used by taxpayers to review tax assessments and refund requests. However, there is no duty to exhaust administrative remedies with regard to the Department's review processes before challenging the Department in a refund action under RCW 82.32.180.

[2] RCW 82.32.300: DEPARTMENT OF REVENUE -- ADMINISTRATION OF STATUTORY LAW -- PRESUMED CONSTITUTIONALITY OF STATUTES. An administrative body does not have the authority to determine the constitutionality of the law it administers, but must presume the statute is constitutional.

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.

ADMINISTRATIVE LAW JUDGE: John M. Gray

NATURE OF ACTION:

A fruit packer seeks refunds of sales tax, use tax, and Business and Occupation Tax (B&O) paid in connection with the construction of buildings, purchases of equipment, and the hiring of "qualified employment positions" involving the storage and packing of fresh apples in an economically distressed area.[1]

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

ISSUES:

1. Whether the taxpayer's failure to apply for deferral of sales or use tax under ch. 82.60 RCW before initiation of the construction of the investment project and acquisition of equipment or machinery is excused because the Department of Revenue (Department) would not have approved the applications and the law does not require futile acts; and

2. Whether the taxpayer's failure to apply for B&O tax credits under ch. 82.62 RCW before the actual hiring of "qualified employment positions" is excused because the Department would not have approved the applications and the law does not require futile acts; and

3. Whether the retroactive provision in HB 2295 is barred by case law from applying to the taxpayer; and

4. If the answers to 1, 2, and 3 are yes, whether the taxpayer otherwise qualifies for the deferral of sales tax, use tax, and B&O tax under the provisions of ch. 82.60 RCW and ch. 82.62 RCW.

BACKGROUND:

The taxpayer filed two separate petitions for refunds; those petitions are consolidated in this determination. The taxpayer filed one petition with the Appeals Division on February 17, 1999, seeking a refund of B&O tax, based on the credit provisions of ch. 82.62 RCW. The taxpayer also filed a petition with the Appeals Division on February 3, 1999, seeking a refund of sales tax, based on the tax deferral and exemption provisions of ch. 82.60 RCW.

The taxpayer filed an application for B&O tax credit for new employees, pursuant to ch. 82.62 RCW, with the Special Programs Division (Special Programs) of the Department. The application bears the date of December 10, 1998. Special Programs denied the application in a letter dated January 28, 1999, because the taxpayer did not "project hiring of 15% over the previous year's average number of full time employees . . . ."

The taxpayer also filed six applications for sales and use tax deferral and exemption, pursuant to ch. 82.60 RCW, with Special Programs on December 31, 1998. The applications were for construction, purchase of equipment, and "repair labor and parts." Special Programs apparently denied the applications in a letter dated January 19, 1999, because the taxpayer purchased the equipment, or began construction, before applying for the deferral and exemption.[2]

The taxpayer's B&O tax refund petition was assigned to another administrative law judge (ALJ). On April 8, 1999, that ALJ informed the taxpayer that he remanded the petition to the Audit

[2] The one letter from Special Programs to the taxpayer refers to a single application and states the date of the application as "December 29, 1998." It is unclear why there is only one letter and why it refers to December 29, 1998, when all six applications are plainly dated December 31, 1998. The taxpayer's name and registration number appear on the letter, however, and correctly identify the same taxpayer present in this appeal.

Division "to review your records consistent with the Court of Appeals decision," referring to the Valley Fruit case. The Audit Division has orally informed the ALJ that it will deny the refund petition. It seems appropriate here for the Appeals Division to reassume jurisdiction over both petitions.[3]

The taxpayer acknowledges that it did not file an application with the Department before purchasing equipment and beginning construction, as required in RCW 82.60.030, or before hiring new employees in qualified positions, as required in RCW 82.62.020. Nonetheless, the taxpayer makes two arguments why it is entitled to tax relief. First, its failure to file applications under RCW 82.60.030 and 82.62.020 is excused because the law does not require the performance of futile tasks. Second, HB 2295 does not apply retroactively to it because the taxpayer was entitled to apply for and receive tax refunds as of the date of its filings.

The facts are taken from an affidavit submitted by one of the taxpayer's directors and officers:

The taxpayer owns and operates controlled atmosphere storage buildings located in eastern Washington, which are used for the storage of fresh apples. The taxpayer also owns and operates a warehouse building comprised of cold storage rooms, a pre-sorting area, a fruit packing area, and an office which is used for storing, packing, and selling fresh apples. The taxpayer owns or leases all of the apple packing and apple handling equipment used in and around its warehouse complex. The taxpayer grows, stores, packs, and sells fresh apples.

The taxpayer stores, packs, and sells fresh apples grown by it and independent growers. The apple packing process begins with freshly picked apples that are delivered to the taxpayer's warehouse bins. Upon delivery to the taxpayer, the bins of apples are then placed in either controlled atmosphere ("CA") storage or cold storage. Before the apples are placed in CA storage, they are treated with chemicals that are designed to extend the storage life of the apples and to prevent storage defects like mold, mildew, and scale. Gold and Red Delicious apples are customarily held in CA storage for at least 90 days. Other varieties of apples, such as Fujis and Galas, are customarily held in CA storage for at least 45 days. During the CA storage process, the CA rooms are sealed and cooled to approximately 32°, and the atmosphere is altered by the removal of oxygen.

The packing process for both CA storage apples and cold storage apples is substantially the same. The apples are removed from the cold storage or CA storage rooms in the bins in which they were stored and transported to the packing warehouse. The apples are then removed from the bins and sorted according to color and size. After the apples are sorted, they are rinsed with fresh water and then washed in a soapy solution with soft brushes. The apples are then dried and food grade wax is sometimes applied to the apples. The apples may be further sorted by color, size, and quality, and then are placed in containers for shipment. The washing, drying, waxing,

[3] The taxpayer's memorandum of authorities also refers to RCW 82.08.02565 (the machinery and equipment exemption from retail sales tax), but the petition does not seek any refund for retail sales tax under RCW 82.08.02565.

sizing, and most sorting of the apples are accomplished through a connected series of mechanized equipment commonly known as a "packing line." Some of the sorting and most of the packing of the apples in containers is accomplished by hand labor. The packed apples are held in cold storage until they are shipped.

The taxpayer built its CA storage building in 1997, and uses it solely for the purpose of storing fresh apples. The taxpayer has used the CA building for that purpose since completion. During 1996 and 1997, the taxpayer also purchased apple packing and handling equipment and rebuilt portions of old apple packing and handling equipment. The new equipment and rebuilt equipment were incorporated into a new apple packing line during 1996 and 1997. All of the apple packing and handling equipment purchased by the taxpayer during 1996 and 1997 has been used for the purpose of storing, packing, and handling of fresh apples.

For the sake of convenience in this determination, the taxpayer's business activities will be referred to as "apple packing," although it is plain that considerably more than mere "packing" is involved.

The taxpayer knew that the Department did not consider apple packing to be manufacturing. The Department's position was confirmed in Custom Apple Packers v. Department of Rev., BTA Docket No. 39498. The BTA upheld the Department's denial of an application for the deferral of taxes under ch. 82.60 RCW for the construction of a CA apple storage and apple packing facility in an economically distressed area.

The taxpayer here filed its refund request following a recent appellate decision. Valley Fruit v. Department of Rev., 92 Wn. App. 413, 963 P.2d 886 (Div. III, 1998), held that the business activities engaged in by the plaintiffs, Valley Fruit and Douglas Fruit Company, Inc. (Douglas Fruit), to be manufacturing and granted the plaintiffs' requests for sales and use tax exemptions. Prior to the appellate court decision, Douglas Fruit and Valley Fruit had applied for a distressed area sales and use tax deferral under ch. 82.60 RCW in 1994. The Department's Appeals Division and, subsequently, the Board of Tax Appeals (BTA), denied their petitions, holding the fruit companies' business activities, apple packing, were not manufacturing. The two fruit companies appealed to Superior Court, one in Franklin County, the other in Yakima County, both of which reversed the BTA. The Department appealed to the Court of Appeals, which consolidated the two appeals. The Court of Appeals described the fruit companies' business activities and held:

> The fruit companies start with whole, edible apples which are treated with fungicide and brushed clean of mineral deposits. They are then rinsed, waxed, and dried. After they are sorted, the apples are stored in a controlled atmosphere to aid preservation. Although not included in the BTA's findings of fact, the uncontroverted evidence before it indicated the apples have a longer life as a result of this process. Using this process, the fruit companies are able to keep the apples 11 months. Without the processing, the apples would decay within a month. This undisputed testimony indicates the processing significantly changes the apples into a more useful product. Application of the facts

> presented to the BTA to the law defining manufacturing indicates these activities should be construed as manufacturing.

Valley Fruit, 92 Wn. App. at 419. The Court of Appeals issued its decision on July 28, 1998. The State Supreme Court denied the Department's petition for review. Valley Fruit v. Department of Rev., 137 Wn.2d 1017, 978 P.2d 1098 (1999). Thus, apple packing constituted manufacturing.

The Department and the legislature had two specific concerns with the Valley Fruit decision. First, in determining that apple packing constituted manufacturing, the implication was that apple packers would be required to pay B&O tax at the manufacturing rate, conflicting with an express exemption from the B&O tax for apple packers.[4] The Director of the Department of Revenue summarized the unintended consequences of the Valley Fruit decision in a May 5, 1999 letter to seven agricultural business associations:

> However, there are some adverse tax consequences in this situation and these consequences fall upon people who may not be aware that they are affected. In most cases the grower retains ownership of the agricultural product being packed. Since the packers in the above referenced case were successful in their legal argument that their apple handling activities qualify as a manufacturing process, a domino effect occurs. By law, the person who owns a product being manufactured is a manufacturer and the processor is considered a processor for hire. The ultimate result is that the grower is no longer eligible for the B&O exemption for farmers, because the agricultural product is being used as an ingredient in a manufacturing process. The packers are no longer eligible for their B&O exemption because they are packing for growers who are no longer exempt farmers under RCW 82.04.330. Both the grower and the packer will owe B&O tax, the grower on every apple sold, either inside or outside the state. The packer will be taxable on the payment it receives for the packing activity. To make matters worse, it is also now unclear whether the grower is entitled to purchase seedlings, fertilizer, or spray materials without paying sales or possibly use tax. You should at least be aware that farmers statewide will soon be liable for millions of dollars in unanticipated taxes.

The second concern was the substance of the Valley Fruit decision itself. The Department's position has long been that apple packing is not manufacturing and that Douglas Fruit and Valley Fruit, as well as the taxpayer in this appeal, do not qualify for the tax deferral program in ch. 82.60 RCW.[5]

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[4] RCW 82.04.4287 provides: "In computing tax there may be deducted from the measure of tax amounts derived by any person as compensation for the receiving, washing, sorting, and packing of fresh perishable horticultural products and the material and supplies used therein when performed for the person exempted in RCW 82.04.330, either as agent or as independent contractor."

[5] The Department has acknowledged that "Yakima County has continuously qualified as an employment distressed county for the distressed area sales tax deferral program since 1985. Yakima County has also qualified for the new

The Department decided to address these concerns in the 1999 regular legislative session. SB 6085 was an attempt to legislatively reverse the Valley Fruit decision, but the bill did not survive, and the regular session ended. In 1999, there was a Special Session of the legislature, and during the First Special Session the legislature approved HB 2295, which was substantially similar to the original SB 6085 of the regular legislative session. The Governor signed HB 2295 on June 7, 1999 and the bill was filed with the Secretary of State the same day.

HB 2295 affects the issues presented in this appeal for two reasons. First, HB 2295 amended the definition of manufacturing[6] to exclude apple packing:

> "To manufacture" shall not include: Conditioning of seed for use in planting; cubing hay or alfalfa; activities which consist of cutting, grading, or ice glazing seafood which has been cooked, frozen, or canned outside this state; the growing, harvesting, or producing of agricultural products; or packing of agricultural products, including sorting, washing, rinsing, grading, waxing, treating with fungicide, packaging, chilling, or placing in controlled atmospheric storage. (Emphasis supplied).

In addition to amending the definition of manufacturing, HB 2295 also amended the definition of "manufacturing" in RCW 82.60.020 and RCW 82.62.010, to make clear that both chapters excluded "apple packing" from their scope.

Second, HB 2295 expressly was retroactive: "This act is intended to clarify that this is the intent of the legislature both retroactively and prospectively." HB 2295 contained an emergency clause and took effect immediately upon filing on June 7, 1999. Const. art. 2, § 1 (amend. 72).

ANALYSIS:

1. Whether the taxpayer's failure to apply for deferral of retail sales tax and use tax under ch. 82.60 RCW before initiation of the construction of the investment project and acquisition of equipment or machinery is excused because the Department would not have approved the applications and the law does not require futile acts; and

2. Whether the taxpayer's failure to apply for B&O tax credits under ch. 82.62 RCW before the actual hiring of "qualified employment positions" is excused because the Department would not have approved the applications and the law does not require futile acts.

[1] These issues arise because of the language in RCW 82.60.030 and 82.62.020. RCW 82.60.030 states, "[a]pplication for deferral of taxes under this chapter must be made before initiation of the construction of the investment project or acquisition of equipment or machinery." RCW 82.62.020

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employee credit program since it was created in 1986." Letter of November 17, 1999, from . . ., Department of Revenue, Special Programs Division, Miscellaneous Tax Specialist, to another fruit packing company.

[6] RCW 82.04.120.

states, "[a]pplication for tax credits under this chapter must be made before the actual hiring of qualified employment positions."

The taxpayer did not file an application with the Department before purchasing equipment, beginning construction, or hiring "qualified employment positions," unlike Valley Fruit and Douglas Fruit in Valley Fruit, supra.[7]
The taxpayer argues that the futility exception to the doctrine of exhaustion of administrative remedies should be applied to the failure of the taxpayer to file the required applications for tax deferrals, exemptions and credits because fairness or practicality demands it.

The duty to exhaust administrative remedies is described in a leading treatise on administrative law: "[It is] the long settled rule of judicial administration that no one is entitled to judicial relief for a supposed or threatened injury until the prescribed administrative remedy has been exhausted." Kenneth Culp Davis and Richard J. Pierce, Jr., 2 Administrative Law Treatise 307 (1994), citing Myers v. Bethlehem Shipbuilding Corp., 303 U.S. 41, 50-51, 58 S. Ct. 459, 82 L. Ed. 638 (1938). The doctrine is the same in Washington State. "It is a general rule that when an adequate administrative remedy is provided, it must be pursued before the courts will intervene." Orion Corp., 103 Wn.2d 441, 456, 693 P.2d 1369 (1985).

The taxpayer cites a number of cases to support its arguments, relying principally on Orion Corp. v. State, supra. Orion Corporation had purchased extensive amounts of land for development, but found its plans thwarted by several state and county legislative enactments. The opinion said, "Orion's efforts at finding alternative uses for its land proved fruitless." Orion, 103 Wn.2d at 449. "Despite the state development and advertising of the sanctuary, Orion continued to negotiate with the State over selling its land but the parties were unable to agree on a price. Finally, Orion instituted the present suit." Orion, 103 Wn.2d at 454. Among other defenses, the defendants argued that Orion failed to exhaust its administrative remedies before filing suit. The Court observed, at the outset:

> As the cases make clear there is a strong bias toward requiring exhaustion before resort to the courts. This court recently noted that the policies underlying the exhaustion doctrine are to (1) insure against premature interruption of the administrative process, (2) allow the agency to develop the necessary factual background on which to base a decision, (3) allow the exercise of agency expertise, (4) provide a more efficient process and allow the agency to correct its own mistake, and (5) insure that individuals are not encouraged to ignore administrative procedures by resort to the courts. South Hollywood Hills Citizens Ass'n v. King Cy., 101 Wn.2d 68, 73, 74, 677 P.2d 114 (1984).

Orion, 103 Wn.2d at 456. In making its decision, the Court noted that "resort to the administrative procedures would be futile and vain" (Orion, 103 Wn.2d at 457), that the "record reveals that the State has made a conscious policy choice to preserve Padilla Bay in its natural

[7] Valley Fruit involved applications under RCW 82.60.030 only; the case did not involve applications under RCW 82.62.020.

state" (Orion, 103 Wn.2d at 457), and that a "willingness to consider an application is irrelevant if there is no hope of success if one is submitted." Orion, 103 Wn.2d at 457. From Orion, the taxpayer argues that it was not required to file applications before beginning construction, as required in RCW 82.60.030, because the Department would never have approved its applications; thus, it was futile.

. . .

We are unconvinced that the duty to exhaust administrative remedies applies in this situation, and consequently, we are unconvinced that the futility exception to the duty to exhaust administrative remedies applies in this situation. First, the filing requirement in RCW 82.60.030 is an element that must be satisfied before certain tax benefits may be realized by any taxpayer. In that regard, it is like any other element for a tax credit, exemption, or deduction:

> In determining whether the exemption is available to the taxpayer in this case we must consider that exemptions to taxing statutes are strictly construed in favor of the application of the tax. Yakima Fruit Growers Association v. Henneford, 187 Wn. 252, 60 P. (2d) 62 (1936); Miethke v. Pierce County, 173 Wn. 381, 23 P. (2d) 405 (1933); Boeing Aircraft Company v. Reconstruction Finance Corporation, 25 Wn.2d 652, 171 P. (2d) 838 (1946). It is required that any claim of exemption be studied with care before depriving the state of revenue. Alaska Steamship Company v. State, 31 Wn.2d 328, 196 P. (2d) 1001 (1948). Only where an exemption is clearly required by law should an individual be exempt from tax. North Pacific Coast Freight Bureau v. State, 12 Wn.2d 563, 122 P. (2d) 467 (1942).

Det. No. 99-043, 18 WTD 452 (1999).

Second, there are no administrative remedies that must be exhausted before any taxpayer seeks relief in court. Any taxpayer, having paid the disputed tax, may sue for a refund in Thurston County Superior Court. RCW 82.32.180. Any taxpayer may petition the Department for a refund. RCW 82.32.170. However, no taxpayer is required to petition the Department for a refund under RCW 82.32.170 before seeking relief in court. The taxpayer could, at any time, file a refund action under RCW 82.32.180. However, the judge in the refund action would be asking the same question: "why are you entitled to a refund when you admit you did not satisfy the application-filing requirement in RCW 82.60.030?"

The petition is denied on the "futility" issue.

3. Whether the retroactive provision in HB 2295 is barred by case law from applying to the taxpayer.

[2] Despite the express retroactivity of HB 2295, the taxpayer argues that HB 2295 does not apply to the taxpayer because HB 2295 interferes with fundamental rights. The heart of the taxpayer's argument is that it applied for the tax deferral before the effective date of HB 2295;

therefore, as of the date of its filing, the taxpayer was entitled to the tax deferral. The taxpayer challenges HB 2295 both facially and as applied as violative of the Equal Protection and Due Process Clauses of the United States and the Washington State Constitutions.

We cannot rule on facial challenges to statutes. "An administrative body does not have authority to determine the constitutionality of the law it administers; only the courts have that power." Bare v. Gorton, 84 Wn.2d 380, 383, 526 P.2d 379 (1974).

The Department frequently determines whether a tax statute may be enforced constitutionally as to particular persons; e.g., whether nexus exists to support B&O or sales tax on business conducted outside of Washington or transactions occurring outside of Washington. However, on the issue of constitutionality of HB 2295 as applied to the taxpayer, we conclude that this issue must be left for an Article IV court to decide. As was noted in National Can Corp. v. Department of Rev., 109 Wn. 2d 878, 887; 749 P.2d 1286 (1988):

> Even if the director's opinion was that Armco placed in question the constitutionality of the B & O tax, it was not within his power to stop collecting taxes under a statute which had been properly enacted by the Legislature. The Department of Revenue was collecting taxes under a statute that had been repeatedly upheld and also enjoyed the presumption of constitutionality. The party challenging the statute would have to prove its invalidity beyond a reasonable doubt. High Tide Seafoods v. State, 106 Wn.2d 695, 725 P.2d 411 (1986).

High Tide Seafoods v. State, 106 Wn.2d 695, 698, 725 P.2d 411 (1986), said:

> Statutes are presumed constitutional and a party challenging a statute has the burden of establishing its invalidity beyond a reasonable doubt, as well as rebutting the presumption that all legally necessary facts exist. Higher Educ. Facilities Auth. v. Gardner, 103 Wn.2d 838, 843, 699 P.2d 1240 (1985).

The issue of the constitutionality of HB 2295 as applied to the taxpayer is not simply one of the administration of a tax statute.[8] We may determine the constitutionality of the application of a tax statute to a taxpayer. However, the question here is the retroactivity of a statute passed by the legislature and signed by the governor, and whether that statute applies to the taxpayer. That is an issue that must be decided by a court of competent jurisdiction. For our part, we must assume HB 2295 is both constitutional and applicable.

The petition is denied on the retroactivity issue.

4. If the answers to 1, 2, and 3 are yes, whether the taxpayer otherwise qualifies for the deferral of sales tax under ch. 82.60 RCW.

[8] The administration of state excise taxes is generally given to the Department of Revenue. See, ch. 82.01 RCW.

Having answered the first, second, and third issues as "no," it is unnecessary to address the fourth identified issue, whether the taxpayer otherwise qualifies for the deferral of B&O tax under the provisions of ch. 82.60 RCW.

The taxpayer and its counsel are commended for the thoroughness of the briefs and the documentation to support the taxpayer's claims for refunds. We will retain the documentation for submission to the Audit Division for verification if this decision is modified or reversed by the Board of Tax Appeals or by a court.

DECISION AND DISPOSITION:

The taxpayer' petitions are denied.

Dated this 15th day of May, 2000