

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

In the Matter of the Petition for     ) D E T E R M I N A T I O N  
A Ruling on Tax Liability by         )  
  )                 No. 87-18  
  )  
  )     Not Registered  
  )  
  )

- [1] **RULE 244:** RETAIL SALES TAX -- NOVELTY ITEMS -- SALES BY BAKERY. The retail sales tax applies to sales of food containers and other novelty items sold by a bakery, if novelty items and food products are sold as a package, the retail sales tax applies unless the value of the non-food items is less than the value of the food or the price of the non-food items is stated separately.
- [2] **RULE 244 and RCW 82.08.0293, RCW 82.12.0293:** RETAIL SALES TAX -- USE TAX EXEMPTION -- FOOD PRODUCTS -- BEVERAGES. Coffee, tea, milk and other noncarbonated beverages are included in the definition of "food products" for purposes of the exemption provisions of RCW 82.08.0293 and 82.12.0293; carbonated beverages are not included as exempt food products.
- [3] **RCW 82.08.0293 AND RCW 82.12.0293:** RETAIL SALES TAX -- USE TAX -- EXEMPTION -- FOOD PRODUCTS. Sales of food products by restaurants, drive-ins, and concession stands in places as amusement parks are subject to the retail sales tax.
- [4] **RULE 244, RCW 82.08.0293:** RETAIL SALES TAX -- EXEMPTION -- FOOD PRODUCTS -- SALES AT MALLS -- COMBINATION BUSINESSES -- ETB 528. A business selling both taxable and nontaxable items is required to keep accounting records and sales receipts which segregate the taxable and nontaxable sales.
- [5] **RULE 244, RCW 82.08.0293:** RETAIL SALES TAX -- EXEMPTION -- SALES AT MALLS -- BAKERY ITEMS. Sales of bakery items by retail bakery located in shopping mall are exempt of retail sales tax where items are enclosed in metal tins, sealed in large paper bags, or wrapped in small paper bags with instruction for reheating at home. Such sales

not found to be sold in a way to invite immediate consumption where seller did not provide tables, chairs, or counters for consumption of food or locate near food courts and provide trays, dishes or tableware to facilitate the immediate consumption of food.

- [6] **RULE 244, RCW 82.04.220:** B&O TAX -- FOOD PRODUCTS.  
The gross proceeds from sales of food products in Washington are subject to the B&O tax.
- [7] **RULE 193B:** B&O TAX -- INTERSTATE COMMERCE -- NEXUS -- FOOD PRODUCTS -- MAIL ORDER SALES. Mail order sales of food products to persons in this state are subject to the retailing B&O tax if the seller has engaged in any activities in this state which are significantly associated with its ability to establish or maintain a market in this state for the sales. Sufficient local nexus exists where the seller's Washington outlet receives the orders or packages and ships the orders.
- [8] **RULE 193B:** B&O TAX -- INTERSTATE COMMERCE -- NEXUS -- MAIL ORDER SALES -- DISSOCIATION. To avoid taxation, the out-of-state seller must sustain the burden of showing the sales at issue are dissociated from the seller's in-state activities. Norton Co. v. Department of Revenue cited.
- [9] **RULE 243, RCW 70.93.120:** LITTER TAX -- FOOD PRODUCTS. Sales by Washington outlets of food products, carbonated beverages and containers are subject to the litter tax. Mail order sales of food products which are subject to the B&O tax are also subject to the litter tax.

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

TAXPAYER REPRESENTED BY: . . .  
. . .

DATE OF HEARING: August 19, 1986

#### NATURE OF ACTION:

On February 24, 1986, a ruling was requested under section 18 of Rule 100 by the above accounting firm on behalf of an undisclosed client, a retail bakery outlet, as to the bakery's Washington sales, business and occupation, and litter tax consequences.

#### FACTS AND ISSUES:

Frankel, A.L.J. -- The taxpayer operates retail bakeries, selling cookies, brownies, muffins and nonalcoholic beverages. The food products are baked on the premises, displayed in unheated window counters, and sold by weight on a "to go" or "take out" basis. Depending on the quantity purchased, the product is enclosed in a metal tin, sealed in a large paper bag, or wrapped in a small paper bag. All packaging includes instructions for reheating the product at home by the consumer.

The taxpayer stated that beverages account for 3.4 percent of total sales. Seventy-five percent of the stores selling carbonated beverages sell by the can; the remainder sell through a fountain dispenser. Some stores sell no beverages. About eight percent of the customers purchasing cookies also purchase a beverage. The stores also sell a few non-food items to complement their food products. These items (e.g. cookie tins) constitute approximately one percent of total sales.

The bakeries are located in leased space in shopping malls or in street-front locations. There are no facilities for seating or food consumption on the premises. The taxpayer stated it does not consider its product for immediate consumption and does not intend to compete with such food product retailers; therefore it positions its stores away from mall locations where food courts are provided.

The taxpayer also provides a mail order service to consumers. The customer completes the mail order request and delivers the request to a retail outlet or mails it to corporate headquarters, located out of state. Requests delivered to stores are forwarded to headquarters. Corporate headquarters then forwards the request to the mail order store nearest the customer. That store fills the order, packages and ships the products to the consumer.

The taxpayer operates in 35 states. Its corporate office prepares the tax returns and remits the state sales taxes for all the outlets. The taxpayer requests the following ruling:

1. The sales of food (bakery goods) are not subject to sales tax, Business and Occupation tax, but are subject to the Litter tax in Washington under RCW Sections 82.08.0293 and 82.12.0293 etc., and 70.93.120.
2. The retail sales of carbonated and non-carbonated beverages are subject to the state sales and litter tax, but not the business and occupation tax.
3. Novelty and other non-food items are subject to sales tax, business and occupation, and litter taxes under RCW 42-1301 etc.

4. Mail order sales of food into Washington are exempt from all taxes.

#### DISCUSSION

[1] Chapter 82.08 of the Revised Code of Washington imposes a retail sales tax on all retail sales in this state unless the sales are within one of the specifically enumerated statutory exemptions. The taxpayer is correct in concluding that the sales tax applies to all retail sales of novelty and other non-food items such as food containers, as no exemption exists for such sales. If food and non-food items are sold together, the retail sales tax applies if the value of the non-food item is more than the value of the food item, unless the food portion is stated separately.

[2] RCW 82.08.0293 (retail sales tax) and RCW 82.12.0293 (use tax) provide exemptions for the sales and use of certain "food products" for human consumption. "Food products" include coffee, tea, milk and other noncarbonated beverages. "Food products" do not include carbonated beverages; thus the taxpayer is correct that all sales of carbonated beverages are subject to the retail sales tax.

[3] The exemption provisions do not apply:

(a) When the food products are furnished, prepared, or served for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware whether provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others, . . . or (b) when the food products are ordinarily sold for immediate consumption on or near a location at which parking facilities are provided primarily for the use of patrons in consuming the products purchased at the location, even though such products are sold on a "takeout" or "to go" order and are actually packaged or wrapped and taken from the premises of the retailer, or (c) when the food products are sold for consumption within a place, the entrance to which is subject to an admission charge, except for national and state parks and monuments. RCW 82.08.0293 and RCW 82.12.0293.

Clearly, food sold in restaurants, drive-ins, and concession stands in places such as amusement parks is subject to the retail sales tax. Questions arise, however, as to the sales taxability of food products sold by food vending vans, combination businesses, and businesses such as the taxpayer's which sell food at malls and similar public shopping centers.

[4] The Department has promulgated WAC 458-20-244 (Rule 244) to implement the statutory exemptions for food products. Excise Tax Bulletin (ETB) 528.08.022, issued in 1984, further explains the

Department's position as to the sales taxability of food sold at malls. The bulletin quotes the following language in Rule 244:

It is the intent of the law that tax be charged by retailers who sell food products ready for consumption at or near the premises of the vendor by furnishing cups, spoons, straws, or the like to facilitate immediate consumption. If such facilities are provided the tax applies even though the food is sold, packaged, or wrapped "to go" and even if the food is in fact removed from the premises of the retailer and is consumed elsewhere. (Emphasis supplied.)

The Department considers the above language in determining the sales taxability of food products sold by retail businesses such as the taxpayer's. ETB 528 states the Department's position:

3. Food sales by combination businesses are taxable under WAC 458-20-244 as follows:

Persons operating a combination of two businesses at one location, one of which provides facilities for consumption on the premises (see paragraph (1), "Vendors Who are Required to Collect Tax"), such as a lunch counter along with a grocery store or a cafe along with a bakery, are required to keep their accounting records and sales receipts segregated between the two businesses. If the two businesses are commingled in accounting, all sales will be deemed subject to tax.

The former requirements of WAC 458-20-244 that combination businesses keep separate "inventories" and that they not be commingled in "operation" have been deleted. The seller is only required to maintain separate accounting and sales receipts for taxable and exempt sales so that sales of exempt foods can be verified.

4. Sales of food products such as candy, baked goods, nuts, and the like, in bulk quantities (generally any amount over 1 lb. or amounts sold in more than individual servings), from shops or counters located at malls or other shopping centers are not subject to sales tax even though there are seating or rest areas available in the general mall area at which such food may be consumed. Individual servings of such food products, sold for consumption on the premises of the mall or shopping center, are taxable. Also, if there are provided tables, chairs, or other facilities in the shop or at the counter where food consumption is invited and permitted, then

these sellers are treated as combination businesses as explained in item number 3 above and in WAC 458-20-244. (Emphasis supplied.)

The taxpayer analyzed the above authority and concluded that only its noncarbonated beverages are subject to the sales tax as they are sold in cups. Under Rule 244, vendors who furnish cups must charge sales tax even if the food is sold "to go." The taxpayer contends that its sales of bakery items, however, should not be subject to the sales tax.

We agree with the taxpayer that its sales of beverages are subject to the retail sales tax. We agree that the taxpayer's mail order sales of food products and its sales of food products at retail outlets located on street fronts are not subject to the retail sales tax. A closer question is whether the taxpayer's sales of bakery items at the retail outlets in shopping malls are subject to the sales tax.

[5] In considering this issue previously, the Department has determined that the benches and other seating areas in shopping malls provide facilities for the immediate consumption of food. Because the Department recognized that such food sellers in malls often sold food for home consumption, ETB 528 allowed an exemption for "bulk sales."

The taxpayer contends the Department's position is stretching the language in the exemption provisions. First, it does not agree that the seating areas in malls are provided for the immediate consumption of food. It contends its sales of food items are exempt because they are not "furnished, prepared, or served for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware whether provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve products to others, . . ."

Second, the taxpayer contends the Department's "individual serving" test is arbitrary and also not included in the exemption provisions. ETB 528 states bulk quantities are generally amounts over one pound or amounts sold in more than individual servings. The taxpayer argues that neither a "pound test" or a "number-of-cookies-sold" test necessarily would indicate whether items were sold as individual servings for consumption on the premises. For example, one person might buy several cookies to be divided and immediately consumed by him or herself and others, as for example one purchasing for a family with several children. Another person might buy the same amount of items for home consumption. Neither a pound test or a cookies test would indicate which sale should be taxable.

Also, if the taxpayer's sales of "individual servings" of food items in mall areas are taxable, sales of "individual servings" of

food items by grocery stores, drug stores or other retail establishments located in mall areas should also be subject to the sales tax. If such a store sells a single piece of fruit, for example, the Department has not required the store to charge sales tax.

In conclusion, we agree with the taxpayer that its sales of food items are exempt from the retail sales tax. We base our decision on the taxpayer's assertion that it does not provide tables, chairs, or counters for the consumption of food. Nor does it locate near food courts and provide trays or tableware to facilitate the immediate consumption of food items. Instead, the bakery items are either sold enclosed in metal tins, sealed in large paper bags, or wrapped in small paper bags with instructions for reheating at home. We do not find such sales of food items are sold in such a way to invite immediate consumption.

[6] We do not agree, however, that its food sales are not subject to the B&O tax. Washington's business and occupation tax is levied on every person for the act or privilege of engaging in business activities in this state. RCW 82.04.220. The tax applies to the income from all business activities unless the activity falls within a specific statutory exemption. As Rule 244 states, "(t)here is no food products exemption for business and occupation tax." Accordingly, the gross proceeds from all sales made by the retailing outlets in Washington are subject to the retailing business and occupation tax.

[7] Mail order sales to persons in this state are also subject to the retailing business and occupation tax if the seller has engaged in any activities in this state which are significantly associated with its ability to establish or maintain a market in this state for the sales. WAC 458-20-193B (Rule 193B).

In Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), the court overruled prior decisions which held that a tax on the privilege of engaging in an activity in the state may not be applied to an activity that is part of interstate commerce. The court noted that such a rule has no relationship to economic realities. "It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business." 430 U.S. at 279 quoting Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938).

To be valid, the state tax on interstate commerce must meet four requirements: (1) there must be a sufficient nexus between the interstate activities and the taxing state; (2) the tax must be fairly apportioned; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to the services provided by the state. Complete Auto Transit at 279. Accordingly, if the tax at issue meets those requirements, it is

not invalid even if the shipments are considered a part of interstate commerce.

Rule 193B is the administrative rule which defines the Constitutional limits upon this state's ability to impose its excise tax upon sales of goods originating in other states to persons in Washington. The crucial factor in establishing the requisite minimal connection or "nexus" is whether the taxpayer's in-state services enable it to make the sales:

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. . . . 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 fact that a tax is contingent upon events that take place outside a state does not destroy the nexus between the tax and the transactions within the state being taxed. Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444-45 (1940).

Rule 193B lists the following as examples of activities of sufficient local nexus for application of the business and occupation tax.

1. The seller's branch office, local outlet or other place of business in this state is utilized in any way, such as in receiving the order, franchise or credit investigation, or distribution of the goods.
2. The order for the goods is given in this state to an agent or other representative connected with the seller's branch office, local outlet, or other place of business.
3. The order for the goods is solicited in this state by an agent or other representative of the seller.
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."

As the taxpayer states some orders are given in this state to its retail outlets, that activity is of sufficient local nexus for application of the business and occupation tax to those sales. Also, if the orders are filled or shipped by a Washington outlet, those activities would be of sufficient local nexus for application of the business and occupation tax.<sup>1</sup>

[8] In cases where a customer completes the mail order request and mails it directly to corporate headquarters, the sales will not be subject to the business and occupation tax, if the mail order store filling the order is also located out of state and the taxpayer can show that its local activities did not establish the market for the sale. Such sales would be "dissociated" from the taxable sales under the principles announced in Norton Co. v. Department of Revenue, 340 U.S. 534 (1951).

Norton Company could not establish that the services rendered by its Illinois office were not decisive in establishing and holding a market for the goods sold to Illinois customers. The court discussed the advantages of approaching a market through a local outlet to process orders, noting that without a local outlet, customers may view the seller as "remote and inaccessible." In such a case, customers cannot reach the seller with process of local courts for breach of contract, or for service if the goods are defective or in need of replacement. Norton at 539. The court upheld the Illinois Retailers' Occupation tax on the sales to the Illinois customers except on orders sent directly by the customer to Norton Company's head office and shipped directly to the customer.

[9] Litter tax--RCW 70.93.120 levies an annual litter tax upon manufacturers, wholesalers, and retailers of certain products. Food products, carbonated beverages and containers are included in the categories subject to the litter tax. WAC 458-20-243.

All of the sales made by the taxpayer at its retail outlets, therefore, are subject to the litter tax. Only those retailers which are able to, and do, control and limit consumption of food and beverages by their customers to indoors and on their own premises are exempt from the litter tax. ETB 445.04.243.

The taxpayer's mail order sales to Washington customers will be subject to the litter tax under the principles set out for the business and occupation tax in Rule 193B discussed above. All

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<sup>1</sup>The retailing tax would apply on sales to Washington customers and the manufacturing tax would apply if Washington outlets baked the cookies for sale to out-of-state customers.

sales to which the business and occupation tax applies also will be subject to the litter tax.

#### DECISION

In summary, the taxpayer's sales are subject to the following Washington taxes:

<u>Retail Outlet Sales</u>	<u>Retail Sales Tax</u>	<u>Retailing B&amp;O</u>	<u>Litter</u>
Beverages	Yes	Yes	Yes
Bakery Items	No	Yes	Yes
Novelty Items (containers)	Yes	Yes	Yes
<u>Mail Order Sales of Food</u>			
In-state activity establishes market	No	Yes	Yes
No in-state activity	No	No	No

DATED this 30th day of January 1987.