Cite as Det. No. 01-188, 21 WTD 289 (2002)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON[1]

In the Matter of the Petition For Refund of	)	D E T E R M I N A T I O N
	)	
	)	No. 01-188
	)	
. . .	)	Registration No. . . .
	)	FY . . . /Audit No. . . .
	)	Docket No. . . .

[1] RULE 194, RULE 193: B&O TAX -- SERVICES TAXABLE UNDER RCW 82.04.290 -- NEXUS. Rule 194, rather than Rule 193, addresses the taxation of service-taxable income of a person doing business both inside and outside the state. Nexus examples in Rule 193 should not be relied upon to determine whether a taxpayer who engages in both sales activity and discrete service activity has sufficient nexus with a state for the state to tax its service income.

[2] RULE 194: SERVICES TAXABLE UNDER RCW 82.04.290 -- NEXUS. Conducting an annual industry convention or seminar as a discrete business activity, for which the taxpayer charges attendees a fee, generally creates nexus with the host state to tax the fee income.

. . .

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:

A manufacturer and seller of canned software, that also puts on an annual national software conference or convention, usually outside Washington, protests the Audit Division's denial of its request for a refund of B&O taxes assessed and paid on registration fee revenue from out-of-state conferences. Taxpayer contends it is entitled to apportion the income outside Washington in years when the conference is held outside Washington.[2]

[1] NONPRECEDENTIAL PORTIONS OF THIS DETERMINATION HAVE BEEN DELETED.
[2] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

FACTS:

Prusia, A.L.J. -- . . . (Taxpayer), a Washington corporation, is a manufacturer and seller of . . . software, particularly . . . . Only a few companies in the U. S. produce . . . software, and Taxpayer is a leader in the field. Its only permanent business location is in . . . , Washington. The majority of its sales are to out of state customers. It solicits sales through its web site, by direct mail, including a quarterly newsletter, and through trade magazine advertisements. Taxpayer also holds an annual national software conference or convention for the . . . industry, most years at locations outside the state of Washington.

The Department of Revenue's (Department) Audit Division examined Taxpayer's books and records for the period January 1, 1996 through March 31, 2000. As a result of the examination, the Audit Division assessed additional taxes and interest. Taxpayer paid the assessment.

Taxpayer now petitions for refund of a portion of the assessment and associated interest. The portion at issue is Schedule 2, which assessed business and occupation (B&O) tax, under the Service and Other classification, on 1999 and 2000 software convention registration fee income. Both of those conventions were held outside Washington, the 1999 convention in . . . , and the 2000 convention in . . . . The amount of refund sought is $ . . . taxes paid, plus associated interest in an amount to be calculated. Taxpayer contends registration income from conventions held outside Washington are not subject to Washington B&O tax, under Department nexus and apportionment rulings.

Taxpayer holds the annual conferences under the name " . . . Software Conference." The annual conferences are held in various cities in the U.S., usually resort or tourist locations. They are for the entire industry, and attendees come from all over the U.S., including from the conference host state. Taxpayer charges conference attendees a registration fee that covers the conference events, meals, printed materials, and a souvenir T-shirt. Because Taxpayer is a leader in the industry, 70-80 percent of attendees are Taxpayer's customers. The conferences typically include three days of general sessions plus an optional fourth day of tutorials and workshops. Industry leaders present papers in the general sessions. The papers discuss theory in general and often compare Taxpayer's products with others. The optional clinics and workshops mostly concern use of Taxpayer's software.[3] Initial conference planning and organizing are done at Taxpayer's office in [Washington] and some printing, mailing, purchasing, and handling of registration forms and payment is also done in [Washington]. Taxpayer sends personnel to the conference location for several weeks to set up the conference. Taxpayer holds the conferences so that it and others in the . . . industry will keep current on software developments, and to

[3] The taxpayer provided copies of 1999 and 2000 conference brochures, conference booklets, as well as handouts of transparencies and other materials used in clinics and tutorials held at the conferences, and quarterly mailings regarding the taxpayer's products. . . . The conferences schedule general sessions with speakers from a number of companies, including the taxpayer. The conferences schedule optional tutorials. The handouts show a number of tutorials were clinics on the use of the taxpayer's products, including the following systems: . . . . The quarterly mailing show that the above-listed products are products the taxpayer manufactures and sells.

promote its own products, maintain continuing personal contact with existing customers, and discuss improvements with customers. Taxpayer does not solicit or take orders at the conferences, and engages in no follow-up activity in the host states.

The Audit Division explains the assessment of B&O tax on the 1999 and 2000 convention registration fees as follows.[4] WAC 458-20-194 (Rule 194), addresses doing business inside and outside the state. It states that "the [B&O] tax applies upon the income received for services incidentally rendered to persons outside this state by a person domiciled herein who does not maintain a place of business within the domicile of the person to whom the service is rendered." The Audit Division reasons (1) Taxpayer is a Washington business, rendering services to persons outside this state, and it has no out-of-state location that is contributing to the activity. (2) The services rendered outside Washington are incidentally rendered, and under Rule 194, B&O tax applies upon the income received. (3) The Department is required to apportion income earned by a Washington business from services rendered outside the state only if the business has "commerce clause nexus" with the other state. (4) The commerce clause nexus test is set out in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), and is discussed in Det. No. 92-262E, 12 WTD 431 (1992). Det. No. 92-262E explains the relationship between commerce clause nexus and apportionment. WAC 458-20-193 (Rule 193) states examples of sufficient nexus in Washington for B&O tax to apply. Therefore, the Audit Division claims the 1999 and 2000 conventions did not create nexus in the host states, under Washington tests.

The Audit Division points to the following facts as particularly supporting its position that Taxpayer's convention activity did not create nexus with the conference host states, and therefore the income from the registration fees is received for services "incidentally rendered." The convention locations vary each year. Attendance is open to everyone, and attendees come from all over the country. There are no sales calls or other follow-up activities targeting the region where the conference was held. The purpose of the conferences is not to enter a specific market. The facts do not show Taxpayer made a meaningful entry into the host states' marketplace.

The taxpayer states it is concerned other states where it holds conventions could claim nexus based on the taxpayer's work in their states in setting up conferences and during the conventions, particularly the tutorials, and its personnel's presence for several weeks for that purpose. Its petition states: "Our conventions are used to promote our software and discuss improvements with our customers." The taxpayer argues review of tax decisions, particularly the Department's Det. No. 98-196, 19 WTD 19 (2000), Det. No. 97-061, 18 WTD 211 (1999), and Det. No. 88-368, 6 WTD 417 (1988), indicate even infrequent goodwill visits are sufficient to give a business nexus with a state. The taxpayer states it reviewed the general literature on the subject of nexus, and found no clear ruling on whether the holding of a trade convention in a state is sufficient to confer nexus.

[4] From the "Auditor's Detail of Differences and Instructions to Taxpayer" (audit report) dated September 28, 2000, and an April 3, 2001 response to Taxpayer's petition.

ISSUE:

Should Taxpayer's software convention fee revenue be apportioned between Washington and the convention host state for years in which the annual software convention is held outside Washington?

DISCUSSION:

We would analyze the apportionment and nexus questions somewhat differently than either the Audit Division or Taxpayer.

The Audit Division and Taxpayer argue the nexus issue by reference to Rule 193 guidelines. Taxpayer's argument relies upon Department decisions that apply Rule 193. Rule 193 explains Washington's B&O tax and retail sales tax applications to interstate sales of tangible personal property. This appeal does not involve the taxation of interstate sales of goods. It involves the taxation of transactions taxable under the B&O tax classification "service and other business activities." Taxation of persons doing service-taxable business both inside and outside Washington is addressed in Rule 194, not in rule 193. Analyzing this case under Rule 194 and relevant Department decisions interpreting Rule 194, we believe Taxpayer's conference (convention) income must be apportioned in years the convention is held outside Washington.

Background -- nexus and apportionment requirements

We will briefly give some background on nexus and apportionment that may help explain why the Department's rules address taxation of interstate sales differently than taxation of revenue from multistate service activity. Nexus and apportionment requirements flow from limits on a state's jurisdiction to tax found in the Due Process and Commerce Clause provisions of the United States Constitution. Generally, a state cannot tax transactions and activities that do not have sufficient connection or "nexus" to the taxing state, and cannot impose taxes that would create undue impediments to the operation of the national and international economy. These limitations have been recognized and articulated in numerous court decisions. *See, e.g., Complete Auto Transit v. Brady*, 430 U.S. 274 (1977); *Tyler Pipe Industries, Inc. v. Washington Department of Rev.*, 483 U.S. 232 (1987); *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992); *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434 (1939); *Dravo Corp. v. Tacoma*, 80 Wn.2d 590, 496 P.2d 504 (1972); *Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 U.S. 175 (1995); and *General Motors v. Seattle*, 107 Wn. App. 42, 25 P.3d 1022 (2001).

In *Complete Auto*, the U.S. Supreme Court adopted a four-prong test for sustaining a state tax against a Commerce Clause challenge:

> [T]he tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.

430 U.S. at 279.

An inherent difference between sales and services makes nexus [a] frequent issue in taxation of sales revenues, and apportionment the more frequent issue in taxation of service revenues. Historically, the taxable incident with respect to sales of goods has been considered to be delivery to the buyer, even though activities in other states may contribute to the value of the article sold. A sale of goods [is treated as a discrete local event occurring] in a single state. Because the seller may be engaging in little if any activity in that state beyond sending goods into it, nexus to tax the seller's revenues from sales in the state is often an issue in sales of goods. On the other hand, apportionment is not an issue with respect to revenue from sales of goods. [A] state may . . . tax [the entire] gross receipts from [a sale] that occur[s] within the state. . . . . [*McGoldrick v. Berwin-White Coal Mining Co.*, 309 U.S. 33 (1940); *International Harvester v. Dept. of Treasury*, 322 U.S. 340 (1944).]

. . . . In *Tyler Pipe*, *supra*, the U.S. Supreme Court identified the crucial factor governing sufficient nexus to tax sales of goods into a state, in a situation where the seller maintained no office, owned no property, and had no employees residing in the state, as follows:

> As the Washington Supreme Court determined, "the crucial factor governing nexus is whether the activities performed in the 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 Wash. 2d, at 323, 715 P.2d at 126.

483 U.S. at 250.

. . . . There must be sufficient nexus before a state can tax revenue from service activity, but nexus usually is not an issue with respect to taxation of service revenue. [If a service is being rendered in a state, the person rendering it usually is physically present.] Performance of the service in the state generally creates nexus. Generally, any state in which a taxpayer directly and actively engages in business and from such activity derives part of its gross receipts, has nexus to tax the revenue from the activity. . . .

On the other hand, apportionment frequently is an issue with respect to service revenues, because performance may begin in one state and end in another, or may occur partly in one state and partly in others. . . . . However, [apportionment is not always required when the service activity goes beyond the state's borders. T]he courts have held that apportionment of service income is not required when the basic business activity is performed wholly in a single state, and the services performed in other states are incidental, related interstate activities, such as transportation, that contribute to the value of the service sold. *See, e.g., Western Live Stock v. Bureau of Revenue*, 303 U.S. 250 (1938), and *Department of Treasury v. Ingram-Richardson Mfg. Co.* 313 U.S. 252 (1941).

Washington has addressed federal constitutional limitations on its ability to tax multistate business activity in several statutes. General statutes tie the state's taxing power to what is

permissible under the federal Constitution and laws. *E.g.,* RCW 82.04.4286 and RCW 82.08.0254. For service-taxable income (and only service-taxable income), a specific statute, RCW 82.04.460, requires apportionment in specified circumstances. It provides:

> Any person rendering services taxable under RCW 82.04.290 and maintaining places of business both within and without this state which contribute to the rendition of such services shall, for the purpose of computing tax liability under RCW 82.04.290, apportion to this state that portion of his gross income which is derived from services rendered within this state.

[1] The Department has adopted two rules, WAC 458-20-194 (Rule 194) and WAC 458-20-193 (Rule 193), that explain Washington's B&O tax and retail sales tax applications to interstate activities. Rule 194 specifies the treatment of service-taxable and construction activity of persons who engage in such business both inside and outside the state. Rule 193 addresses the taxation of inbound and outbound interstate sales of tangible personal property.

The focus in Rule 193 is nexus, which is to be expected, since nexus is more often the issue in the taxation of revenue from sales of goods. Rule 193 gives examples of sufficient nexus in Washington to tax inbound sales. One of those, example (5), restates the same principle set out in the above quote from *Tyler Pipe*. There is sufficient nexus if:

> 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."

This is the provision that both the Audit Division and Taxpayer cite in arguing whether Taxpayer's convention fee income is subject to apportionment. As we discuss below, it does not apply to taxation of Taxpayer's convention fee income if Taxpayer's service activity is a discrete activity. While similar nexus principles may apply to service activity, nexus to tax discrete service activity does not depend upon whether the service activity would create nexus to tax sales into the state. Using Rule 193 to analyze nexus to tax service income can lead to confusion and error.

Rule 194, rather than Rule 193, addresses the taxation of service-taxable income. Rule 194 provides, in relevant part:

> Persons domiciled outside this state who . . . render services to others herein, are doing business in this state, irrespective of the domicile of such persons and irrespective of whether or not such persons maintain a permanent place of business in this state.
>
> Persons domiciled in and having a place of business in this state, who . . . render services to others outside this state, are doing business both inside and outside this state.
>
> . . .

> When the business involves a transaction taxable under the classification service and other business activities, the tax does not apply upon any part of the gross income received for services incidentally rendered to persons in this state by a person who does not maintain a place of business in this state and who is not domiciled herein. However, the tax applies upon the income received for services incidentally rendered to persons outside this state by a person domiciled herein who does not maintain a place of business within the jurisdiction of the place of domicile of the person to whom the service is rendered.
>
> For example, persons domiciled herein, but having no place of business outside this state, are taxable upon the following types of income: [examples omitted]
>
> Persons engaged in a business taxable under the service and other business activities classification and who maintain places of business both inside and outside this state which contribute to the performance of a service, shall apportion to this state that portion of gross income derived from services rendered by them in this state. Where it is not practical to determine such apportionment by separate accounting methods, the taxpayer shall apportion to this state that proportion of total income which the cost of doing business within this state bears to the total cost of doing business both within and without this state.
>
> For purposes of apportionment under RCW 82.04.460 and this rule the term "place of business" generally means a location at which regular business of the taxpayer is conducted and which is either owned by the taxpayer or over which the taxpayer exercises legal dominion and control. The term does not include locations or facilities at which the taxpayer acquires merely transient lodging nor does it include mere telephone number listings or telephone answering services.

Rule 194 does not use the word "nexus," but rather references rendering services in the state and having a place of business in a state. In interpreting . . . [statutory and constitutional limitations on the state's power to impose gross receipts tax on services, the Department has held there is no requirement that a taxpayer maintain physical places of business both within and without the state in order for apportionment to be necessary. Fair apportionment is required if the gross receipts are derived from business activities "which are substantially performed" both within and outside the state. Det. No. 87-186, 3 WTD 105 (1987).]

The Department has held that a seller of services has taxable nexus with a state by entering its marketplace to sell its services. Det. No. 98-196, 19 WTD 19 (2000). Performing services in a state for accounts located in that state, or at customer locations in that state, usually creates nexus with that state. *See, e.g.*, Det. No. 87-186, . . . [*supra*]; Det. No. 89-553, 9 WTD 039 (1989); Det. No. 93-276, 13 WTD 392 (1994); and Det. No. 94-031, 14 WTD 194 (1995) (overruled in part by Det. No. 01-006, [20 WTD 124 (2001)]. Rendering services in another state for Washington customers may create nexus with the other state. *See* Det. No. 93-132, 13 WTD 271 (1994) (transporting Washington patients to Oregon hospitals).

A series of Department decisions have established the principle that a Washington business may apportion its gross receipts derived from service activities when the benefits derived by the customer are the direct result of out of state services performed by the taxpayer. *See, e.g.*, Det. Nos. 87-186, 89-553, 93-132, 93-276, and 94-031, *supra*.

Taxpayer's Conference (Convention) Fee Revenue

We now attempt to apply the above principles, statutes, and rules to Taxpayer's conference fee income.

[2] Taxpayer is in the business of manufacturing and selling software. However, it also engages in service activity (software conferences), from which it derives revenue. While an underlying purpose of the conferences may be to promote Taxpayer's software sales by raising its profile, the conference activity is a discrete activity. Taxpayer charges persons to attend. The conference is not directly tied to Taxpayer's sales activity (as contrasted with training, e.g.).

Income from Taxpayer's conference registration fees is taxable under the service and other business activities classification. Rule 194 specifies the tax treatment of the gross income derived from service activities.

The Audit Division and Taxpayer are in error in viewing the crucial factor to be that set out in example (5) in Rule 193, and in citing sales of goods determinations. The issue in the present appeal is not whether the conference activity creates sufficient nexus with the conference states for those states to tax Taxpayer's software sales into the states. Rather, the issue is whether the out-of-state portion of service activity creates nexus with the conference states and is more than incidental.[5]

We believe there is no question Taxpayer's activities in the conference host state create nexus. Taxpayer goes into the host states for the purpose of selling its services in those states. Taxpayer's has its personnel physically present in the host state to set up and run the conference. Taxpayer has a temporary office in those states. It rents hotel space out of which its personnel operate, and it rents facilities to put on the convention. It puts on the conference in the host state. The conference income comes from conference attendees. It is the activity in the conference host states that generates the revenue being taxed. We do not believe the fact the convention in a particular state may be a one-time event makes any difference, for nexus purposes.

[5] We should note that other jurisdictions have ruled that conducting seminars in the state (as opposed to merely attending) creates sufficient nexus to allow the state to tax sales of manuals and other tangible personal property in the state. *See* Private Letter Ruling No. 94-0372, 1994 Ill. PLR LEXIS 516 (Illinois 1994); Hearing Nos. 34,207 and 34,944, 1996 Tex. Tax LEXIS 879 (Texas 1996); Letter Ruling, 1981 Mass. Tax LEXIS 119 (Massachusetts 1981) (held taxpayer will be subject to Massachusetts corporate excise tax and sales and use tax if it conducts seminars in Massachusetts). *See also,* Sales and Use Tax Ruling, 1996 Tenn. Reg. LEXIS 27 (Tennessee 1997) (indicates creates nexus, but services are not subject to sales tax, and seminar materials apparently are not separately charged for).

Taxpayer "maintains places of business both inside and outside this state" as that term is defined in Rule 194 in years when it holds the annual software conference outside Washington. The conference host state activities are not merely incidental to service activity performed in Washington. Therefore, Taxpayer should apportion its software conference registration fee revenue in years when it holds the software conference outside Washington.

. . .

DECISION AND DISPOSITION:

Taxpayer's petition for refund is remanded to the Audit Division. Taxpayer shall have 30 days, or such additional time as the Audit Division, in its sole discretion, may allow, for the submission of additional information necessary to calculate the amount of convention fee income apportionable to Washington. The Audit Division shall then grant a refund of B&O taxes, and related interest, assessed under Schedule 2 of the above assessment, consistent with this determination.

Dated this 13th day of December 2001.