Cite as Det. No. 93-120, 14 WTD 007 (1994).

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

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 93-120
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

RULE 193B: RETAILING B&O TAX -- OUT-OF-STATE VENDOR -- WASHINGTON CUSTOMER -- DUE PROCESS -- NEXUS. Washington has sufficient nexus with the taxpayer and does not violate either the Due Process Clause or the Commerce Clause by assessing its retailing B&O tax against an out-of-state vendor who contracted to sell and deliver a vessel to a Washington customer when the vendor's officer and employees entered Washington to solicit sales, monitor construction of the vessel, and perform tests to ensure it met contractual performance standards before the sale was complete.

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.

. . .

NATURE OF ACTION:

Taxpayer protests a retailing business and occupation (B&O) tax assessment by claiming the state of Washington has insufficient nexus with it.

FACTS:

De Luca, A.L.J. -- The Department of Revenue (Department) audited the taxpayer for the period September 14, 1989 through December 31, 1990. The Department originally assessed the taxpayer retailing B&O tax, retail sales tax, penalties and interest. Subsequently, the Department deleted the sales tax when the taxpayer provided information showing the taxpayer's customer paid use tax directly to the state of Washington. The adjusted assessment of retailing B&O tax, penalties and interest remains unpaid.

The taxpayer is a foreign corporation based in another state. The taxpayer does not have a local office or resident employee in Washington. The taxpayer sells oil-and-debris-recovery vessels. The taxpayer contracted in 1989 with a Washington customer to design, build, launch, complete and test such a vessel. The contract required the taxpayer to deliver the vessel to the customer in Washington. The contract also provided that the taxpayer would arrange for the vessel to be constructed by a specific third-party shipyard in Washington. The vessel remained the property of the taxpayer until delivery to the customer took place. The taxpayer also insured the vessel until then. Thus, the shipyard actually built the vessel while the taxpayer provided the shipyard the oil skimming equipment to install in it.

According to the Washington Business Activities Statement and Supplemental Business Activities Statement prepared by the taxpayer's secretary/treasurer, the taxpayer's president does solicit oil skimmer sales in Washington. Moreover, the taxpayer has three employees travelling into Washington approximately two trips per year per employee. Each trip averages three to four days. The taxpayer's memorandum declares that the purpose of some of these trips was to monitor the subcontractor's progress and performance on the vessel. Indeed, the contract required the taxpayer to give the customer two weeks notice before specified tests and events were to take place. Additionally, the taxpayer had to ensure that the vessel with its appurtenances was completed and sea trials conducted for acceptance by the customer within twelve months from the date of the agreement. Finally, the business activities statements reveal the taxpayer both ships goods from points outside Washington to points in Washington and makes deliveries from points in Washington to other points in Washington.

The taxpayer states that the customer approached it directly and requested a proposal to construct the vessel. The taxpayer further claims the parties negotiated the contract outside Washington. The parties have had prior dealings. The customer purchased a similar vessel from the taxpayer in 1981, but it was built outside Washington. During the intervening years before the second vessel contract, the taxpayer sold the customer replacement parts and equipment and assisted it with technical advice as requested. We gather that some of the trips made by the taxpayer's employees to Washington state during the intervening years pertained to the first vessel.

The Department's Audit Division determined Washington had sufficient nexus with the taxpayer for two reasons contained in the rule which governed interstate sales of tangible personal property to Washington customers at the time of the sale, former WAC 458-20-193B (Rule 193B). Audit found that contracting to build the vessel was similar to the inherently local business activity of constructing or repairing buildings or other structures. Additionally, Audit found the vessel was a local stock of goods belonging to the taxpayer when it was delivered to the customer.[1]

ISSUE:

Does Washington have sufficient nexus with the taxpayer to assess B&O tax?

DISCUSSION:

RCW 82.04.220 imposes the B&O tax:

> There is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities. Such tax shall be measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be.

RCW 82.04.140 defines "business" as including:

> . . . all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly.

The taxpayer contends it is operating exclusively in interstate commerce and therefore the B&O tax creates an unconstitutional burden on interstate commerce and violates the Due Process Clause of the Fourteenth Amendment. The taxpayer cites some U.S. Supreme Court decisions to support its argument as well as the claim that "state taxation on interstate commerce can only be justified to make commerce bear a fair share of the cost of local government whose protection it enjoys." Freeman v. Hewit, 329 U.S. 249, 253 (1946). See also National Bellas Hess, Inc. v. Department of Rev. of Ill., 386 U.S. 753, 756 (1967); American Oil Co. v. Neill, 380 U.S. 451, 458 (1965); Miller Bros. Co. v. Maryland, 347 U.S. 340, 344-345 (1954); Wisconsin v. J.C. Penney, 311 U.S. 435, 444 (1940). The taxpayer further asserts its activities occurring in Washington do not constitute a sufficient

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

nexus to support the tax on its sales and do not meet the nexus examples listed in Rule 193B.

More recent U.S. Supreme Court decisions have greatly impacted the holdings in some of the cases cited by the taxpayer. The Supreme Court has directly addressed the due process concerns raised in National Bellas Hess and the Commerce Clause standards found in Freeman v. Hewit. See Complete Auto Transit v. Brady, 430 U.S. 274 (1977); Tyler Pipe Indus., Inc. v. Washington State Dep't. of Rev., 483 U.S. 232 (1987); and, in particular, Quill Corp. v. North Dakota, _ U.S. _ , 112 S.Ct. 1904 (1992).

Quill recognized the continuing validity of Miller Bros. Co., supra, where it stated the Due Process Clause "requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." 112 S.Ct. at 1909. However, Quill also states "our due process jurisprudence has evolved substantially in the 25 years since Bellas Hess, . . ." 112 S.Ct. at 1910. The Court explained that the due process requirements now are met where ". . . a foreign corporation purposefully avails itself of the benefits of an economic market in the forum State . . . even if it has no physical presence in the State." id. The Court continued at 112 S.Ct. at 1911:

> Thus, to the extent that our decisions have indicated that the Due Process Clause requires physical presence in a state for the imposition of duty to collect a use tax, we overrule those holdings as superseded by developments in the law of due process.

Furthermore, the U.S. Supreme Court has decided Washington has sufficient nexus to impose the B&O tax on out-of-state sellers who use independent contractors rather than employees to solicit sales in this state. See Tyler Pipe Industr., supra. In that case an out-of-state taxpayer sought a refund of wholesaling B&O taxes it paid on sales to customers in Washington because it claimed it lacked sufficient nexus with the state. The products it sold were manufactured outside Washington. Tyler maintained no office, owned no property and had no employees residing in Washington. The state courts found the in-state sales representative engaged in substantial activities that helped establish and maintain Tyler's market in Washington by "calling on its customers and soliciting orders." 483 U.S. at 249.

The Supreme Court continued at 483 U.S. at 250-251 by agreeing with the Washington Supreme Court's holding that determined:

> . . . `the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to

> establish and maintain a market in this state for the sales.' 105 Wn.2d at 323, 715 P.2d at 126.

The Department of Revenue does not require a vendor's representative to live in Washington or take orders in the state before the tax can apply. Significant activity which establishes or maintains sales controls. Such activity by a representative or agent does not have to be the only or most important factor, but it is significant if it has an impact on sales. Otherwise, no reason exists to employ the person. The Department has consistently held "if the in-state activity is economically meritorious for a taxpayer (if it is worth spending budget dollars to do it), then the activity is market driven and it generally establishes nexus with the state of Washington." Determination No. 87-286, 4 WTD 51 (1987).

For example, the Department has held infrequent visits to Washington customers by nonresident employees, who are not salespersons, constitute sufficient local nexus to allow taxation of income from sales. See Determination No. 88-368, 6 WTD 417 (1988). In that matter, the employees provided advice to the customers regarding the safe handling of a product. Such activity was important in maintaining sales into the state. See also Standard Pressed Steel Co. v. Department of Rev. of Wash., 419 U.S. 560 (1975) where nexus was established through the presence of a resident employee engineer who was not involved in sales, but instead consulted the customer regarding its product needs.

As noted, Rule 193B governs whether sales of goods originating in other states to persons in Washington are subject to the B & O tax. The rule provides in part:

> RETAILING, WHOLESALING. Sales to persons in this state are taxable when the property is shipped from points outside this state to the buyer in this state and the seller carries on or has carried on in this state any local activity which is significantly associated with the seller's ability to establish or maintain a market in this state for the sales. If a person carries on significant activity in this state and conducts no other business in this state except the business of making sales, this person has the distinct burden of establishing that the instate activities are not significantly associated in any way with the sales into this state. The characterization or nature of the activity performed in this state is immaterial so long as it is significantly associated in any way with the seller's ability to establish or maintain a market for its products in this state. The essential question is whether the

> instate services enable the seller to make the sales. (Underlining ours.)
>
> Applying the foregoing principles to sales of property shipped from a point outside this state to the purchaser in this state, the following activities are examples of sufficient local nexus for application of the business and occupation tax:
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> . . .
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> (4) The delivery of the goods is made by a local outlet or from a local stock of goods of the seller in this state.
> (5) Where an out-of-state seller, either directly or by an agent or other representative, performs significant services in relation to establishment or maintenance of sales into the state, the business tax is applicable, even though (a) the seller may not have formal sales offices in Washington or (b) the agent or representative may not be formally characterized as a "salesman."

We hold the taxpayer's activities meet the nexus examples (4) and (5) of Rule 193B. Example (4) is met because the vessel was delivered from the local shipyard to the Washington customer's place of business. According to the contract, the taxpayer owned the vessel until delivery was completed. Example (5) is met because the in-state technical activities of its employees were significant services in relation to establishing or maintaining sales into the state. The vessel had to meet precise performance standards before the customer would accept it. The taxpayer's presence in this state through its employees was essential to guarantee that those standards were met in order to complete the construction, delivery and sale. The taxpayer admits its employees were in Washington upon occasion to monitor the subcontractor's progress and performance.

Moreover, the taxpayer had an on-going presence in this state due to the sales activities by the taxpayer's president as well as the sale of the first vessel and the subsequent parts sales and technical advice provided for that vessel. Thus, even if the contract for the second vessel was negotiated outside Washington and even if the customer initiated the proposal to construct the second vessel, Washington still has nexus due to the taxpayer's other in-state activities. Chicago Bridge v. Department of Rev., 98 Wn.2d 814, 659 P.2d 463 at 469, appeal dis'd 464 U.S. 1013 (1983).

Under Rule 193B when the taxpayer/seller has nexus with this state, the burden is on the seller to establish that its in-state activities are not significantly associated in any way with sales into this state. See Det. 87-69, 2 WTD 347 (1987), Det. 88-144, 5 WTD 137 (1988), Norton Company v. Department of Rev., 340 U.S. 534, at 537 (1951); Chicago Bridge, 659 P.2d at 468 and 471. The present taxpayer has not and cannot meet its burden because its employees periodically entered Washington and performed technical services to ensure the skimming equipment was properly installed and working.

The present taxpayer availed itself of the benefits of the economic market in Washington by contracting to build a vessel in Washington and deliver it in-state to a customer. Unlike Bellas Hess, the taxpayer also had a physical presence in the state. Its employees and president regularly visited the state for business purposes. Thus, the tax assessment does not violate the Due Process Clause either under the old standard in Bellas Hess or the new standard in Quill.

Quill next addressed the Commerce Clause and the rights of states to tax transactions in interstate commerce. The opinion declares at 1911-1912:

> . . . in Freeman v. Hewit, 329 U.S. 249, 256 (1946), we embraced again the formal distinction between direct and indirect taxation, invalidating Indiana's imposition of a gross receipts tax on a particular transaction because that application would `impose a direct tax on interstate sales.' Most recently in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 285 (1977), we renounced the Freeman approach as `attaching constitutional significance to a semantic difference.' . . . . Complete Auto emphasized the importance of looking past the `formal language of the tax statute [to] its practical effect,' Complete Auto, 430 U.S. at 279, and set forth a four-part test that continues to govern the validity of state taxes under the Commerce Clause.

Thus, as long as a state's tax complies with the four-part test of Complete Auto, it may tax an interstate transaction. Indeed, the B&O tax does comply with Complete Auto. We have already discussed that nexus exists. Furthermore, the Supreme Court in Tyler Pipe, 483 U.S. at 251 declared that the wholesaling and retailing B&O complies with the requirement that the tax be fairly apportioned by stating:

> Thus, the activity of wholesaling - whether by an in-state or out-of-state manufacturer - must be viewed as a separate activity conducted wholly within Washington that no other State has jurisdiction to tax.

The third prong of the test is the requirement that the tax not discriminate against interstate commerce. A state tax on interstate commerce is not discriminatory unless it affords a "differential tax treatment of interstate and intrastate commerce." Commonwealth Edison Co. v. Montana, 453 U.S. 609, 618 (1981). Washington's tax treats interstate and intrastate commerce equally and, therefore, does not discriminate against interstate commerce.

The fourth prong is the requirement that the tax be fairly related to the services provided by the state. This requirement does not address the rate or amount of the tax, nor does it look to the actual value of the services in relation to the actual taxable activities engaged in. Commonwealth Edison, 453 U.S. at 622. Instead, it is closely connected to the nexus prong. It requires that the measure of the tax, as well as its incidence, " `be tied to the earnings which the state . . . has made possible'". Commonwealth Edison, at 626 quoting Wisconsin v. J.C. Penney, supra.

That tie exists. The taxpayer contracted to build the vessel in Washington and had its employees and president enter the state for business purposes. In order to complete the contract, the taxpayer used Washington roads and transportation facilities for travel and to ship items into the state. Government services including police and fire protection were provided by the state. A trained work force was present to complete the construction. Because the measure of the tax is based solely on the gross proceeds of sales to customers in this state, it is closely tied to the earnings which the state made possible. Chicago Bridge, 659 P.2d at 473-474.

DECISION AND DISPOSITION:

The taxpayer's petition for correction of the assessment is denied.

DATED this 19th day of April, 1993.