I'm very pleased to be beginning my term as Tax Section President. On behalf of the Tax Section, I want to thank outgoing President Ada Ko for her great service to the Section. I also want to acknowledge outgoing Tax Section board member and former Stouder Award winner Alan Kane of K&L Gates. Alan is rotating off the board after many years of dedicated service to the Section. He is a skilled tax lawyer, a consummate professional, and a tremendous repository of Tax Section history.

The Tax Section is fortunate to have three new incoming committee chairs and board members. Alan Macpherson of Gordon Thomas Honeywell in Tacoma has taken the helm of the Estate and Gift Tax Committee from outgoing chair Luke Thomas. The Estate and Gift Tax Committee has devoted significant energy in recent years to issues surrounding Washington’s state estate tax. Chauncey Maclean, a state and local tax attorney practicing at Deloitte Tax, has agreed to take over from me as chair of the State and Local Tax Committee. Finally, I’m excited that Jeff Mahan, a manager in the Washington Department of Revenue Appeals Division, will be serving as the Tax Section’s Department of Revenue liaison.

Most of the Tax Section’s work and activities occur in our ten committees: Estate and Gift Tax, International Tax, State and Local Tax, Transactional Tax, IRS Liaison, DOR Liaison, Continuing Legal Education, Legislative, Scholarship, and Website Committees. If you are not involved in any Tax Section committees, I encourage you to do so by contacting one of the committee chairs listed in this newsletter or at our website, www.wsbatax.org/board.php. Tax Section members can also subscribe to committee email lists and listserv at www.wsbatax.org/membership.php.

Although the committees are involved in a wide variety of activities, I want to briefly highlight the work of the Tax Section on an issue related to the imposition of Washington business and occupation (B&O) on lawyers. In late 2006, the Washington Department of Revenue began reviewing its excise tax rule addressing the taxation of lawyers, WAC 458-20-207. The Department’s review of Rule 207 was prompted by a 2006 amendment to Rule of Professional Conduct (RPC) 1.8(e), which inadvertently called into question the longstanding exclusion from B&O tax for litigation costs advanced by lawyers and reimbursed by clients. With the help and support of the Tax Section, the WSBA Board of Governors successfully petitioned the Washington Supreme Court to amend the RPC to correct the unintended tax consequence. The Tax Section is currently working cooperatively with the Department of Revenue to clarify WAC 458-20-207 while preserving the long-standing B&O tax treatment of litigation costs and expenses.

Please feel free to contact me if you have any questions or suggestions about the Tax Section. I can be reached at (206) 359-6360 or RMahon@perkinscoie.com.

IRS Liaison Committee Report

Bob Boeshaar of IRS Counsel and Darek Jariski of LeSourd & Patten, P.S. are currently serving as co-chairs of the IRS Liaison Committee. The committee continues to conduct regular meetings to discuss various topics pertinent to practice before the Internal Revenue Service. The meetings generally take place in the Eagle Room of the Jackson Federal Building in Seattle. Past meeting topics include: collection of tax from LLCs, fraud issues during IRS audits, trust fund recovery penalty investigations, dealing with federal tax liens, domestic and cross-border issues related to gambling income, and Bank Secrecy Act (BSA) issues.

If you have any questions regarding past or future topics, please feel free to contact Bob or Darek.
When Businesses Visibly Pass on Their Washington B&O Tax to Customers

*Nelson v. Appleway* Examined from the Perspective of Comparable Trade Practices in Hawaii and Guam

*by Stephen A. Cohen, Esq.*

1.0 - INTRODUCTION

In *Nelson v. Appleway Chevrolet, Inc.*, 160 Wn.2d 173, 157 P.3d 847 (April 26, 2007), the Washington State Supreme Court scrutinized the practice of those businesses in Washington that visibly pass on their Washington Business & Occupation Tax (B&O Tax) to customers in receipts, bills, invoices and contracts. The Court, in its majority opinion, ruled that RCW 82.04.500 does not permit a business to visibly pass on the tax to customers by separately itemizing and adding it to the purchase price in bills, invoices, receipts and contracts unless it is negotiated between the parties before the contract is entered into and is included in the final purchase price as part of the business’s overhead expense.

In applying RCW 82.04.500 to a Spokane car dealer, the Court’s majority affirmed the decisions of the trial and appeals courts that the dealer’s method of passing on its B&O tax expense to customers violated RCW 82.04.500 because the dealer charged the tax on top of the final purchase price after the final purchase price was negotiated. In effect, the dealer treated the B&O tax as a retail sales tax imposed directly on consumers and collected by businesses on transactions at the point of sale. Hawaii, on the other hand, unlike Washington and Guam, levies a state net income tax on businesses and individuals.

2.0 - WASHINGTON

2.1 - Nature of the B&O Tax

Washington levies the B&O tax on every person engaging in business in Washington. The tax is imposed for the privilege of transacting business within the state. The tax is measured by the application of rates against value of products, gross proceeds of sale, or gross income of the business, as the case may be, all determined without any deduction for the cost of property sold, materials, labor, delivery costs, interest, taxes or any other expense whatsoever paid or accrued, and without any deduction for losses. RCW 82.04.070, 82.04.080, 82.04.090, 82.04.220. The applicable tax rate depends on the particular activity engaged in. For instance, manufacturing and wholesaling are taxed at the rate of 0.484%, retailing at the rate of 0.471%, and services and other activities at the rate of 1.5%. RCW 82.04.240, 82.04.250, 82.04.270, 82.04.290(2).

2.2 - Visibly Passing on the B&O Tax to Customers

2.2.1 - *Nelson v. Appleway* Facts

*Nelson v. Appleway* is the first reported Washington case to address whether a business may visibly pass on its business’s B&O tax expense to customers in receipts, bills, invoices and contracts. The facts of the case are straightforward. In 2004, Mr. Nelson negotiated the purchase of a used Volkswagen Cabriolet from Appleway Chevrolet in Spokane for an agreed purchase price of $16,822.00. After the purchase price was agreed upon, Appleway presented a written contract to Nelson, which the parties signed. The written contract separately itemized and charged to Nelson an additional $79.22 for the amount of Appleway’s B&O tax attributable to the transaction and $1,225.60 for sales tax.

Nelson paid the entire amount for the car specified in the written contract, including B&O tax and sales tax on the B&O tax, and took delivery of the car. Soon thereafter, he commenced a class action against Appleway in the Spokane County Superior Court. He sought a declaratory judgment that Appleway’s charging of the B&O tax and the sales tax thereon to him and to others similarly situated violated Washington law, sought an injunction prohibiting Appleway from continuing the practice, and sought restitution of the taxes paid. The Superior Court granted summary judgment to Nelson, and the Court of Appeals, Division III, affirmed on appeal. The Supreme Court granted review and affirmed the lower courts.

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The tax issue at the core of the case was the meaning of RCW 82.04.500:

“It is not the intention of this chapter that the taxes herein levied upon persons engaging in business be construed as taxes upon the purchasers or customers, but that such taxes shall be levied upon, and collectible from, the person engaging in the business activities herein designated and that such taxes shall constitute a part of the operating overhead of such persons.”

2.2.2 - Nelson v. Appleway

The Supreme Court ruled that RCW 82.04.500 is clear and unambiguous on its face and must be applied to the facts of the case in accordance with its plain language, to wit: (1) The B&O tax is not a tax on customers, and (2) The B&O tax is a tax on business and is part of a business’ operating overhead.

When the Court applied the statute’s plain meaning to Appleway’s practice of separately itemizing and adding the B&O tax to the purchase price of a car after the purchase price was agreed upon, it concluded that Appleway had violated the statute. Appleway violated the statute because its practice had the effect of treating the B&O tax as a tax directly imposed by law on the customer, as opposed to an overhead expense of Appleway and includible in the agreed purchase price. In adding B&O tax after the final purchase price was agreed upon, Appleway charged the tax on top of the agreed purchase price in the manner of retail sales tax, and not as part of its own cost of doing business.

Although the majority ruled that RCW 82.04.500 is clear and unambiguous, the statute is silent on two points that were central to the Court’s decision: (1) whether a business may choose to separately itemize in writing the amount of its B&O tax overhead attributable to a particular transaction, or must bury the amount of its B&O tax overhead into the total purchase price without the tax being separately stated; and (2) at what point in a transaction must a business disclose its B&O tax overhead if it chooses to visibly pass its B&O tax overhead onto customers.

The majority addressed these points by acknowledging that RCW 82.04.500 does not preclude a business from separately itemizing B&O tax overhead in writing and visibly adding it to the initial purchase price as long as the tax is disclosed “while setting the final purchase price.” Thus, a business is not required to bury its B&O tax overhead in total price of an item. Either way, the tax may be passed on to the customer as a cost of doing business. The economic burden of the tax, as opposed to its legal burden, is placed on the customer.

The majority rejected Appleway’s contention that RCW 82.04.500 violated Appleway’s First Amendment right to freedom of speech by preventing Appleway from itemizing the B&O tax in the written contract. The Court ruled that “Appleway is free to disclose and itemize any tax or cost” and was “free to inform Nelson that $79.23 of the final purchase price would be used to pay for B&O tax.” Appleway may “identify any claimed element of overhead” but “Appleway may not add a B&O charge as one of several fees and taxes after Appleway and Nelson negotiated and agreed upon a final purchase price.”

The majority also rejected Appleway’s contention that an April 2002 notice issued by the Washington Department of Revenue approved the manner Appleway used to visibly pass on the B&O tax to Nelson. The Department’s notice was “at worst ambiguous” and “if the statement does say businesses can pass through the tax after a final price has been set, then it is wrong and conflicts with the plain language of RCW 82.04.500.”

2.2.3 - Nelson v. Appleway

The dissenters objected to the majority’s decision on several grounds. First, they contended the majority’s application of RCW 82.04.500 rested on an illogical premise, to wit: That if the parties agree during the course of their negotiations that the amount of the B&O tax can be added to the initial or stated price of the item, then the tax may be added to the price at the conclusion of the transaction, but if the parties’ negotiations do not include reference to the tax, then it may not added to the sale price of the item at the point of sale.

The dissenters reasoned that if RCW 82.040.500 prohibits pass through of the B&O tax to customers, then it is irrelevant at what point the tax is added to the selling price because it cannot be added. On the other hand, if RCW 82.040.500 allows pass-through of the tax to customers, then it should make no difference at what point the tax is added to the selling price under the statute. Similarly, whether the amount of the B&O tax is itemized separately makes no difference because itemization does not determine whether the customer is or is not paying the tax. And, if itemizing is prohibited, the seller can simply bury the amount of the tax in the total amount charged.

Second, the dissenting justices contended that the majority misread the plain meaning of RCW 82.040.500. According to the dissenters, the statute does not say that a business cannot include the amount attributable to its B&O tax liability in the price it charges to the customer, whether itemized or not. It provides merely that the legal burden of the tax falls on the business and constitutes the business’s operating overhead.

Moreover, the dissenters contended the statute does not declare that a business cannot obtain the funds necessary to pay the tax by charging the customer. B&O tax is a cost of doing business and like any other overhead expense such as rent or utilities, for which the business is also responsible, it is routinely passed on to the customer. Since operating overhead, including B&O tax, cannot be deducted from the amount of a business’s gross receipts of sale for B&O tax purposes, it is necessarily included in the measure of gross receipts of sale. RCW 82.04.070. Thus, when a business passes on B&O tax to a customer, whether itemized or not, it does not pass on a tax per se. Rather, it passes on an overhead expense which it must re-

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cover from the purchaser in order to make a profit.

Finally, the dissenters observed that if the Court’s decision was based on the majority’s concern that customers of a business may be misled into thinking that the B&O tax is a tax imposed on the customer in the manner of the retail sales tax, a customer can bring an action for violation of the Washington Consumer Protection Act to rectify such misconduct. RCW 19.86.010 et seq; RCW 46.70.180(1) & 46.70.310. Nelson did not plead a violation of the Consumer Protection Act in his complaint.

The dissenters’ objections seem to be based on the perception that the majority’s decision improperly prevents a business from freely recovering its B&O Tax overhead from customers. It is hard to discern the basis of this concern in the majority’s opinion.

3.0 - HAWAII

3.1 - Nature of the GET

Hawaii levies the GET against persons on account of their business and other activities in Hawaii engaged in with the object of gain or economic benefit. The tax is imposed for the privilege of conducting such activities within the state. The tax is measured by the application of rates against values of products, gross proceeds of sale, or gross income, whichever is specified, determined without any deduction on account of the cost of property sold, materials used, labor cost, taxes, royalties, interest, discount paid or any other expenses whatsoever. HRS 237-1, 237-2, 237-3, 237-13. The applicable tax rate depends on the particular activity engaged in. For instance, manufacturing and wholesaling are taxed at the rate of 0.5%, insurance premiums at the rate of 0.15%, and contracting, retailing and services at the rate of 4.0%. HRS 237-13. Since 2007, the City and County of Honolulu has imposed a 0.5% surcharge on the 4.0% rate, bringing the total tax rate to 4.5%. HRS 237-8.6.

3.2 - Visibly Passing on the GET to Customers

3.2.1 - Hawaii v. Sundstrom

The only court decision in Hawaii to address the practice of businesses that visibly pass on their GET expense to customers is the 1957 decision of the Circuit Court of Hawaii in Territory of Hawaii v. Sundstrom, Criminal No. 29707 (unpublished, Dec. 10, 1957). The Circuit Court, in a bench trial, found the defendant not guilty of violating former Sec. 117-14.6(3)(d), Revised Laws of Hawaii 1965, now codified as HRS 237-49. Entitled “Unfair competition; penalty,” it states:

No taxpayer shall advertise or hold out to the public in any manner, directly or indirectly, that the tax hereby imposed upon the taxpayer is not considered as an element in the price to the purchaser. Any person violating this section shall be fined not more than $50 for each offense.

The defendant, an owner of a restaurant, had charged the sum of $1.10, plus 4 cents tax, to a customer for certain food items. The prosecutor contended that the statute prohibits the “pass on” by a retailer to a consumer of the GET and the showing of such tax as a visible item in the determination of the final charge to the consumer. The Court disagreed. The Court concluded that the statute is intended only to prevent advertising by a retailer that the tax is being absorbed by him and thereby giving to such retailer an unfair competitive advantage over other retailers. Indeed, the Court declared that the statute likely requires a business to pass-on the GET to customers.

3.2.2 - 1965 Attorney General’s Opinion

In 1965, the Attorney General of Hawaii issued an opinion to the Hawaii Legislature regarding proposed legislation that would prohibit businesses from visibly passing on the GET to customers. Op. No. 65-13. The Attorney General opined that the proposed legislation would be legal although it would reverse the decision of the Circuit Court in Territory of Hawaii v. Sundstrom holding that visibly passing on the GET to customers in receipts, bills, invoices and contract was an acceptable practice in Hawaii. The Attorney General also opined that the proposed legislation would not affect the practice of the State Tax Office (Hawaii had since become a state) of including in gross receipts of sale any portion of the purchase price attributable to GET whether or not the amount of GET is separately stated. According to the Attorney General, the then (and current) custom of separately stating and visibly passing on the GET to customers in bills, receipts, invoices and contracts “is entirely a matter of contractual agreement between the seller and the buyer.”

The Attorney General observed that the proposed legislation would likely affect a ruling of the U.S. Internal Revenue Service that treated the GET as an itemized sales tax deduction for purposes of the federal income tax when the GET is separately identified for the customer, even though the burden of the GET is on the business and not the customer. That income tax provision was repealed by Congress for years beginning in 1987, but was subsequently restored for years 2004 through 2007. IRC §164(b)(3); Reg. §1.164-5. The proposed legislation did not become law.

3.2.3 - Tax Facts No. 96-1

The Hawaii Department of Taxation in Tax Facts No. 96-1, revised July, 2000, summarizes the rules that apply when businesses visibly pass on their GET to their customers in receipts, bills, invoices and contracts, or bury the GET in the total purchase price without separately identifying it.

Tax Facts No. 96-1 points out that any GET visibly passed on by a business to its customers is itself gross income of the business which must be included in the tax base upon which the tax rate is applied, which is unlike a retail sales tax. Thus, if a merchant sells a product to a customer for $125.00 and separately adds $5.00 to the bill of sale for the 4% GET (the rate in Honolulu would be 4.5% on account of
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the 0.5% surtax), the merchant must report a total of $130.00 on its return to the Hawaii Department of Taxation. Since the 4.0% GET must be computed and paid on the entire $130.00, the total amount due the Department is $5.20 including the tax on the tax. The merchant will net $124.80 from the transaction after payment of the GET, leaving the merchant 20 cents short of recovering its entire GET expense.

To recover the entire cost of the GET on the transaction resulting from having to pay tax on the tax, the merchant would have to visibly pass on its GET expense to the consumer at a rate greater than 4.0%. To accomplish this, Tax Facts No. 96-1 shows that the merchant would have to “gross-up” the expense of the GET to an effective pyramiding rate of 4.166% (the effective pyramiding rate in Honolulu would be 4.7% on account of the 0.5% surcharge). The pass-on would equal $5.21 on the $125.00 transaction, for a total invoice price of $130.21, allowing the merchant to fully recover the 4% GET it pays to the Department of Taxation on the $130.21 total invoice price.

Many businesses in Hawaii regularly “gross up” the GET in order to fully recover their GET expense on transactions. “Grossing-up” is legal, according to Tax Facts No. 96-1, as long as businesses do not charge customers a rate greater than the actual rate needed to recover GET expense. Thus, a business may not round up the 4.166% pyramiding rate to 4.167%, or charge any other rate greater than 4.166%. To charge a greater rate would violate Hawaii’s consumer protection laws because it would constitute a misrepresentation of fact of the rate needed to fully recover the merchant’s GET expense (the GET statutes are silent on the issue of “grossing-up” the GET).

Since the practice of businesses visibly passing on their GET expense to customers in receipts, bills, invoices and contracts is fundamentally a matter of contract law in Hawaii, Tax Facts No. 96-1 emphasizes that businesses must notify their customers in advance that GET attributable to the transaction will be separately added to the price to be paid by the customers and must specify the rate at which it will be charged. Echoing the majority opinion in Nelson v. Appleway, Tax Facts No. 96-1 states that any GET to be visibly added to the price should not be disclosed to the customer for the first time at the cash register after the purchase price has already been agreed on.

4.0 - GUAM

4.1 - Nature of the GRT

The Guam GRT is derived from the Hawaii GET. Guam Atty. Gen’t. Opinion 04-0215 (Feb. 18, 2004). Guam levies the GRT against persons on account of their businesses and other activities in Guam carried on for economic benefit. The tax is imposed for the privilege of conducting such activities within the territory. The tax is measured by the application of rates against values of products, gross proceeds of sale, or gross income, as the case may be, determined without any deductions whatsoever except that actual bad debts may be excluded in the period they accrued. 11 GCA §26101(a) & (g), and §26201. Unlike Washington and Hawaii, the GRT has a single rate of 4.0% for all activities subject to tax, with one minor exception. 11 GCA §26202. Certain manufacturing activities are exempt from the GRT and income derived from wholesaling is exempt from the tax. 11 GCA §26202(a)(3) & (4), and §26203(k)(22).

4.2 - Visibly Passing on the GRT to Customers

4.2.1 - Guam v. Marfega Trading Co., Inc.

The first court case in Guam to address the practice of businesses that visibly pass on their GRT expense to customers is Guam v. Marfega Trading Co., Inc., dbfa Islander Rent-a-Car, 1998 Guam 4 (May 18, 1998). A car rental company at the Guam International Airport added to the rental price of its cars a 5.0% charge when the cars were returned to the company. Customers were told that they were required by the government of Guam to pay the charge because it was a “sales tax,” or was a “gross receipts tax” that was “similar to a sales tax.” The charge was also sometimes referred to as simply a “tax” or a “service charge.” The company had a sign at its booth stating that an additional 5.0% “tax” would be charged for car rentals, which was later changed to read “Plus Service Charge of 5%.” The company also posted its rental rates on a sign at the booth. Line 36 of the company’s rental contract stated that an additional 5.0% fee would be added to the rental charge. The company’s branch manager testified in her deposition that employees described the line 36 fee to customers as a “sales tax.” The company’s general manager testified in his deposition that the rate of the charge was set at 5.0% and not the statutory 4.0% GRT rate because the company had to pay “tax on top of the tax.”

The Attorney General of Guam commenced an action against the car rental agency in the Guam Superior Court. The Attorney General alleged that the car rental agency breached the territory’s Deceptive Trade Practices - Consumer Protection Act, in that the company engaged in false, misleading or deceptive acts or practices by falsely representing that the consumer was obligated by the government to pay a 5.0% tax on the daily rental rate, and that the company misrepresented the total cost of renting the car itself. 5 GCA §32201(a), (b)(29) & (c)(3). The Attorney General also alleged that the company violated 11 GCA §26115, entitled “Unfair Competition.” Section 26115, which is substantially identical to HRS §237-49, states:

“It shall be unlawful for any taxpayer under this Chapter to advertise, or hold out to the public in any manner, directly or indirectly, that any tax levied hereunder is not considered as an element of the purchase price. Any person found guilty by a court of competent jurisdiction of violating this Section shall be guilty of a violation punishable by fine of not more than Fifty Dollars ($50.00) for each separate offense.”

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The Superior Court granted the rental car company’s motion for summary judgment of dismissal, determining as a matter of law that the car rental company did not violate the Guam statutes cited in the complaint. The Attorney General appealed to the Supreme Court of Guam, which reversed the Superior Court, holding that the car rental company violated the Deceptive Trade Practices - Consumer Protection Act and 11 GCA §26115 as a matter of law, and granted the Attorney General’s motion for summary judgment.

By misrepresenting that the government of Guam imposed a 5.0% sales tax on consumers who rented cars from the company when the car rental company was, in actuality, seeking reimbursement of its own 4.0% GRT expense, the Supreme Court concluded the company engaged in false, misleading or deceptive acts or practices regarding the nature and amount of the GRT. Moreover, by representing that the tax charged by the company was in addition to or on top of the purchase price, the company misrepresented that the charge was not an element of the purchase price (“It is misleading to inform a consumer of a surcharge, over and above an expressed flat rate, after the initial rate is relied upon”).

4.2.2 - 1983 Attorney General’s Opinion

The car rental company contended in the litigation that its practice of visibly passing on the GRT to customers was authorized by a 1983 opinion of the Attorney General of Guam, Op. Atty. Gen. 84-01. In that opinion, the Attorney General addressed the question of whether it is “unlawful [under 11 GCA §26115] for a merchant to designate the amount of gross receipts tax arising from a sale of goods on an invoice, bill, sales slip, price tag or other document relating to the sale.” The Attorney General opined that it was lawful to include such information provided that “no additional language is inserted, or verbal representations made, which state or imply that the gross receipts tax is not being passed on to the customers as part of the purchase price.” The Attorney General observed that “the Legislature’s intent was to prohibit a merchant from misleading potential customers into believing that the gross receipts tax was not being passed on as part of the purchase price,” as it would be “misleading to customers, unfair to competitors, and probably untrue in any situation since the tax is a cost imposed on the seller which must be recovered along with other elements of cost if the seller is to make a profit on the transaction.”

The Supreme Court rejected the rental car company’s argument that Op. Atty. Gen. 84-01 supported its practice of visibly passing-on the GRT to customers.

4.2.3 - 1975 Attorney General’s Opinion

In reaching its decision, the Supreme Court did not mention another opinion of the Attorney General of Guam issued in 1975, Op. Atty. Gen. 75-17. There, the Attorney General dealt with a company that sold prepaid funeral plans to the public. In its written contract entered into with customers, the company provided that “any gross receipts tax, sales tax or other tax imposed by law which is payable as a result of this agreement shall not be included in the purchase price provided for in this agreement.” The Attorney General determined that this provision violated 11 GCA §26115 because in visibly passing on its GRT tax to customers the company misrepresented the nature of the GRT, holding out that the GRT was in addition to the purchase price and was an obligation imposed by law on the customer, rather than a tax imposed by law on the company and included as an element of the purchase price. Thus, the company misrepresented the purchase price to its customers.

Nothing in the Supreme Court’s opinion in Marfega or in the two Attorney General’s opinions appears to specifically prevent a business in Guam from visibly passing on the GRT to customers in bills, invoices, receipts and contracts as long as the applicable rules are followed. Unfortunately for the rental car company, it did not follow the applicable rules.

4.2.4 - Visible GRT Law

In 2003, the Guam Legislature passed a temporary increase in the GRT rate from 4.0% to 6.0%, effective for the period April 1, 2003, through September 30, 2005. Guam Pub. Law 27-05:V:6 (Feb. 28, 2003). To allay public concern that the higher GRT rate would result in a sharp increase in prices paid by consumers, the Legislature also passed a law to provide an incentive to businesses to separately display the amount of GRT attributable to a transaction on invoices, sales slips and other receipts, which became known as the Visible GRT Law. Guam Pub. Law 27-41 (Nov. 13, 2003), amending 11GCA §26201(b).

Although the statute was not a model of clarity, it allowed a business to exclude from its measure of taxable gross receipts the amount of GRT reimbursement a business obtained from a customer on a transaction if the business filed an election with the Guam Department of Revenue and Taxation (DRT) agreeing to visibly display on invoices, sales slips and other receipts the amount of GRT that would be transmitted to the government of Guam as a result of the transaction. The effect of deducting the amount of GRT attributable to a transaction was to eliminate the tax-on-tax effect of passing on the GRT to customers. Pursuant to the Visible GRT Law’s dictate, DRT promulgated regulations to implement the new practice. Reg. §26201-3.

The Visible GRT Law did not expressly repeal 11 GCA §26115 and made no mention of what effect the Visible GRT Law would have on 11 GCA §26115 or the Supreme Court’s decision in Marfega. Because the 2.0% increase in the GRT rate and the enactment of the Visible GRT Law were both controversial, the Legislature repealed the tax increase on March 10, 2004 (returning the tax rate to 4.0%), and repealed the Visible GRT Law on May 18, 2007. Guam Pub. Laws 27-76 & 27-41.

The Macy’s department store in Guam opted to pass on its 6.0% GRT expense to customers under the Visible GRT Law. Macy’s announced its intention in a press (continued on next page)
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release and posted signs at the entrances to its store and at checkout counters stating that Macy’s “will be reflecting the 6 percent gross receipts tax on customer’s receipts beginning February 1, 2004.” Macy’s began to visibly pass on its GRT expense to customers in receipts on February 1st. Other merchants in Guam also opted to utilize the Visible GRT Law.

4.2.5 - 2004 Attorney General’s Opinion

On February 18, 2004, after consumer protests of the Visible GRT Law reached fever pitch, the Attorney General of Guam issued an advisory opinion addressing whether Macy’s and other retailers complied with the Visible GRT Law, the Visible GRT regulation, 11 GCA §26115 and Marfega. Op. Atty. Gen. 04-0215. The opinion noted, at the outset, that the Visible GRT Law was not applied uniformly by all the retailers that elected to utilize it. Macy’s, for instance, on its sales receipts, displayed the shelf prices of the goods, totaled the amount, added the 6.0% GRT “just as if it were a sales tax,” and then showed the total amount due on the transaction at the bottom of the receipt. The GRT was not listed as part of the price on the shelf, though notice of its addition was prominently displayed on signs at the check-out counters.

On the other hand, Payless Supermarket displayed on its receipts the shelf prices of the goods and totaled them, which was the amount due. Then, on separate line, not added to the customer’s total bill, was shown the amount of the GRT attributable to the transaction.

The Attorney General determined that the Visible GRT Law, the Visible GRT regulation, 11 GCA §26115 and the Supreme Court’s decision in Marfega were in harmony with each other and he would not depart from them. The Attorney General also determined that the Hawaii practice was relevant to Guam, although he acknowledged that Hawaii practice was not cited by the Supreme Court in Marfega.

In reviewing the two methods that Guam merchants used to apply the Visible GRT Law and to pass on the GRT to customers, the Attorney General concluded that:

(1) The Payless Supermarket method complied with the letter of the Visible GRT Law requiring the merchant to visibly display the amount of GRT to be transmitted to the Government on the transaction. Payless was free to raise its overall shelf prices as it sees fit since pricing is not restricted by Guam law;

(2) The Macy’s method violated Guam law and Hawaii precedent because the customer was not informed of the add-on for GRT until reaching the checkout counter. Macy’s method of visibly passing on the GRT to customers would have been lawful if Macy’s had followed Hawaii practice and existing Guam law by prominently notifying the customer of the GRT add-on when the customer enters the store or by placing notice on the merchandise itself.

After the Attorney General’s opinion, Macy’s replaced its existing signs at the entrances to its store and at the check-out counters to reflect the correct practice indicated in the Attorney General’s opinion.

4.2.6 - Quichocho et al v. Macy’s Department Stores, Inc.

The Visible GRT Law sparked the second court case in Guam to address the practice of businesses that visibly pass on their GRT expense to customers. In Quichocho, et al v. Macy’s Department Stores, Inc., et al, 2008 Guam 9 (June 27, 2008), the plaintiffs commenced a class action in the Guam Superior Court on February 26, 2004 to stop the practice Macy’s had adopted under the Visible GRT Law and to obtain restitution of the GRT that Macy’s had charged to the plaintiffs and to others similarly situated. The complaint alleged that Macy’s collection of GRT from customers violated the Deceptive Trade Practices - Consumer Protection Act in that Macy’s had engaged in false, misleading or deceptive acts or practices by misrepresenting that the initial shelf price of merchandise was the total purchase price that consumers were obligated by the government to pay the GRT at the checkout counter, and that the GRT was not an element of the purchase price of the merchandise purchased. 5 GCA §32201(a), (b)(29) & (c)(3); 11 GCA §26115.

After the lawsuit was filed, all of the retail stores in Guam except for Macy’s stopped charging separately for GRT at cash registers. Macy’s only initial change in business practice in response to the suit and after the GRT rate was reduced by the Legislature to 4.0% was to include a notice of the 4.0% GRT charge in its published advertisements and in its signs posted at the entrances to the store and at cash registers.

On November 24, 2004, the Attorney General’s Office wrote a letter to Macy’s attorneys altering the Attorney General’s position in its February 18, 2004, opinion regarding Macy’s noncompliance with applicable law. The letter informed Macy’s that “the present plan of Macy’s wherein they put notices prominently at the entrances to their store and at the register counters stating that the total price will include a 4% GRT … is acceptable.” Later on, Macy’s discontinued its practice of visibly passing on the GRT to customers after the Legislature repealed the Visible GRT Law on May 18, 2007.

The Superior Court dismissed the case on Macy’s rule 12(b)(6) and summary judgment motions. The Court concluded that the notices Macy’s utilized to inform consumers in advance that Macy’s GRT expense would be added to the shelf price of merchandise at the checkout counter to arrive at the total price was sufficient as a matter of law. The GRT charge, although separately stated on the receipts, was not exclusive of the total purchase price, but was a component of the total purchase price. The plaintiffs appealed to the Supreme Court of Guam, which reversed the Superior Court’s decision and remanded (continued on next page)

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the case to the Superior Court for further proceedings.

With respect to the alleged violation of the Deceptive Trade Practices - Consumer Protection Act, the Supreme Court held that Macy’s motion for summary judgment should not have been granted because there was a material issue of fact as to whether Macy’s method of passing on the GRT to customers was likely to mislead reasonable consumers. The issue of fact revolved around the adequacy of the notice that Macy’s gave to customers regarding visibly passing on of the GRT. The Supreme Court rejected Macy’s contention that its practice was not misleading as a matter of law because the Attorney General had approved of Macy’s method of passing on the GRT in its November 24, 2004 letter.

Insofar as the claimed violation of 11 GCA §26115 was concerned, the Supreme Court also held that the summary judgment of dismissal was improper because there was a material issue of fact regarding the sufficiency of notice that Macy’s gave to consumers. The Court could not say as a matter of law whether Macy’s had intended to misrepresent to customers that the GRT was not an element of the purchase price.

The Supreme Court rejected Macy’s contention that Marfega Trading was legally distinguishable due to the subsequent enactment of the Visible GRT Law, and that it was factually distinguishable because Macy’s did not misrepresent the nature and amount of the GRT to customers.

The Supreme Court also declined Macy’s invitation to rule that Marfega had been wrongfully decided by the Supreme Court. Macy’s pointed to language in Territory of Hawaii v. Sundstrom, supra, and in Hawaii Attorney General’s Opinion 65-13, supra, that states HRS §237-49 is “intended only to prevent advertising by a retailer that the tax is being absorbed by him and thereby possibly giving to such retailer an unfair competitive advantage over other retailers.” Since HRS §237-49 is virtually identical to 11 GCA §26115, Macy’s argued that the Supreme Court should give the same construction to 11 GCA §26115 that the Hawaii authorities give to HRS 237-49.

While acknowledging that the interpretation given to HRS 237-49 by the Hawaii authorities was reasonable, the Supreme Court held that it did not provide a compelling basis to overrule Marfega. According to the Supreme Court, the “facts in the Sundstrom decision can be distinguished from the facts here because retailers follow different standard practices in Hawaii and Guam” in that in Hawaii they “typically add a separate charge at the register on top of the marked or advertised price.” The Supreme Court observed that “the practice [in Hawaii] of not only ‘passing on’ this tax but also of showing it as a visible item in the total price has been carried on in [that] jurisdiction by many retailers and service establishments for a long period of time,” whereas “consumers in Guam are unaccustomed to a separate charge for GRT, and are therefore more likely to be misled or confused by it.” The Court noted that declaration testimony submitted by Macy’s stated that the “typical modern practice for retailers in Hawaii is to add a GET charge at the register without providing any notice to consumers of the charge,” apparently in violation of Tax Facts No. 96-1.

The Supreme Court’s refusal to graft Hawaii interpretations and practices onto Guam and its reaffirmation of its decision in Marfega, combined with the Legislature’s repeal of the Visible GRT Law, strongly suggests that Guam’s practices and interpretations remain unchanged. Nowhere in its opinion did the Supreme Court rule as a matter of law that a business cannot visibly pass on its GRT expense to customers, provided the practice is done properly. Nonetheless, it will be necessary to await the outcome of the case on remand to the Superior Court and of any subsequent appeal to the Supreme Court before it can be said with finality that the law remains the same in Guam.

5.0 - CONCLUSION

Several common threads run through the jurisprudence of Washington, Hawaii and Guam regarding the practice of businesses that visibly pass on their business privilege tax to customers: (1) Merchants may visibly pass on their business privilege tax expense to customers or bury the tax in the sales price; (2) Business privilege taxes are considered as overhead or an element of the purchase price and may not be represented to the contrary; (3) Business privilege taxes may not be added to the purchase price of an item after the final purchase price has been established; (4) If business privilege tax will be visibly added to the purchase price of merchandise at the point of sale, customers must be notified during negotiations, before the final purchase price is agreed upon, that the tax will be separately itemized and added to the initial purchase price.

Hawaii is the most liberal of the three jurisdictions when it comes to the practice of businesses that visibly pass on business privilege tax to customers. Washington and Guam, on the other hand, impose restrictions which must be carefully followed. Even if a merchant in good faith attempts to comply with the restrictions, he may still face litigation from a customer who believes the practice is unlawful. Consumer-protection laws in Guam are strictly applied to this practice and will undoubtedly be applied in Washington in future litigation.

In Washington, unlike Hawaii and Guam, merchants charge and collect the retail sales tax from customers. Due to misunderstanding by customers and merchants regarding the differences between the retail sales tax and the B&O tax, confusion is bound to occur. And, when the B&O tax and the retail sales tax are both itemized on a receipt or bill, the combined total of both taxes could lead to customer disgruntlement (in Seattle, the visible tax on a retail transaction would total 9.471%, inclusive of the 9.0% sales tax and the 0.471% B&O tax). Indeed, the problem would be magnified if the merchant sought to “gross up” the B&O tax by an amount greater than the actual B&O tax rate to eliminate the tax on tax effect of visibly passing on the B&O tax to customers.

The key question a merchant must address is whether the nature of his or her (continued on next page)
When Businesses Visibly Pass on Their Washington B&O Tax to Customers continued from previous page

business would be amendable to visibly passing on B&O tax to customers, or would be better suited to burying the tax in the total purchase price of an item? One example of this conundrum is the case of Macy’s in Guam. The evidence showed that Macy’s throughout the United States charges uniform shelf prices for all of its merchandise. In jurisdictions having retail sales tax but no business privilege tax, Macy’s simply adds the sales tax to the purchase price at the point of sale and collects the total amount from the customer without complaint. In Guam, where there is GRT but no sales tax, if Macy’s can visibly add the amount of GRT attributable to a transaction onto the shelf price of merchandise at checkout, à la sales tax, Macy’s can easily recover its GRT expense (the Supreme Court expressed no sympathy to Macy’s on this point). In Washington, where Macy’s also has retail stores, the problem is more complex because Washington has both the retail sales tax and the B&O tax.

The notice and negotiation requirements which must be observed by a business to visibly pass on the B&O tax to customers are problematic when it comes to mass merchandisers that sell products at fixed prices, such as Macy’s or Wal-Mart. How individualized must the notice and negotiations be to pass muster? On the other hand, businesses such as car dealers, where individualized negotiation of price is the norm, offer a more fruitful environment to visibly pass on the B&O tax to customers. Also, professional service providers who bill at an hourly rate, such as attorneys, may be able to satisfy the rules for visibly passing on their B&O tax to clients, particularly since the state’s retail sales tax would not apply to these transactions.

In those situations where B&O tax can be visibly passed on to customers, the practice would be beneficial to customers as well as the businesses if, for years following 2007, Congress were to extend the effective date of IRC §164(b)(5) to allow taxpayers to claim the B&O tax as if it were an itemized sales tax deduction on Schedule A of their Form 1040. Reg. §1.164-5; Hawaii Atty. Op. No. 65-13, supra.

Stephen A. Cohen is a member of the Washington, Oregon, Guam and Northern Mariana Islands bars. He resides in Seattle where he practices taxation.

CLE Committee Report

by John Clynch

The CLE Committee has been very busy these past few months. Paige Davis from Lane Powell stepped down from her position as co-chair to become treasurer of the Tax Section. She is still a member of the CLE Committee. Chris Brown from Summit Law Group and Amber Quintal from Ogden Murphy Wallace are the new co-chairs, and I still amble on as co-chair. Kate Szurek from Skagit Law Group and Renee Grant-Bluechel from Lane Powell are also members of the CLE Committee.

For anyone interested in joining the CLE Committee, please check out information on the Tax Section website of the WSBA.

The WSBA Tax Section presented a half-day seminar entitled “Internal Revenue Code Section 409A: Complying with the Final Regulations in Time” at the WSBA offices on August 25, 2008. This timely CLE was exceptionally well received with over 50 pre-registrants. Presenters included Richard A. Hopp of Stoel Rives, Jeff Belfiglio of Davis Wright Tremaine, and Rob Starin of K&L Gates. This CLE was videotaped by the WSBA, so if you missed it, contact the WSBA for information on whether the video will be made available.

The first annual Oregon and Washington Tax Institute, co-sponsored by the WSBA Tax Section and the Oregon State Bar Tax Section, was held on May 1, 2008, at the W Hotel in Seattle. The Institute ran for a day and a half and afforded 9 general CLE credits to Washington attendees. The Institute was well attended by over 80 attorneys and accountants from throughout Oregon and Washington. The Institute included presentations on a variety of tax topics covering federal, state and local and international topics. Speakers included Professor Martin McMahon of the University of Florida, Paul D. Carman of Chapman and Cutler in Chicago, Brian D. Pederson of Alvares & Marsal Taxand in Seattle, Louis Nostro of Shutts & Bowen LLP in Miami, Institute co-chair Larry J. Brant of Garvey Shubert Barer in Portland, Leonard Glass of Lawson Lundell in Vancouver, B.C, Nancy Lee Gallup of Perkins Coie in Seattle, Institute co-chair David C. Culpepper of Theede Culpepper Moore Munro & Silliman in Portland, and Neil D. Kimmelfield of Lane Powell in Portland. University of Washington School of Law Professor and Director of the Graduate Program in Taxation Sam Donaldson spoke at the luncheon. This Institute is not to be missed, so plan to attend the next Oregon and Washington Tax Institute in Portland, Oregon, during summer 2009!

On June 2nd, Wendy Goffe presented a brown-bag CLE on Estate Planning for the Unmarried Couple at Deloitte Tax. Future brown-bag CLEs include Tax Controversy Issues presented by Bob Kane of LeSourd and Patten at Deloitte Tax, and Likely Tax Policy Agendas of the presidential candidates presented by Professor Roland Hjorth of the University of Washington School of Law at Lane Powell on October 20th.
Estate & Gift Tax Committee Report

by Alan MacPherson

The Estate and Gift Tax Committee is planning to meet at noon on the following dates in 2008/2009:

- September 19
- October 31
- December 12
- January 23
- March 6
- April 24
- June 5

The June date might be changed if it conflicts with the RPPT mid-year meeting. We will meet at the offices of Gordon, Thomas, Honeywell in Seattle (21st floor, One Union Square, 600 University). Non-Seattleites can call in.

New members are welcomed; please contact me at amacpherson@gtb-law.com if you want to join. I’ll put you on the email list and you’ll get notices of the meetings, with agendas. I want to encourage the participation of Committee members in ongoing and new study groups on topics of interest. I was in a little group last year, the more experienced Committee members were very welcoming, and I learned some things that probably made me a bit better lawyer.

Ongoing study groups include the following:

Rewrite-your-Will bill (mostly to help with the soon-to-be-differing Federal and State estate tax exemptions). This group is already into the legislative process.

QTIP and related issues under the State estate tax. There is a group already but they have a big task and Dean Butler welcomes others to help formulate recommendations to the greater Committee. So email Dean at Butler@carneylaw.com if you want to jump in.

RCW 6.15, retirement plans, and non-prorata allocations. Mike Carrico and Claudia Gowan have this part way along. Let Mike (mcarrico@Riddellwilliams.com) or Claudia (cgowan@rlmalaw.com) know if you want to learn about this.

Here are a few topics that occur to me as new study group possibilities; if you’re interested in leading a study on one of these, or another estate tax topic, please let me know:

- Tax reimbursement provisions
- Estate tax inclusion
- State estate tax procedure
- Joint revocable trusts

Thanks.

Alan D. MacPherson,
Estate and Gift Tax Committee Chair

International Tax Committee Report

by Ada Ko

The International Tax Roundtable, co-sponsored by Washington CPA and the Tax Section, provides a forum for tax practitioners to discuss pertinent cross-border tax issues. Held during the lunch hour at firms throughout King County, the International Tax Roundtable promotes an interactive environment in which attorneys and CPAs can network with their peers, and share information and ideas about issues facing taxpayers engaging in international activities. The Roundtable also provides a platform for attorneys from other countries to speak to Washington-based practitioners about tax issues they are facing in foreign countries, as well as a platform for in-house counsel to voice their opinions on the international tax issues that matter to multinational companies. The International Tax Roundtable is generally held every other month. Please send an e-mail to Ada Ko at Lane Powell PC at KoA@lanepowell.com to find out more information or sign up on the International Tax Roundtable list serve.

State and Local Tax Committee Report

by Chauncey MacLean

The State and Local Tax Committee of the Tax Section will resume its meeting schedule in September 2008 covering a variety of topics. For the coming year, Chauncey MacLean of Deloitte Tax LLP will be assuming the chair of the Committee in place of Bob Mahon of Perkins Coie LLP, who has assumed the chair of the Tax Section.

During the last year, the WSBA SALT Committee had a number of brown-bag lunches to discuss state tax matters. For example, on Thursday, May 22nd the Committee met with Stephen Saynisch, the executive director of the Board of Tax Appeals, to review the BTA’s workload and performance, new BTA initiatives, and BTA procedures. The Committee used the opportunity to ask questions, raise concerns, and provide feedback to Mr. Saynisch.

On Friday, April 25th, the Committee was joined by Mary Barrett, assistant director of the Appeals Division, and Jeff Mahan, appeals review manager. Among the topics discussed were the Division’s statistics on resolved appeals, the management of administrative law judge turnover, and new Appeals Division/DOR initiatives.

In the coming year, the SALT Committee will continue to host brown-bag lunches in order to meet with key personnel from the operating divisions of the Department of Revenue, as well as examine new initiatives for practitioners in the field. Among the initiatives will be the Committee’s continued focus on publication of DOR determinations, and a new look at the publication of Court of Appeals decisions in the area of tax.

Other topics and areas of interest are being considered and are certainly open to suggestion. If you have any questions or comments, please do not hesitate to contact Chauncey.
The Taxation Law Section newsletter invites its readers to submit articles, items of interest, and announcements for publication in upcoming issues. Share your expertise, your knowledge, and your insights for the benefit of your colleagues.

So you have an idea you would like to flesh out, or a finished article ready to go?

Please contact the Newsletter Editor, Jennifer Gellner, by sending an e-mail to jennifer@gellnertaxlaw.com.

We would like to read what you have to say.
Scholarship Committee Report

by Cori Flanders-Palmer

Each year, for the past eight years, the Tax Section has offered a scholarship to a law school graduate attending an LL.M. program in tax.

The scholarship is offered to an individual who currently attends a Washington law school, and has demonstrated a strong academic record, a financial need, and the intent to become an active member of the WSBA Tax section upon completion of his/her LL.M. tax education. This year the Tax Section received applications from many outstanding candidates. Each year the pool of applicants gets more competitive and the decision becomes more difficult.

Due to the generosity of firms around the area and Tax Section members, this year the Tax Section was able to offer a $5,000 scholarship to My Vo. My Vo is a University of Washington Law School graduate and will attend the New York University School of Law LL.M. program this fall. My Vo’s academic record stood out from the rest and he will be a great addition to our local tax community.

For more information, please visit the scholarship link under our Tax Section website.

Pension Roundtable Report

by Richard A. Hopp

The Pension Roundtable is a group of lawyers, actuaries and accountants who focus on the law of employee benefits. Tax law is the largest component of our focus, because employee benefits enjoy significant tax advantages. However, the group also focuses on other applicable law, especially federal labor law that regulates or affects employee benefits. The group’s activities are largely focused on self-education, although on occasion the group has recommended to the Tax Section revisions of state law that impact employee benefits, such as the exemption of certain retirement benefits from attachment or garnishment by creditors.

The group meets monthly. Anyone interested in more information about the Pension Roundtable should contact its chair, Richard A. Hopp (206) 386-7609 or rahopp@stoel.com.

When you have finished reading this newsletter, please pass it on to someone else in your firm.