Cite as 4 WTD 229 (1987)

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

In the Matter of the Petition For Correction of Assessment	)	D E T E R M I N A T I O N
	)	No. 87-342
. . .	)	Registration No. . . .

[1] **RCW 82.04.4286:** B&O TAX -- FEDERAL INTERSTATE INCOME TAX ACT -- APPLICABILITY. The federal interstate income tax act (15 U.S.C. § 381 et seq.) does not apply to the business and occupation tax.

[2] **RCW 82.04.440:** B&O TAX -- MULTIPLE ACTIVITIES EXEMPTION -- TYLER PIPE.
The multiple activities exemption, RCW 82.04.440, which the Court declared unconstitutional in Tyler Pipe Industries, Inc. v. Department of Revenue, is not at issue when an out-of-state seller's only business activity is making wholesale sales.

[3] **RULE 193B:** RCW 82.04.4286 -- B&O AND RETAIL SALES TAX -- INTERSTATE COMMERCE -- NEXUS -- FACTORS DETERMINING. Sales to persons in this state are taxable when property is shipped from points outside this state to the buyer in this state and the seller has performed activities in this state which are significantly associated with its ability to establish and maintain a market in this state for the sales.

[4] **RULE 193B:** RCW 82.04.4286 -- B&O AND RETAIL SALES TAX -- INTERSTATE COMMERCE -- NEXUS -- WHOLESALE SALES. Out-of-state taxpayer which made wholesale sales to its parent company in Washington found to have nexus with this state where it employed two sales representatives in Washington who called on parent corporation's Washington customers to promote interest in and the sales of the taxpayer's products. Promotional activities which directly affect retail sales of a product are related to wholesale sales

and such activities can provide nexus for taxing the wholesale sales. (General Motors Corp. v. State cited).

[5] **RULE 203:** RCW 82.04.270 -- B&O TAX -- WHOLESALE SALES -- AFFILIATED COMPANIES -- SEPARATE "PERSONS." The sale of property by a subsidiary to its parent corporation constitutes a sale within the meaning of the Revenue Act, as each separately organized corporation is a separate taxable "person."

[6] **RULE 193B:** NEXUS -- AFFILIATED CORPORATIONS. Sales made by out-of-state wholesaler to its parent company in Washington not subject to this state's taxes after its sales representatives became employees of the parent company and the out-of-state wholesaler itself performed no activities in this state significantly associated with its ability to maintain a market for the sale of its products.

[7] **RULE 103:** B&O TAX -- WHOLESALE SALES -- OUT-OF-STATE SELLER -- DELIVERY TO BUYER OUTSIDE WASHINGTON. If an out-of-state seller delivers its products to a Washington buyer and delivery takes place outside this state, no B&O tax applies to the sales. The seller's records must document the out-of-state delivery.

[8] **RCW 82.32.100:** FOUR YEAR NON-CLAIM PERIOD -- EXCEPTION -- UNREGISTERED TAXPAYER. An assessment of taxes for a period more than four years after the close of the tax year upheld where an out-of-state seller did not register as required by the Revenue Act, even though the Department had previously advised the seller that it did not need to register. Assessment upheld because Department's earlier advice was based on the taxpayer's incorrect answer on the Business Activities Statement about its activities in Washington.

[9] **RULE 228:** RCW 82.32.105 -- INTEREST AND LATE PAYMENT PENALTIES -- WAIVER -- INCORRECT WRITTEN INSTRUCTIONS FROM DEPARTMENT -- EVASION PENALTY DISTINGUISHED. The Department will consider a waiver of interest and late payment penalties on a tax assessment in situations where it has advised a taxpayer it need not register if the written instructions were based on correct information about the taxpayer's activities in this state. Interest and late payment penalties not waived where an out-of-state wholesaler which made sales to its parent corporation in Washington had not disclosed that it employed two sales representatives in this state when it submitted a Business Activities Statement. No intent to evade taxes was found because of the taxpayer's good

faith belief that the sales representatives were not promoting sales on its behalf but only on behalf of the parent company.

[10] **RCW 82.04.270:** B&O TAX -- WHOLESALE SALES -- MEASURE OF. The Wholesaling B&O tax is measured by the gross proceeds of the taxable sales. Estimated tax assessments will be adjusted if a taxpayer provides actual figures for the taxable sales.

TAXPAYER REPRESENTED BY: . . .
. . .
. . .

DATE OF HEARING: January 27, 1987

NATURE OF ACTION

The taxpayer, an out-of-state corporation, protests the assessments of Wholesaling B&O tax on its sales to its parent company's two distribution centers located in Washington.

FACTS AND ISSUES:

Frankel, A.L.J. -- The taxpayer is an out-of-state corporation which buys and repackages . . . and makes wholesale sales to its stockholders. Ninety percent of its stock is owned by its parent company, ... The remaining ten percent is owned by two out-of-state companies.

In June of 1986, the Department sent the taxpayer two estimated tax assessments, contending it had sufficient nexus with the state and owed Wholesaling B&O tax on its income from sales made to its parent company's two . . . distribution centers located in Washington. One assessment was for the period January 1, 1978 to December 31, 1981 for estimated taxes of $ . . . in interest and $ . . . in penalties. The other assessment was for the period 1982 through 1986 for estimated taxes of $ . . . , interest of $ . . ., and $ . . . in penalties.

Prior to issuance of the assessments, the taxpayer and the Department had exchanged numerous letters and had several phone calls regarding the taxpayer's business activities in this state. . . . . On the basis of the answers to that statement, the Department first determined that the taxpayer did not have sufficient nexus with the state and did not need to register.

In September of 1984, the Department sent the taxpayer another inquiry, asking the taxpayer to complete another Business Activities Statement. The taxpayer answered the statement the same way that it had answered the one in 1981. A letter accompanying that statement added the following information:

> Your department is aware of [taxpayer] most likely because of state withholding taxes paid on account of 2 [taxpayer corporation] sales representatives who live in the State of Washington. These two individuals call on one customer in the state of Washington - [parent company]. Our company owns . . . distribution centers in . . . , Washington and . . . , Washington. [Parent company] is a distributor of . . . and merchandise purchased from [taxpayer] is distributed by us to our customers in the state. We, [parent company], pay the tax to your state for the [taxpayer] products we sell and distribute.
>
> The [taxpayer's] sales representatives have no office or other place of doing business in the state. (Letter of October 3, 1984, from corporate counsel).

The Department then asked the taxpayer to describe the activities of the sales representatives who lived in Washington in greater detail. The taxpayer provided more background information and described the jobs of the two sales representatives as "serving" [parent company] rather than "calling on" the parent company as it had previously stated. The letter explained the difference as follows:

> The proper word is "serve" because [parent company] is the only [taxpayer] customer in the state. However, these representatives call not only on [parent company] but on the independent . . . jobbers referred to above. These sales representatives endeavor to promote interest in and the sale of the "[taxpayer]" line of products. These sales representatives try to sell the independent jobbers on increasing their stocks of [taxpayer] products and, on occasion, would help those jobber's customers, parts dealers, promote the sale of [taxpayer] products. (Letter of January 30, 1985).

The taxpayer also noted the sales representatives spent a great deal of time traveling outside the state of Washington, as their territory also included Montana, Oregon, Idaho and Alaska.

The Department concluded that the sales activities performed in this state by the taxpayer's two sales representatives were well within the nexus guidelines established by WAC 458-20-193B, a copy of which was provided to the taxpayer. The taxpayer was told that its Washington sales were, therefore, subject to the Wholesaling-Other classification of the B&O tax. (Letter of February 25, 1985).

The taxpayer again responded, contending that its activities in Washington were not "<u>significantly</u>" associated with its ability to

establish or maintain a market in Washington. It continued to believe that it did not have sufficient nexus with this state to be subject to taxation. (Letter of March 19, 1985). In that letter, the counsel for the parent company stated he had addressed similar issues in Montana and Pennsylvania and New Jersey. He stated the debates lasted several years and all three states had ceased making demands for their respective state's taxes. The attorney asked the Department to set forth which "significant" activities of the taxpayer's sales representatives supported the Department's position.

The Department's answer included the above quote from the taxpayer's January 30, 1985 letter describing the jobs of the two sales representatives located in Washington. The Department's response added:

> Your letter indicated that in addition to calling on the two [parent company] distribution centers in Washington, the [taxpayer's] salesmen also call on 131 independent . . . jobbers within this state. Further, and on occasion, they help jobbers' customers promote sales of [taxpayer] products.
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> [Taxpayer] must sell its products to exist. It is obviously clear that they have approached the Washington market through the presence and efforts of two resident sales representatives (employees). We can think of no prudent business reason why these two sales representatives would remain on [taxpayer]'s payroll if their efforts did not lead to the ultimate generation of sales and/or the handling of customer relations. Their activities as you have described them to us constitute vital contributing services toward establishing, maintaining and holding a share of the Washington market.
>
> It most certainly appears to us that the total overall scope of the two salesmen's business activities in this state are significantly associated with their ability to establish or maintain a market for their products in this state.
>
> In view of the above, it is our firm position that you are required to register and bring your account up to date. (Letter of April 9, 1985).

Following that response, the taxpayer and the Department exchanged additional correspondence and had more phone conversations in which the Department continued to assert that the taxpayer needed to register and the taxpayer contended that it did not.

In summary, the taxpayer protests the assessments for the following reasons:

1) The taxpayer did not perform any activities during the periods at issue that provided sufficient nexus for application of the B&O tax. It contends it had no employees or agents in this state soliciting sales on its behalf from Washington customers. Rather, the activities of the two sales representatives were directed toward soliciting sales for its parent company;

2) The taxpayer's sales to Washington customers are completed outside the state of Washington;

3) The B&O tax should be applied to the taxpayer and the parent company, . . . , on a combined basis, as the taxpayer is an integral part of the parent company's . . . distribution business. The parent company has paid Wholesaling B&O on all of the taxpayer's products that were sold in this state. The taxpayer relies in part on RCW 82.04.270 which states that the wholesaling tax is not to be assessed twice to the same person for the same article;

4) The Washington B&O tax unconstitutionally discriminates against interstate commerce. Armco, Inc. v. Hardesty, 467 U.S. 638 (1984);

5) The assessments are prohibited by Public Law 86-272, 15 U.S.C. § 381, et seq; and

6) The assessment for the years prior to 1982 are barred by RCW 82.32.100.

In the alternative, the taxpayer protests the measure of the tax and the assessment of interest and penalties. The taxpayer states its actual sales were much lower than the estimated figures used in making the assessments. It seeks a waiver of interest and penalties because it previously submitted all requested information to the Department and was advised in writing that it need not register.

DISCUSSION:

We will first address the taxpayer's arguments that the assessments are prohibited by Section 381 and/or Armco v. Hardesty. We will then discuss the taxpayer's primary argument that the assessments are unconstitutional because it did not have nexus with this state. We conclude that the assessments are not invalid for any of those reasons.

We will then address the alternative arguments that the assessment of taxes prior to 1982 is barred by RCW 82.32.100 and that interest and penalties should be waived. We conclude that the assessments

should not be reduced because of the Department's initial conclusion in 1981 that the taxpayer was not required to register with the state. We do agree with the taxpayer that the assessments should be reduced to reflect its actual sales and that the tax should be deleted on any sales in which delivery occurred out of state.

[1] The taxpayer contends the assessments are invalid because of PL 86-272, 15 U.S.C. Section 381 et seq. Section 381 is the federal statute which prohibits any state from imposing a net income tax on interstate business if the only business activity within the state is the solicitation of orders within the state. Section 381, however, does not apply in this case because the tax at issue is a gross receipts tax, not an income tax.[1] Tyler Pipe Industries, Inc. v. Department of Revenue 105 Wn.2d 318, 327 (1986).

[2] Furthermore, we do not find the assessments are prohibited by the holdings in Armco Inc. v. Hardesty, 467 U.S. 638 (1984) or Tyler Pipe Industries, Inc. v. Department of Revenue, 483 U.S. ___, 107 S.Ct. 2810, 97 L.Ed.2d 199 (1987). In Tyler Pipe, the Supreme Court found Washington's "multiple activities exemption" set forth in RCW 82.04.440 was unconstitutional. In Armco, the Court had invalidated West Virginia's similar manufacturing B&O tax.

The multiple activities exemption provided that a person engaged in making and selling a product would be subject to only one B&O tax. In the present case, the taxpayer does not manufacture the . . . it sells. Its only activity is making wholesale sales. The multiple activities exemption, therefore, is not applicable. Neither Armco nor Tyler Pipe support the taxpayer's position that it does not have nexus with this state.

[3] The taxpayer's primary argument is that the tax is invalid because Washington does not have adequate jurisdictional "nexus" over the sales at issue to impose a tax on the interstate activities. Both the Commerce Clause and the Due Process Clause require a sufficient nexus between the interstate activities and the taxing state. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 436-37 (1980). (Due process requires a "minimal connection" between the interstate activities and the taxing state and a "rational relationship" between the income attributed to the state and the intrastate values of the business.)

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[1] We note that one of the taxpayer's arguments was that its counsel had successfully addressed the nexus issue in Montana, Pennsylvania and New Jersey. (Letter of March 19, 1985 from counsel for [parent company]). Those states do not have gross receipts taxes.

WAC 458-20-193B (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 instate 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.

[4] We agree with the revenue officer's conclusion that the activities of the taxpayer's two resident sales representatives in Washington provided the minimal connection to uphold the tax in this case. Promotional activities which directly affect retail sales of a product are related to wholesale sales, and such activities can provide nexus for taxing the wholesale sales. General Motors Corp. v. State, 60 Wn.2d 862 (1962), aff'd, 377 U.S. 436 (1964), rev'd on other grounds, Tyler Pipe Industries, Inc. v. Department of Revenue, supra. See also, Standard Pressed Steel Co. v. Department of Revenue, 419 U.S. 560 (1975) (one lone employee who engaged in no direct sales activity created the necessary relationship).

The taxpayer stated its sales representatives "promote interest in and the sale of the '[taxpayer]' line of products." (Letter of January 30, 1985). By promoting retail sales of its products, the taxpayer was also promoting its wholesale sales as the retailers would purchase from the parent company which would then purchase from the taxpayer. As the Washington Supreme Court found, activities by sales representatives which maintain and improve a taxpayer's name recognition, market share, and goodwill, and instate activities which provide a taxpayer with information about the Washington market would be significantly associated with the taxpayer's ability to establish or maintain a market for its products. Tyler Pipe Industries, Inc. v. Department of Revenue, 105 Wn.2d at 325. The tax is not invalid because the taxpayer had no formal sales office or no representatives actually making the sales in Washington.

[5] The fact that all of the sales at issue were made by the taxpayer to its parent company does not preclude the assessment of the Wholesaling B&O tax. As WAC 458-20-203 provides:

> Each separately organized corporation is a "person" within the meaning of the law, notwithstanding its affiliation with or relation to any other corporation through stock ownership by a parent corporation by the same group of individuals.
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> Each corporation shall file a separate return and include therein the tax liability accruing to such corporation. This applies to each corporation in an affiliated group, as the law makes no provision for filing of consolidated returns by affiliated corporations or for the elimination of intercompany transactions from the measure of tax.

In Washington Sav-Mor Oil Co. v. State Tax Commission, 58 Wn.2d 518 (1961), the court found the sale of property by a wholly owned subsidiary to its parent corporation constituted a sale for purposes of the B&O tax. The court quoted the following portion of the annotation "Sale by wholly owned subsidiary to parent corporation, or vice versa, as within retail sales tax, or similar, statute," 64 A.L.R.2d 769 (1959).

> Since a wholly owned subsidiary is generally incorporated or acquired by the parent corporation for the purpose of advantageously carrying on some phase of the parent corporation's activities or business, the courts have been reluctant to disregard the separate legal entities of the parties merely to grant relief from sales, or similar, taxes at the expense of the state or its subdivision. Thus, the contention that because the wholly owned subsidiary and the parent corporation are so closely integrated, sales by one to the other do not constitute 'sales' within the meaning of a sales tax, or similar, statute has been rejected by a number of courts.
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> This result has been reached in a number of cases involving sales by a wholly owned subsidiary to the parent corporation, especially where the parties to the transaction have recognized their status as separate legal entities for a considerable time, enjoyed the economic advantages resulting therefrom, and in making the transactions observed the usual formalities of purchase and sale.

58 Wn.2d at 521.

Accordingly, even though the taxpayer and its parent company had an "integrated business," they were separately organized and each liable for B&O tax. The assessments on the taxpayer's sales were not paid by its parent company. The assessments do not violate RCW 82.04.270, as the wholesaling tax was not assessed on the same "person" twice.

[6] The taxpayer stated that since October 1, 1985 its former sales representatives have been employed by its parent company, ... Since that time it contends it has had no activity in this state which could be deemed to create nexus with this state. We agree. Once the sales representatives became employees of the parent company their activities did not provide nexus to tax the taxpayer's sales.

[7] Also, the taxpayer stated that since October of 1985, all of the parts destined for its parent company's two Washington distribution centers have been delivered to the parent company at the taxpayer's [out-of-state] distribution center. For the purpose of determining the tax liability of persons selling tangible personal property, a sale takes place when the goods sold are delivered to the buyer in this state. WAC 458-20-103. We agree, therefore, that the assessment of taxes on any sales in which the taxpayer provides evidence of out-of-state delivery should be deleted.

[8] RCW 82.32.100 provides that the Department may not make an assessment more than four years after the close of the tax year. An exception is provided, however, where a taxpayer has not registered as required by the Revenue Act. The taxpayer relies on this provision, contending the Department is barred from assessing taxes prior to 1982 because it was advised in 1981 that it was not required to register.

As discussed above, the Department relied on the taxpayer's answers to the Business Activities Statement when it initially concluded that the taxpayer was not required to register. We believe the taxpayer's negative response to the question "are sales solicited on your behalf from Washington customers?" was incorrect. Because we find the activities of the taxpayer's two sales representatives were on its behalf and established sufficient nexus to tax the Washington sales, the taxpayer was required to register and the non-claim period provided by RCW 82.32.100 is inapplicable.

[9] Interest and Penalties. -- The taxpayer also argues that the Department should waive all interest and penalties on the assessments because of the written instructions in 1981 that it was not required to register.

As an administrative agency, the Department has limited authority to waive penalties and interest. RCW 82.32.100 provides that when a taxpayer fails to make any return as required, the Department shall proceed to obtain facts and information on which to base its estimate of the tax. As soon as the Department procures the facts and information upon which to base the assessment, "it shall proceed to determine and assess against such person the tax and penalties due, . . . To the assessment the Department shall add, the penalties provided in RCW 82.32.090." (Emphasis added.)

RCW 82.32.090 provides that if any tax due is not received by the Department of Revenue by the due date, there shall be assessed a penalty. The penalty for returns which are not received within 60 days after the due date is 20 percent of the amount of the tax. RCW 82.32.050 provides that if a tax or penalty has been paid less than properly due, the Department shall assess the additional amount due and shall add interest at the rate of nine percent per annum from the last day of the year in which the deficiency is incurred until the date of payment.

The only authority to cancel penalties or interest is found in RCW 82.32.105. That statute allows the Department to waive or cancel interest or penalties if the failure of a taxpayer to pay any tax on the due date was the result of circumstances beyond the control of the taxpayer. That statute also requires the Department to prescribe rules for the waiver or cancellation of interest and penalties.

The administrative rule which implements the above law is found in the Washington Administrative Code 458-20-228 (Rule 228). Rule 228 lists the situations which are clearly stated as the only circumstances under which a cancellation of penalties and/or interest will be considered by the Department. As Rule 228 states, the Department will consider a waiver of penalties where "(t)he delinquency was due to erroneous information given the taxpayer by a department officer or employee" (penalty waiver situation no. 2) and will consider a waiver of interest where "(t)he failure to pay the tax prior to the issuance of the assessment was the direct result of written instructions given the taxpayer by the department." (interest waiver situation no. 1).

In this case, the Department would not have advised the taxpayer in 1981 that it need not register if the taxpayer had disclosed the fact it employed two sales representatives in Washington. We did not waive taxes because of the 1981 letter and do not find interest and penalties should be waived because of the incorrect instructions either.

The late penalty is imposed partially to compensate the state for the additional expense in collecting taxes that are late or not paid. Interest is added to late payments because the taxpayer, not the state, had the use of the money that was owed. The state does recognize the difference between nonpayment due to lack of knowledge of a tax obligation and tax evasion. In the case of tax evasion, the Department is required to impose a penalty of 50 percent of the additional tax found due. RCW 82.32.050.

Because the Department accepted the taxpayer's statement that it believed it was answering the Business Activities Statement correctly when it stated sales were not solicited on its behalf from Washington customers, no evasion penalty was imposed. We

agree that the taxpayer's good faith belief that it did not have nexus with this state warranted the decision not to impose an evasion penalty. Lack of knowledge of a tax obligation, however, is not identified by statute or rule as a reason to abate the late payment penalties or interest. We do not agree that a taxpayer can reasonably rely on written instructions that were based on incomplete or incorrect information which it provided about its business activities.

[10] Measure of tax. The Wholesaling B&O tax is measured by the gross proceeds of the taxable sales. RCW 82.04.270. The taxpayer stated that the estimated tax assessments are totally incorrect and out of proportion to its actual sales to customers in Washington. The taxpayer has provided figures for its sales to its parent company. These figures will be accepted and will reduce the assessments accordingly. Revised assessments will be issued under the condition that they are subject to verification by examination of the taxpayer's records.

DECISION AND DISPOSITION:

The taxpayer's petition is denied except as provided herein. The taxpayer shall receive amended assessments which shall be due on the date provided thereon. In summary, the assessments of taxes, interest and penalties are upheld for the period of time the taxpayer employed sales representatives in this state, except the assessments shall be reduced based on the taxpayer's actual sales records. Taxes shall also be deleted on any additional sales if the taxpayer provides evidence that delivery took place outside this state. Such evidence should be provided prior to the due date of the revised assessments or with a petition for refund if after that date.

DATED this 4th day of November 1987.