Cite as Det No. 08-0158ER, 29 WTD 10 (2010)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of . . .	)	FINAL EXEC LEVEL DETERMINATION No. 08-0158ER Registration No. . . . Document No. . . . Docket No. . . .

Rule 193: B&O TAX – SUBSTANTIAL NEXUS – AFFILIATED CORPORATION AS TAXPAYER'S REPRESENTATIVE. In order for the activities of an in-state affiliate to establish nexus for an out-of-state mail order company, the in-state affiliate must act on the out-of-state company's behalf as an agent or representative, and the activity must be significantly associated with the out-of-state company's ability to establish or maintain a market in Washington for its sales. Here, an out-of-state mail order retailer was found to have substantial nexus with Washington where an in-state affiliate distributed the out-of-state company's brochures and made representations about the out-of-state company's quality to its customers.

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.

DIRECTOR'S DESIGNEE: Ronald J. Rosenbloom, Policy and Operations Manager

Chartoff, A.L.J. – An out-of-state limited liability company engaged in selling prescriptions by mail order to [an affiliate's] health and pharmacy benefit plan subscribers, requests executive reconsideration of Det. No. 08-0158, which sustained an assessment of retailing B&O tax on mail order pharmacy sales delivered to subscribers in this state. In dispute is whether the actions of the taxpayer's affiliate in this state establish nexus for the taxpayer. We conclude the taxpayer's affiliate performs activities on behalf of the taxpayer that are significantly associated

with the taxpayer's ability to establish and maintain a market in this state for the sales, and therefore, establish nexus for the taxpayer in this state. We sustain the assessment.[1]

ISSUE

Under WAC 458-20-193, does an out-of-state mail order pharmacy have substantial nexus to Washington where an in-state insurance company promotes the use of the mail-order pharmacy in its health plan promotional materials?

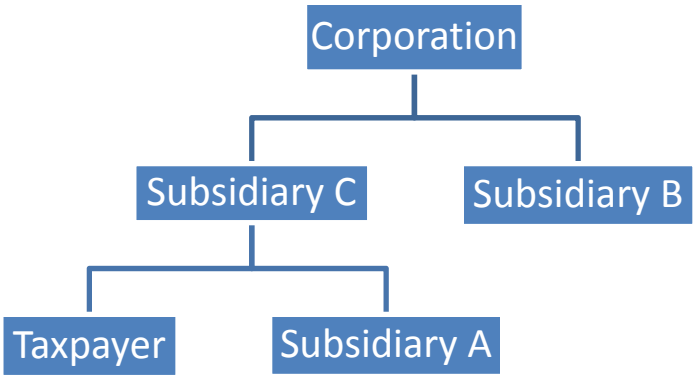
FINDINGS OF FACT

[Corporation] is a publicly traded corporation headquartered [outside of Washington], offering . . . health insurance products and related services, including medical [and] pharmacy . . . plans.

[Corporation] offers these products and services nationwide through its many subsidiaries. [Corporation] and many of its subsidiaries are licensed to do business in this state with the Washington Department of Licensing (DOL). [Several of the] subsidiaries are registered with the Washington State Office of the Insurance Commissioner (OIC) to sell insurance in this state. [Subsidiary A] is a wholly owned subsidiary of [Corporation] that sells health insurance plans in this state. [Subsidiary A] has resident agents and employees who solicit sales in Washington State. . . .

The taxpayer in this case is [an out of state] limited liability company, and a wholly owned subsidiary of [Corporation]. [The taxpayer] is a pharmacy with offices [outside of Washington] that sells pharmacy items by mail order, phone, or internet to subscribers of [Corporation's] health and pharmacy benefit plans. [The taxpayer] ships orders to customers in Washington by common carrier. [The taxpayer] is licensed by DOL to do business in this state, and has a nonresident pharmacy license from the Washington State Department of Health (DOH).

The following diagram illustrates the ownership structure of the . . . companies discussed herein. The subsidiaries of [Corporation] in the diagram are all wholly owned subsidiary corporations or companies.



[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410. Nonprecedential portions of this determination have been deleted.

As illustrated in the diagram, [the taxpayer and Subsidiary A] are brother-sister companies. As of [early 2008, the taxpayer and Subsidiary A] each had [several] officers in common with the other. The taxpayer represents that [the taxpayer and Subsidiary A] do not share employees. [The Corporation's name] is the brand name used for products and services provided by one or more of the [Corporation's] group of subsidiary companies.

The taxpayer provides services pursuant to an agreement . . . between [the taxpayer] and [Subsidiary B], "on behalf of itself and its Affiliates." [Subsidiary B] is a wholly owned subsidiary of [Corporation], licensed to do business in Washington by DOL, and authorized to sell insurance in Washington by the Office of Insurance Commissioner (OIC). "Affiliate" is defined in the agreement as "any corporation, partnership or other legal entity (including any plan) directly or indirectly owned or controlled by, or which owns or controls, or which is under common ownership or control with [Subsidiary B]." Therefore this one agreement binds [the taxpayer] to every . . . subsidiary and affiliate [of Corporation], including [Subsidiary A].

The agreement states that [the taxpayer] will provide pharmacy services to [Subsidiary A] health and/or pharmacy benefit plan members, and describes compensation terms, data access and sharing, and service standards. With respect to the relationship of the parties, the agreement states: "The relationship between [Subsidiary B] and [the taxpayer] and their respective employees and agents is that of independent contractors, and none shall be considered an agent or representative of the other for any purpose, nor shall any party or its agents or employees hold themselves out to be an agent or representative of any other party for any purpose." . . .

With respect to advertising, the agreement states: "Pharmacy consents to the use of Pharmacy's name and other identifying and descriptive material in provider directories and in other materials and marketing literature of Company." . . . The Agreement further states: "Company will include Pharmacy in the applicable Provider Directory(s) and will make the directory available to Members." . . . The agreement contains no further obligation for [Subsidiary B] or its affiliates to market [the taxpayer].

[Corporation, which] purchased [the taxpayer] . . . explains . . . that it purchased the facility [to manage drug expenditures for clients, grow its pharmacy business, and more effectively integrate health care and pharmacy benefits].

[At that time, a briefing for Corporation brokers] describes the reasons for acquiring the pharmacy and explains that all members will be required to switch to [the taxpayer]. [The reasons include process management and integrating member information. The briefing goes on to give effective dates for members to switch to the taxpayer, and notes that the taxpayer's mail-order brochures are available.]

While [Corporation's health and pharmacy benefit plan subscribers] are free to use any participating retail pharmacy, mail order benefits are generally only available through [the taxpayer]. . . . [The taxpayer] provides services only to [Corporation's health and pharmacy benefit plan subscribers]. . . .

[Subsidiary A] has employees and representatives in Washington who solicit sales of [Corporation's] health plans. As part of their solicitation activities, they distribute brochures regarding the health plans which contain descriptive material regarding [the taxpayer], and which refer members to [Corporation's website] where there is additional descriptive material regarding [the taxpayer]. During the audit period, [that website] had a link to [the taxpayer's] website. Currently, it appears that members can order drugs from within the [Corporation] member secure website. The [Corporation] website . . . currently [describes the taxpayer as saving subscriber time and money by ordering through them; and offering convenience, ease of use, quality of service and cost savings. It also offers a view of a sample 90-day prescription.]

The taxpayer represents that the relationship of [Corporation] and its affiliates to [the taxpayer] is no different from [Corporation's] relationship to [many other] participating providers in the [Corporation] network. The taxpayer states that [Subsidiary A] provides information to subscribers on all participating pharmacies. The taxpayer provided copies of . . . documents [that] merely list the names of participating pharmacies but do not provide additional descriptive material. We also note that [the taxpayer] is not included in the list of participating pharmacies. The [Corporation] website lists participating pharmacies but does not provide web links or make representations about the quality of services they provide. [Corporation's] webpage further explains [that Corporation offers a network of pharmacies, but that subscribers may be able to maximize pharmacy benefits by getting medications through the taxpayer; and that they may choose retail pharmacies which typically only provide 30-day supplies of prescription medications.]

In Det. No. 08-0158, we noted that certain plan documents contained the following disclosure: "With the exception of [the taxpayer], all participating . . . health care providers are independent contractors and are neither agents nor employees of [Corporation]."[2] Based on this evidence, we find that the relationship of [Corporation] and its affiliates to [the taxpayer] is different from [Corporation's] relationship to other participating providers in the [Corporation's] network. [The taxpayer] is the only service provider promoted by [Corporation] and referred to as [Corporation's] service provider.

The taxpayer states it "does not pay a direct fee to [Subsidiary A] to compensate [Subsidiary A] for market making activities performed within the state of Washington." . . . The taxpayer represents that [Subsidiary A] benefits when subscribers purchase drugs from [the taxpayer] versus independent pharmacies due to negotiated price discounts and other cost efficiencies.

In 2006, Compliance investigated whether the taxpayer had nexus to Washington, and concluded that nexus in Washington was established for [the taxpayer] through the use of [Subsidiary A] representatives calling on Washington customers. On June 5, 2007, Compliance issued an

[2] The taxpayer represents that this statement is to provide notice to third parties that [the taxpayer] and [Subsidiary A] are both owned by [Corporation]; that [the taxpayer] and [Subsidiary A] are related parties; and that health care providers are independent contractors who are solely responsible for health care services provided to [Corporation] members. The taxpayer represents the statement "was not intended to create or document a principal-agent relationship between [Subsidiary A] and [the taxpayer]."

assessment for $. . ., consisting of $. . . retailing B&O tax, $. . . interest, $. . . delinquent return penalty, $. . . unregistered business penalty, and $. . . assessment penalty.

On July 2, 2007, the taxpayer appealed asserting it has no nexus to Washington. The taxpayer argued that [Subsidiary A's] activities cannot be attributed to [the taxpayer] because there is no agency relationship between the two companies. The taxpayer further argued that [Subsidiary A] does not perform any activity on behalf of [the taxpayer] that helps [the taxpayer] establish or maintain a market in this state.

On June 24, 2008, we issued Det. No. 08-0158 denying the taxpayer's petition for correction of assessment. Det. No. 08-0158 concluded that [Subsidiary A's] marketing of the taxpayer to subscribers in this state is significantly associated with the taxpayer's ability to establish and maintain a market in this state and therefore confers nexus. We were not persuaded by the taxpayer's claim that [Subsidiary A] markets the taxpayer in this state solely on its own behalf, and not pursuant to some agency or representative relationship or agreement with the taxpayer.

On September 8, 2008, the taxpayer requested executive reconsideration of Det. No. 08-0158, which was granted. . . . On reconsideration, the taxpayer reasserts its original arguments. The taxpayer also argues that [Subsidiary A] is not paid a direct fee for marketing [Taxpayer] and is not under [Taxpayer's] control. The taxpayer argues that [Subsidiary A] is not a pharmacy and is not in the business of selling prescription drugs. The taxpayer also raises *Barnesandnoble.com LLC v. State Board of Equalization*, California Super. Ct., No., CGC-06-456456, (October 11, 2007), which held that an in-state affiliate was not the online store's agent because the store was not authorized to bind or control the online store in any way.

ANALYSIS

Washington imposes the B&O tax on every person for the act or privilege of engaging in business activities in Washington. RCW 82.04.220. The tax is measured by applying particular rates against the value of products, gross proceeds of sales, or gross income of the business as the case may be. RCW 82.04.220. The gross proceeds from the sale of prescription drugs to consumers in this state are taxable under the retailing classification of the B&O tax. WAC 458-20-18801(2); WAC 458-20-103. However, the sale of prescription drugs is exempt from retail sales tax. RCW 82.08.0281.

WAC 458-20-193 (Rule 193) explains Washington's B&O tax application to interstate sales of tangible personal property. It states, in relevant part:

> (7) **Inbound sales.** Washington does not assert B&O tax on sales of goods which originate outside this state unless the goods are received by the purchaser in this state and the seller has nexus. There must be both the receipt of the goods in Washington by the purchaser and the seller must have nexus for the B&O tax to apply to a particular sale. The B&O tax will not apply if one of these elements is missing.

(c) If a seller carries on significant activity in this state and conducts no other business in the 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. Once nexus has been established, it will continue throughout the statutory period of RCW 82.32.050 (up to five years), notwithstanding that the instate activity which created the nexus ceased. Persons taxable under the service B&O tax classification should refer to WAC 458-20-194. The following activities are examples of sufficient nexus in Washington for the B&O tax to apply:

(i) The goods are located in Washington at the time of sale and the goods are received by the customer or its agent in this state.

(ii) The seller has a branch office, local outlet or other place of business in this state which is utilized in any way, such as in receiving the order, franchise or credit investigation, or distribution of the goods.

(iii) The order for the goods is solicited in this state by an agent or other representative of the seller.

(iv) The delivery of the goods is made by a local outlet or from a local stock of goods of the seller in this state.

(v) The 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, even though the seller may not have formal sales offices in Washington or the agent or representative may not be formally characterized as a "salesperson".

(vi) The out-of-state seller, either directly or by an agent or other representative in this state, installs its products in this state as a condition of the sale.

. . . With respect to the duty to collect retail sales tax or use tax, "substantial nexus" includes a requirement of some physical presence (more than the "slightest presence") in the state. *Quill Corp., supra.* In Det. No. 96-144, *supra,* we concluded that, once the activities of a company go beyond purely mail order activities, and it has demonstrably more than the slightest presence in the state, substantial nexus is established.

Nexus may be established through the activities of the seller's employees or independent contractor representatives. Rule 193(7); *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960); *Tyler Pipe Industries, Inc., supra.*[3]

[3] In *Scripto,* a Georgia corporation's only connection with Florida was that it had ten wholesalers, jobbers, or "salesmen" conducting continuous local solicitation in Florida and forwarding the orders from Florida to the Georgia seller for shipment. The court held that Florida could constitutionally impose upon the Georgia seller the duty of collecting Florida's use tax upon goods shipped to customers in Florida. In *Tyler Pipe,* the court held that Washington had sufficient nexus with an out-of-state seller whose only connection with Washington was the use of

It is not necessary for the employee or independent contractor to be engaged in the direct solicitation of orders for nexus purposes. Any activity performed in this state on behalf of the seller that is significantly associated with the seller's ability to establish and maintain a market in this state for the sales establishes nexus over the seller. Rule 193(7); *Standard Pressed Steel Co. v. Department of Rev.*, 419 U.S. 560 (1975); *National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551 (1977).

The applicable example of sufficient nexus listed under Rule 193(7)(c) in this case is example (v) -- "The 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, even though the seller may not have formal sales offices in Washington or the agent or representative may not be formally characterized as a 'salesperson.'" Services in the state in relation to sales that fit that description will also meet the demonstrably more than the slightest presence requirement of *Quill*.

In the present case, [the taxpayer] does not have a sales office in Washington State. . . . The taxpayer takes orders from Washington customers by phone, internet, or mail order, and delivers the orders solely by common carrier. The taxpayer has no employees or stock of goods in this state.

The issue presented in this appeal is whether the activities performed in this state by [Subsidiary A] are sufficient to establish nexus to tax [the taxpayer]. The mere existence of an affiliate doing business in this state is insufficient to establish nexus for an out-of-state affiliate. *See, e.g., SFA Folio Collections, Inc. v. Tracy*, 73 Ohio St.3d 119, 652 N.E.2d 693 (1995) (Saks Fifth Avenue's retail store does not establish tax nexus for Saks Fifth Avenue's out-of-state mail-order subsidiary); *Bloomingdale's by Mail, Ltd. v. Commonwealth Dep't of Revenue*, 130 Commw.190, 567 A2d 773 (1989), *aff'd per curiam*, 527 Pa. 347, 591 A 2d 1047 (1991), *cert. denied*, 504 US 955, 112 S. Ct. 2299 (1992). In order for the activities of [Subsidiary A] to establish nexus for [the taxpayer], [Subsidiary A] must act on [the taxpayer's] behalf as an agent or representative, and the activity must be significantly associated with [the taxpayer's] ability to establish or maintain a market in Washington for its sales.

The facts clearly establish that representatives of [Subsidiary A] perform activities significantly associated with [the taxpayer's] ability to maintain a market in Washington for its sales. [Subsidiary A] has employees and representatives soliciting sales of insurance in this state. These agents and representatives distribute brochures to customers containing information about the benefits of ordering from [the taxpayer]. The brochures also direct subscribers to [Corporation's website], which contains additional descriptive information about [the taxpayer] and a link to [the taxpayer's] website… Currently … subscribers can order drugs from within [Corporation's] secure site. The distribution of this information and making representations about its quality is a significant service in relation to the establishment and maintenance of sales into this state.

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independent contractors in the state who acted daily on its behalf to solicit sales, call on customers, and maintain and improve the seller's goodwill, customer relations, and name recognition.

[The taxpayer] argues that [Subsidiary A's] activities in this state are in relation to establishing and maintaining a market for [Corporation's] health plans, and that [Subsidiary A] is not performing services on behalf of [the taxpayer] at [the taxpayer's] direction and control. [The taxpayer] argues it is one of [many] independent participating providers in [Corporation's] network. [The taxpayer] further argues that the written agreement between [the taxpayer] and its affiliates does not authorize nor require the affiliates to act on behalf of [the taxpayer], other than to list [the taxpayer] in the provider directory distributed to subscribers.

The creation of an agency or representative relationship is not dependent solely on the existence of a written agreement, and can be implied based on conduct, circumstances, or ratification. *Scholastic Book Clubs, Inc., v. State Bd. of Equalization*, 207 Cal.App.3d 734 (1989); *Borders Online, LLC v. State Bd. of Equalization*, 129 Cal.App.4th 1179 (2005). For example, in *Scholastic Book Clubs*, the appellant was an out-of-state mail order book-seller with no physical presence in California. The taxpayer maintained a market in California by mailing catalogs to teachers, who distributed offer sheets to students, and then forwarded orders to the appellant. The court held that "[b]y accepting the orders, the payment and shipping the merchandise, appellant clearly and unequivocally ratified the acts of the teachers and confirmed their authority as appellant's agents or representatives." *Scholastic Book Clubs*, at 738; *But see, Scholastic Book Clubs, Inc. v. State Dep't of Treasury, Revenue Div.*, 223 Mich. App. 576, 567 N.W.2d 692 (1997) (Held teachers were not company's agents where they were not company's employees, had no authority to bind company, and were not controlled by the company).

More recently, in *Borders Online, LLC v. State Bd. of Equalization*, the California Court of Appeals held that Borders retail stores in California (Borders) were engaged in selling property as authorized representatives of Borders Online (Online), an out-of-state internet retailer, and therefore established nexus for Online. While there was no written agreement between Borders and Online evidencing an agency or representative relationship, the court found that such agreement was implied, reasoning, in part: "Online announced on its website that Borders was authorized to accept Online's merchandise for return, or that Borders would provide customers with an exchange, store credit, or a credit card credit. By accepting Online's merchandise for return, Borders acted on behalf of Online as its agent or representative in California." *Id*. at 1190. Additional factors evidencing an agent or representative relationship were that "Borders encouraged its store employees to refer customers to Online's website; and … receipts at Borders stores sometimes invited patrons to 'Visit us online at www.Borders.com.'" *Id*. at 1189. *But see, St. Tammany Parish Tax Collector v. Barnesandnoble.com*, 481 F. Supp.2d 575 (2007) (Held internet bookseller, which was affiliated with in-state retailer, did not have substantial nexus with state for sales and use tax, despite existence of close corporate relationship, common corporate name, participation in joint gift card program with several retailers, including bookseller, and bookseller's preferential policy of accepting returns from taxpayer's customers.)

In the present case, the contract between [the taxpayer] and [Subsidiary A], and affiliates, evidences only that [the taxpayer] will provide mail order drug services to [Subsidiary A] subscribers as an independent contractor, and that [Subisidary A] will list [the taxpayer] in its directory of preferred providers. However, other evidence, including the practice of the parties, suggests that [Subsidiary A] is authorized to represent the taxpayer in this state. Unlike with

other participating providers who are merely listed in the provider directory, [the taxpayer] is referred to in [Corporation's] advertising as "[Corporation's] mail order prescription drug service" and [Corporation] makes representations regarding the quality of service and benefits of ordering from [the taxpayer]. The . . . [Corporation's] affiliates instructed most members that [the taxpayer] would be the sole mail order provider, and distributed [the taxpayer] brochures to members. Because [Subsidiary A] holds itself out as a representative of [the taxpayer], we conclude [Subsidiary A] markets [the taxpayer] as an authorized representative of [the taxpayer] in this state.

On reconsideration, the taxpayer argues that [Subsidiary A] is not paid a direct fee for marketing [the taxpayer]. While a direct fee for marketing [the taxpayer] would be clearer evidence of an agency or representative relationship, we cannot conclude that the absence of a direct fee precludes such a relationship. In *Borders Online*, the court concluded Borders acted as Online's agent despite there being no direct fee or commission for services provided to Online.

On reconsideration, the taxpayer cites *Barnesandnoble.com LLC v. State Board of Equalization*, California Super. Ct., No., CGC-06-456456, (October 11, 2007), which held that an in-state retail store was not the online store's agent because the retail store was not authorized to bind or control the online store in any way. We note that this Superior Court decision conflicts with *Borders Online*, the California Court of Appeals Decision, which did not require the in-state store to be able to bind or control the out-of-state affiliate. The fact that Borders retail store adopted the Borders online return policy was sufficient to show Borders acted as Online's representative.

Finally, on reconsideration, the taxpayer contends that the *Borders Online* case in not applicable because it involved two booksellers, while the present appeal involves a health insurer and a mail order pharmacy. We disagree. While there are factual differences, the agency and nexus principles discussed in the case are applicable to the present case.

We conclude that [Subsidiary A's] marketing of the taxpayer to subscribers in this state is significantly associated with the taxpayer's ability to establish and maintain a market in this state and therefore confers nexus. We are not convinced by the taxpayer's argument that [Subsidiary A] markets the taxpayer in this state solely on its own behalf, and not pursuant to some agency or representative relationship or agreement with the taxpayer. Accordingly, we sustain the assessment and deny the petition for reconsideration.

DECISION AND DISPOSITION

Taxpayer's petition for reconsideration is denied.

Dated this 25th day of September 2009.