Cite as Det. No. 02-0130, 23 WTD 13 (2004)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Tax Ruling of	)	D E T E R M I N A T I O N
	)	
	)	No. 02-0130
	)	
. . .	)	Unregistered
	)	
	)	Docket No. . . .
	)	
	)	

[1] RULE 193: B&O TAX -- SUBSTANTIAL NEXUS -- MINIMUM CONTACTS -- INDEPENDENT CONTRACTORS -- SOLICITATION OF SALES. An out-of-state manufacturer was found to have substantial nexus with Washington where it solicited sales within the state of Washington through the use of independent contractors and employees.

[2] RULE 101; RCW 82.04.150: B&O TAX – ENGAGING IN BUSINESS – SOS CERTIFICATE OF AUTHORITY. Even though a foreign corporation may not be transacting business under RCW 23B.15.010, that fact has no bearing for determining whether it is engaging in business in Washington for purposes of RCW 82.04.150.

[3] MISCELLANEOUS -- B&O TAX -- EQUITABLE ESTOPPEL – ELEMENTS -- INACTION. Where DOR had originally contacted a manufacturer three years earlier and notified it that it had nexus and was required to register, DOR's failure to issue a tax assessment at that time, did not preclude DOR from making a current tax assessment for all years still open under RCW 82.32.050.

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:

An out-of-state manufacturer of [products] asks for a determination regarding whether it has nexus with Washington.[1]

FACTS:

Okimoto, A.L.J. -- . . . (Petitioner) operates a manufacturing plant [outside Washington]. The Compliance Division (Compliance) of the State of Washington Department of Revenue (Department) originally contacted Petitioner on March 3, 1998 and asked whether Petitioner was registered with the Department. If not registered, Compliance asked Petitioner to fill out a Washington Business Activities Statement and return it to Compliance. In response to this inquiry, Petitioner completed the business activities statement and returned the inquiry letter and statement on March 23, 1998. In the statement, Petitioner acknowledged that it made sales of [products] into the state and that local independent agents regularly solicited sales in Washington on Petitioner's behalf. Petitioner also acknowledged that one of its employees traveled into Washington to visit key accounts approximately once a year for 2-3 days per trip.

Based on the activities statement, Compliance determined that Petitioner had nexus with Washington and was required to be registered with the Department. On April 2, 1998 Compliance sent a letter to Petitioner informing it of these facts. Compliance asked Petitioner to return a completed Master Business Application (MBA) after which Compliance indicated that it would assist Petitioner in completing past tax returns. Petitioner did not register at that time and did not complete the requested MBA. Instead, Petitioner retained legal counsel who sent a letter to Compliance on June 18, 1998 disputing the nexus finding and arguing that because Petitioner's business activities did not rise to the level of "minimum contacts," any assessment of B&O taxes on Petitioner's sales would be unconstitutional under both the Due Process and Commerce Clauses.

After that letter was written to Compliance, Petitioner heard no further follow-up from Compliance. Petitioner states that it presumed that Compliance had acquiesced to the conclusions advocated by its legal counsel.

Three years went by until, on September 21, 2001, Petitioner received another letter from Compliance inquiring whether Petitioner was registered with the Department. If not registered, Compliance asked Petitioner to again fill out a Washington Business Activities Statement and return it to Compliance. In response to this inquiry, Petitioner again completed the business activities statement and returned the letter and statement to Compliance on November 16, 2001.

In this statement, Petitioner repeated the information stated in the prior statement and also described its Washington sales activities as follows:

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

> [Taxpayer] is in the business of selling . . . (the "Product"). [Taxpayer] does not own or lease any real or personal property (including inventory) in Washington. Customer calls are made by independent agents with multi-state sales territories. Although [Taxpayer] does not employ a sales force in Washington, one to two times annually a non-resident [Taxpayer] sales manager will accompany certain independent agents when the agents call on key accounts. Because of the reputation and immediate recognition of the Product which has been sold in essentially the identical form for many years, independent agents do little more than ask a customer how much Product they would like to purchase . . . . Independent agents do not have authority to accept an order for Product on behalf of [Taxpayer]. The decision to accept a customer's order is made at [Taxpayer's] offices [on the East Coast]. Once an order has been accepted, Product is shipped from [the East Coast] to Washington by independent common carriers.

PETITIONER'S CONTENTIONS AND ARGUMENTS:

Petitioner first argues:

> [Taxpayer] should not be liable for any assessment of the Washington State Business and Occupation Tax (the "B&O Tax") because [Taxpayer's] business activities conducted in the State of Washington (the "state") do not provide sufficient "minimum contacts" with the State to create "nexus." Therefore, the assessment of a B&O Tax on [Taxpayer] would be unconstitutional under both the Due Process Clause and the Commerce Clause.

Petitioner contends that its business activities are distinguishable from the cases relied on by Compliance, i.e., Det. No. 97-061, 18 WTD 211 (1999); Det. No. 99-216E, 18 WTD 264 (1999); Det. No. 91-188, 11 WTD 231 (1991); and *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*, 483 U.S. 232 (1987), because, the assessed taxpayer's business activities in all the cited cases were substantially more significant than Petitioner's in-state activities.

Next, Petitioner argues that its in-state business activities do not constitute transacting business under RCW 23B.15.010 and therefore, should not be considered to be engaging in business within Washington under RCW 82.04.150.

Finally, Petitioner argues that the Department should be estopped from assessing additional taxes because Petitioner was led to believe that it was exempt from tax by the Department's failure to assess B&O taxes after the 1998 exchange of letters. Petitioner further states that it relied on that inaction to its detriment and asks that any assessment be made prospective as of the date of this determination. Petitioner cites *Conversions and Surveys, Inc. v. Department of Rev*., 11 Wn. App. 127, 521 P.2d 1203 (1974), in support of its position.

ISSUES:

1. Does Petitioner have sufficient nexus for Washington to tax its sale of products to Washington customers?

[2. Does the fact that a foreign corporation may not be transacting business under RCW 23B.15.010 have significance for determining whether it is engaging in business in Washington for purposes of RCW 82.04.150?]

[3.] Is the Department estopped from assessing taxes because it failed to assess B&O taxes after a similar inquiry was made in 1998?

DISCUSSION:

NEXUS:

[1] In order for Washington to impose its B&O tax on sales made from a point outside the state to customers located within Washington, the Department has held that there must be both nexus with the out-of-state seller and receipt within Washington. WAC 458-20-193 (Rule 193).

Washington imposes the wholesaling B&O tax on interstate sales of goods into Washington pursuant to RCW 82.04.220, RCW 82.04.270, and Rule 193. Petitioner contends that the imposition of B&O taxes on Petitioner's sales violates Petitioner's constitutional rights under both the Due Process Clause and Commerce Clause. We disagree

The United States Supreme Court addressed both Due Process and Commerce Clause challenges to a state use tax in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). *Quill* involved an out-of-state mail-order company. The State of North Dakota filed an action to require Quill to collect use tax on merchandise sold and delivered to customers in that state. Quill performed no sales solicitation nor did it have any physical presence within the state. The Court differentiated between the "minimum contacts" required to establish "nexus" for purposes of the Due Process Clause and the "substantial nexus" required by the Commerce Clause. The Court held that for purposes of the Due Process Clause, the "minimum contacts" required to establish nexus were met where the out-of-state seller "has purposefully directed its activities" at instate residents even though the seller had no physical presence within the state. The Court also held, however, that challenges to a seller's use tax collection obligations under the Commerce Clause would be sustained unless the seller had "substantial nexus" with the taxing state.

Due Process Nexus:

In evaluating challenges to a state tax, . . . the Court has long held that the minimum connection requirement of the Due Process Clause is satisfied by the physical presence of sales personnel within the taxing state, *Felt & Tarrant Mfg. Co. v. Gallagher*, 306 U.S. 62 (1939), and also the solicitation of product sales within the state by independent contractors, *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960). More recent cases have found the minimum connection where a seller "has purposefully

directed its activities" at instate residents even though the seller had no physical presence within the state. *Quill Corp. v. North Dakota,* 504 U.S. 298, (1992).[2] There is no question that Petitioner has purposefully directed its sales and public relations activities at Washington residents. Furthermore, Petitioner has regularly sent employees into Washington to visit customers and regularly solicits product sales through independent contractors. We further note that Washington only seeks to tax income attributed to sales made and delivered to Washington customers. Based on these facts, we find that Petitioner has sufficient minimum connections with the State of Washington and that the income attributed to Washington for tax purposes is rationally related to values connected with the taxing state.[3] Accordingly, we find that the Due Process Clause has not been violated. Petitioner's petition is denied on this issue.

Commerce Clause Nexus:

The leading case in Commerce Clause challenges is *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977). Under *Complete Auto's* four-part test, the Court will sustain:

> . . .a tax against Commerce Clause challenge when the 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.

Complete Auto, 430 U.S. at 279.

Petitioner has not argued that the B&O tax is not "fairly apportioned" or that the tax discriminates against interstate commerce, or that the services are not fairly related to the services provided by the state, but only argues that its activities in Washington do not rise to the minimum level of contacts necessary to establish substantial nexus under the Commerce Clause. In *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*, 483 U.S. 232 (1987), the United States Supreme Court quoted with favor, the standard used by the Washington State Supreme Court to determine nexus in cases involving the sale of goods:

> As the Washington Supreme Court determined, "the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." 105 Wash. 2d, at 323, 715 P.2, at 126.

Tyler Pipe, 483 U.S. at 250.

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[2] In *Quill*, the Court stated: " we have held that if a foreign corporation purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's *in personam* jurisdiction even if it has no physical presence in the State." *Quill,* 504 U.S. at 307 (italics supplied).

[3] Although Petitioner has not challenged the values being taxed, taxes based only on the dollar amount of sales made into a state have consistently been upheld as rationally related to the taxes being assessed. *See, Moorman Mfg. Co. vs. Bair*, 437 U.S. 267 (1978); s*ee also*, Det. No. 00-003, 19 WTD 685 (2000).

In Petitioner's case it has a local independent contractor that visits customers and solicits and takes orders for approval at the home office. In addition, once a year Petitioner sends an employee/sales manager into the State of Washington to supervise the local independent agents and to personally call on key accounts. A primary purpose of these sales and public relation activities is to establish and maintain Petitioner's market for products in this state. Consequently, these activities are significantly associated with Petitioner's ability to establish and maintain a market in this state. Therefore, we find that Petitioner has substantial nexus.[4]

We further find that Petitioner's Washington activities do not fall within the limited "safe harbor" identified in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). In *Quill* the Court followed long-standing precedents and created a safe harbor from state use tax collection responsibilities for those vendors whose only connection with the taxing state was through the U.S. Mail or a common carrier. The Court left open, however, the question of whether vendors whose activities went beyond the safe-harbor could be taxed.

In interpreting *Quill*, the Department has relied on the reasoning in *Matter of Orvis Co., Inc. v. Tax Appeals Tribunal*, 86 N.Y. 2d 165, 654 N. E. 2d 954 (1995), and held that when the activities of an out-of-state company go beyond purely mail order activities, and it has demonstrably more than the slightest presence in the state, substantial nexus has been established. Det. No. 00-003, 19 WTD 685 (2000). Petitioner has significantly more than the slightest presence in this state. Accordingly, Petitioner's request is denied on the Commerce Clause challenge.[5]

[CERTIFICATE OF AUTHORITY:]

[2] We also find Petitioner's reliance on RCW 23B.15.010 to be misplaced. RCW 23B.15.010 pertains only to whether a foreign corporation needs to obtain a certificate of authority from the secretary of state and has no bearing on whether a taxpayer is engaging in business in Washington for purposes of RCW 82.04.150.

ESTOPPEL:

[3] In Washington, the burden is on the taxpayer to establish the following three elements to create an equitable estoppel: (1) an admission, statement, or act inconsistent with the claim afterwards asserted; (2) action by the other party on the faith of such admission, statement, or act; and (3) injury to such other party resulting from allowing the first party to contradict or repudiate such admission, statement, or act. *Shafer v. State*, 83 Wn.2d 618, 521 P.2d 736 (1984). In addition, when a party seeks to assert equitable estoppel against the Department, that party must also show (1) that equitable estoppel is necessary to prevent a manifest injustice; and (2) that the exercise of governmental powers will not thereby be impaired. *Finch v. Matthews*, 74 Wn.2d 161, 443 P.2d 833 (1968). The Department has adopted these guidelines for applying estoppel. *See*, Det. No. 93-300,

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[4] *See also*, Rule 193(2)(f).

[5] Physical presence may not be required in cases involving B&O tax. *See, General Motors Corp. v. City of Seattle*, 107 Wn. App. 42, 25 P.3d 1022 (2001).]

13 WTD 396 (1994). Based on these standards, we will now examine the facts surrounding Petitioner's claim.

We have examined Petitioner's facts and find that Petitioner has not established the first element of equitable estoppel, i.e., an admission, statement, or act inconsistent with the claim afterwards asserted. After receiving Petitioner's completed Washington Business Activities Statement in 1998, Compliance sent a letter to Petitioner on April 2, 1998 informing Petitioner that it had nexus with Washington and was required to complete an MBA. Compliance instructed Petitioner to return the completed MBA after which Compliance would assist Petitioner in completing past-due tax returns. Petitioner did not register at that time and did not complete the requested MBA. Instead, Petitioner retained legal counsel and sent a letter on June 18, 1998 disputing the nexus finding on the grounds that it was unconstitutional. Compliance took no further action until September 25, 2001 when Petitioner's name came up on a different referral, and Compliance started the process over again. Compliance again contacted Petitioner and received a similar Business Activities Statement, which resulted in a similar finding of nexus and request to register on November 27, 2001. Petitioner again did not register or complete the requested MBA and instead sent another letter contending the tax was unconstitutional.

In examining the facts we find that Compliance's position has been consistent throughout. In its April 2, 1998 letter, Compliance stated that Petitioner had nexus and was required to complete an MBA. This identical position was repeated in its November 27, 2001 letter. Although Petitioner contends that the inaction or lack of follow-up by Compliance after Petitioner's June 18, 1998 protest letter constituted an implied acquiescence to Petitioner's constitutional argument, we disagree. Even though Compliance's normal follow-up procedure in these situations would have been to make a tax assessment against Petitioner, the absence of any written reply, leads us to believe that the inaction was simply an oversight by Compliance.[6] Regardless, we find that Compliance made no affirmative ruling that Petitioner was exempt from B&O taxes and in fact always and consistently maintained that Petitioner was subject to Washington B&O taxes. Therefore, we find that Compliance did not take a position inconsistent with its 1998 position.

We further find Petitioner's reliance on *Conversions and Surveys, Inc. v. Department of Rev*., 11 Wn. App. 1267, 521 P.2d. 1203 (1974), to be misplaced. *Conversions* involved a taxpayer that had been assessed additional taxes and interest due. Because of the controversial nature of the issue, the Tax Commission[7] refused the taxpayer's request for an immediate hearing, but placed the assessment into abeyance for over a ten-year period despite repeated inquiries by the taxpayer. The Court of Appeals remanded the case to the lower court to determine whether the 10-year delay by the Tax Commission detrimentally precluded the taxpayer from being able to effectively assert its nonliablilty for the tax. In Petitioner's case, there has been no tax assessment and no request for a hearing. Compliance had only made an initial inquiry and such

[6]We contacted the Compliance officer and he indicated that approximately 150 inquiries are sent out each month. The sheer volume of inquiries suggests that Petitioner's response may have been lost or misplaced or perhaps never received.

[7]Predecessor to the Department of Revenue.

inquiries are only the beginning stages of the tax discovery and audit process. Consequently, the *Conversions* case is distinguishable since the Tax Commission had made a tax assessment and affirmatively placed that assessment into abeyance. Based on the totality of the events, it involved significantly more than mere inaction by the Commission.

Instead, we rely on *Wasem's, Inc. v. State*, 63 Wn.2d 67, 385 P.2d 530 (1963). *Wasem's* involved a drug and furniture store owner located on the Washington side of the Washington/Idaho border. Because Idaho residents were discouraged from patronizing Wasem's store by the high retail sales tax, Wasem's sought to neutralize its competitive disadvantage through a liberal interpretation of what constituted an out-of-state delivery under WAC 458-20-193 (Rule 193). Wasem's submitted its interpretation to the Tax Commission and waited approximately a year before implementing its own liberal interpretation of Rule 193 in 1955. Based on that interpretation, Wasem's quit collecting retail sales tax on sales to Idaho residents. The Tax Commission made no ruling on the proposal and took no action beyond the acknowledgement of Wasem's letters. In 1960, the Tax Commission examined Wasem's records and assessed uncollected retail sales taxes on sales to Idaho residents. In rejecting Wasem's claim of estoppel by inaction, the Court stated:

> While it is likely and understandable that the continuing inaction on the part of the Tax Commission may have been frustrating for appellant's officers; nevertheless, the courts must be, and are, most reluctant to find an estoppel where the state is acting in its taxing capacity and for the enforcement and collection of taxes imposed by the legislative branch of government.

Wasem's Inc., 63 Wn.2d at 68.

Accordingly, we find that the Department is not estopped from assessing B&O taxes properly due and owing.

DECISION AND DISPOSITION:

Petitioner's request is denied.

Dated this 9th day of August 2002.