Cite as Det. No. 96-147, 16 WTD 117 (1996)

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

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 96-147
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

RULE 195; RCW 82.04.070: B&O TAX -- MEASURE OF TAX. A taxpayer may not treat collected retail sales tax as a reduction of the selling price for the purpose of the measure of the tax. The B&O tax is imposed on the business and cannot be charged to the buyer.

1 RULE 193: SUBSTANTIAL NEXUS. Substantial nexus, for commerce clause purposes, includes three factors: (1) An activity within the state attempting to impose taxes; (2) A physical presence related to the activity; and (3) The activity must be for the purpose of either entering or maintaining a position in the marketplace of the taxing state.

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:

The taxpayer requests a refund of retail sales and retailing business and occupation (B&O) taxes paid as the result of a tax assessment issued by the Department of Revenue (Department).[1]

FACTS:

Coffman, A.L.J. -- The taxpayer is a corporation whose only office is in another state (State A). All of the taxpayer's employees are located in State A. The taxpayer sells its products through in-home parties. The taxpayer's method of operation consists of contracting with individuals to be Regional and District Managers. The District Managers contract with individuals to act as Supervisors. The

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

Supervisors contract with individuals who act as Demonstrators. The Demonstrators engage Hostesses who hold parties in their homes for the purpose of selling the taxpayer's products.

The taxpayer developed the form contracts used throughout its sales organization. The contracts identify the Regional Manager, District Manager, Supervisor, and Demonstrator as independent contractors. The taxpayer was requested by the Department to provide the name, address, and physical location of its agents in this state. The taxpayer replied: "WE WILL NOT SUPPLY THIS INFORMATION."

The Regional Manager is responsible for training the District Managers who report to him or her. Further, the Regional Manager will act as a District Manager. District Managers are required to "recruit and encourage Supervisors."

The Supervisor Agreement is signed by the District Manager. The Supervisor Agreement states that the taxpayer will pay the Supervisor's commissions. Further, it requires the Supervisor to hire Demonstrators. The Supervisor can sell the taxpayer's products only through the "party plan." Under the "party plan" only the Hostess handles the money.

The Demonstrator agreement is entered into between the Supervisor and the Demonstrator and binds the taxpayer to pay the Demonstrator a commission.

The taxpayer provides each person within its sales organization a sample kit valued at $300. If certain sales levels are achieved, the kit becomes the property of the independent contractor. If those sales levels are not achieved, the independent contractor may purchase the kit for $150.

The Regional Manager is paid a commission based on the productivity of the District Managers under him or her. The District Managers are paid a commission based on the productivity of the Supervisors reporting to him or her. Likewise, the Supervisors are paid a commission based on the productivity of the Demonstrators. The Demonstrators receive a commission based on the sales at parties they arrange and Hostesses receive free merchandise based on the sales at their parties.

The taxpayer registered with the Department and collected retail sales tax on all orders taken in Washington. The Department audited the taxpayer's books and records for the period January 1, 1989 through March 31, 1993. The Department's Audit Division determined that the taxpayer had underreported its gross sales from its retail activity. The "Auditor's Detail of Differences and Instructions to Taxpayer" states:

In the past, you calculated gross sales by dividing the sales tax collected for each location by the sum of the sales tax rate and the retailing business and occupation tax rate (.00471 during the audit period). This resulted in sales being underreported. Sales tax collected by you must be remitted to the state as sales tax and cannot be used to pay the business and occupation tax, an expense of your firm.

Thus, if the taxpayer made a $100 sale and retail sales tax rate was 8%, then the taxpayer collected $108. When it reported its gross sales, the taxpayer divided $8 by .08471 and reported the quotient ($94.44) as its gross sales. In so doing, the taxpayer paid $7.56 in retail sales tax and $.44 in B&O tax. The Audit Division believes that the gross sale was for $100.

The Audit Division, applying its theory, determined the taxpayer's total gross sales, subtracted the gross sales reported by the taxpayer, and calculated the amount of the underreported sales. It then calculated the amount of the underpayment of retail sales and B&O taxes. Thus, in the example above, the Department found that the taxpayer underreported the sale by $5.56 ($100 - $94.44) and calculated the retail sales tax ($.44) and B&O tax ($.04). The taxpayer agrees that, if the Audit Division's position is sustained, the tax assessment was properly calculated.

The Department issued the tax assessment on October 6, 1993. Prior to the final issuance of the tax assessment, the Department provided the taxpayer with copies of the workpapers and the proposed tax assessment. The taxpayer paid the proposed tax assessment prior to issuance and requests a refund.

ISSUES:

1. Whether the taxpayer properly calculated its total sales to Washington customers.

1. Where the taxpayer pays retail sales and B&O taxes totaling the amount of collected retail sales tax, by underreporting its gross receipts, may the Department assess additional retail sales tax for the audit period.

1. Whether the taxpayer has substantial nexus with the state of Washington.

1. Whether the taxpayer was making retail sales or sales for resale.

DISCUSSION:

1. Total Sales to Washington Customers.

The taxpayer collected retail sales tax on all sales made in Washington. The retail sales tax is imposed on the buyer. The seller is required to collect and remit it to the Department. RCW 82.08.050. The measure of the retail sales tax is the selling price. RCW 82.08.020(1). The selling price is defined in RCW 82.08.010(1) as:

. . . the consideration, whether money, credits, rights, or other property except trade-in property of like kind, expressed in the terms of money paid or delivered by a buyer to a seller without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes other than taxes imposed under this chapter if the seller advertises the price as including the tax or that the seller is paying the tax, or any other expenses whatsoever paid or accrued and without any deduction on account of losses; but shall not include the amount of cash discount actually taken by a buyer . . . .

(Emphasis added.)

The B&O tax is imposed by chapter 82.04 RCW and, therefore, it is not deductible from the measure of the retail sales tax. Thus, the measure of the retail sales tax is the total amount received from the customer less retail sales tax.

[1] Likewise, the B&O tax is not deductible from the measure of the B&O tax. The B&O tax is imposed by RCW 82.04.220. In the case of items sold, the measure is the gross proceeds of sale which is defined as:

the value proceeding or accruing from the sale of tangible personal property and/or for services rendered, without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

RCW 82.04.070. (Emphasis added.)

Certain taxes are excluded from the measure of the tax because they are imposed on the taxpayer's customer. For example, retail sales tax collected from a customer is excluded from the measure of tax because the tax is imposed on the buyer and the seller receives the tax in trust. WAC 458-20-195 (Rule 195). However, the B&O tax is never excluded from the measure of state taxes. Rule 195.

2. Calculation of underpayment of taxes.

The taxpayer argues that the Department assessed the wrong taxes. Specifically, the taxpayer argues that it remitted all the retail sales tax that it collected. Therefore, if any tax was underpaid, it was only the B&O tax. Thus, argues the taxpayer, the Department's assessment of retail sales tax was in error.

As stated above, the taxpayer underreported its gross income to the Department because of a miscalculation that was solely within the taxpayer's ability to correct. The Department properly determined the taxpayer's gross sales then subtracted the amount the taxpayer had reported to determine the amount of the underreported sales. The Department then properly calculated the amount of the underpayment. There was no error by the Department.

Because we find that the Department properly assessed the retail sales tax, it is unnecessary to address the taxpayer's argument that RCW 82.32.050 requires the Department to refund the assessed additional retail sales taxes for tax years 1989 and 1990.

3. Substantial nexus with the state of Washington.

The ability of a state to tax the activities of a nonresident corporation's business activities is limited by the Commerce Clause of the U. S. Constitution. The United States Supreme Court, in Complete Auto Transit v. Brady, 430 U.S. 274 (1977), listed the four conditions that must exist before a state may tax a nonresident business. The Washington Supreme Court restated the Complete Auto test as:

Under this test, state taxation of interstate business must (1) tax only interstate activities having a sufficient connection to the taxing state (nexus requirement); (2) . . .

American National Can v. Dept. of Rev., 114 Wn.2d 236, 241 (1990).

The U.S. Supreme Court has further clarified the nexus requirement to mean "substantial nexus". Quill Corp. v. North Dakota, 504 U.S. 298 (1992). See, also, Det. No. 92-262E, 12 WTD 431 (1992).

[2] Substantial nexus has three elements. First, there must be some activity in Washington. See, Standard Pressed Steel Co. v. Department of Rev., 419 U.S. 560 (1975) and Tyler Pipe Industries, Inc. v. Washington State Dept. of Rev., 483 U.S. 232 (1987). Second, there must be a physical presence related to that activity in the state. Quill Corp., supra and Norton Co. v. Department of Rev. of Ill., 340 U.S. 534 (1951). Third, the activity's purpose is to establish or maintain a position in Washington's marketplace. Det. No. 92-262E, supra.

The taxpayer clearly has engaged in an activity in Washington -- The sale of its products.

Physical presence means more than a slight presence. Quill Corp., supra, and National Geographic Society v. California Bd. of Equalization, 430 U.S. 551 (1977). Physical presence may be established through employees or independent contractors. Scripto, Inc. v. Carson, 362 U.S. 207 (1960). The taxpayer has established a network of agents in this state which satisfy this requirement. The sole purpose of these agents is to sell the taxpayer's products. The agents use the taxpayer's forms commit the taxpayer to pay Supervisors and Demonstrators commissions.

These agents represent the taxpayer's interests and are paid for the purpose of establishing and maintaining a market for the taxpayer's products in Washington. This is no different than the facts in Tyler Pipe, supra, where the Court said:

The trial court found that the in-state sales representative engaged in substantial activities that helped Tyler to establish and maintain its market in Washington. The State Supreme Court concluded that those findings were supported by the evidence, and summarized them as follows:

The sales representatives acted daily on behalf of Tyler Pipe in calling on its customers and soliciting orders. They have long-established and valuable relationships with Tyler Pipe's customers. Through sales contacts, the representatives maintain and improve the name recognition, market share, goodwill, and individual customer relations of Tyler Pipe.

Tyler Pipe sells in a very competitive market in Washington. The sales representatives provide Tyler Pipe with virtually all their information regarding the Washington market, including: product performance; competing products; pricing, market conditions and trends; existing and upcoming construction products; customer financial liability; and other critical information of a local nature concerning Tyler Pipe's Washington market. The sales representatives in Washington have helped Tyler Pipe and have a special relationship to that corporation. The activities of Tyler Pipe's agents in Washington have been substantial." 105 Wash. 2d, at 325, 715 P.2d, at 127.

As a matter of law, the Washington Supreme Court concluded that this showing of a sufficient nexus could not be defeated by the argument that the taxpayer's representative was properly characterized as an independent contractor instead of as an agent. We agree with this analysis.

Tyler Pipe, at 249-50.

The taxpayer cites three cases that it believes support its claim that nexus does not exist. In Care Computer Systems v. Arizona Dept. of Rev., Arizona Board of Tax Appeals, Docket No. 1049-93-S, the Board held that where a nonresident corporation has no office, no employees, and no regular presence in the state, there is not substantial nexus.

In Florida Dept. of Rev. v. Share International, Inc., 667 So. 226 (Fla. Dist. Ct. App., 1995), the court held that the presence in the state of two corporate officers for three days a year at a seminar

was insufficient to demonstrate substantial nexus. Share International collected and remitted retail sales tax on sales made during that three-day period. It was the additional mail-order sales that were at issue.

In NADA Services Corp., State of New York-Division of Tax Appeals, DTA 810592(1996), the Division of Taxation attempted to assess a retail sales tax collection responsibility on a foreign corporation through two theories. The state argued that it could pierce the corporate veil and attribute the activities of NADA, Inc (the taxpayer's parent) to NADA Services Corp. and thereby establish nexus. The Administrative Law Judge (ALJ) rejected that position as not supported by the facts. Additionally, the state claimed that a total of 20 trips to New York by employees over a 39 month period was sufficient to establish nexus. These trips were for the purposes of educational seminars (15), receipt of an honorary judging role (1), research for article to be published (2), visit an independent contractor whose work was unrelated to the New York market (1), and one trip to solicit advertising. The ALJ said the sporadic visits by a nonresident independent contractor performing nontaxable services did not establish nexus. This case likewise does not support the taxpayer's position because the taxpayer's presence in Washington is significant and is for the purpose of soliciting sales of taxpayer's products.

As discussed above, the taxpayer has a substantial physical presence in this state, while in each of the cited decisions there is a conspicuous lack of significant physical presence relating to the taxable activity. Therefore, none of the cited cases apply to taxpayer's appeal.

4. Retail sales versus sales for resale.

There is no evidence that the taxpayer took any resale certificates from the hostesses. Therefore it has the burden to show that the sales were not at retail. RCW 82.04.470. The taxpayer argues that the sales made at the parties were made to the Hostess for the purpose of resale to his or her guests. The taxpayer bases this argument on the fact that all orders are submitted on a master order form (without the names of the ultimate customer) and the Hostess is responsible for delivering the products to the ultimate customers. However, the Hostess collects money from the customers and submits it to the Taxpayer, and is paid in products based on the sales made. The Hostesses do not purchase and then resell the product. The Hostesses are the taxpayer's agents.

The definition of a retail sale includes the sale of tangible personal property except "purchases for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person". RCW 82.04.050(1)(a).[2] There is no evidence that the Hostesses are engaged in any business when they host a party for the taxpayer. Therefore, they could not have purchased the goods for resale in the ordinary course of business. Further, there is no evidence that the Hostesses purchase anything. It is, at best, inconsistent for the taxpayer to collect the retail sales tax, yet claim that it was engaged in a wholesale business.

The taxpayer is bound by its agreements, which state that the Hostesses will receive "free" merchandise, if a party is held. As such, they are acting on behalf of the taxpayer. Further, the Hostess collected the retail sales tax and remitted it to the taxpayer per taxpayer's requirements. Therefore, the taxpayer must have assumed that the sales were made to the party guests.

The Hostesses are acting as the taxpayer's agents when they are compensated for using their homes or other location, collect money for the products, remit that money to the taxpayer, and deliver the goods to the customers.

DECISION AND DISPOSITION:

The taxpayer's request for a refund is denied.

DATED this 29th day of August 1996.

---

[2] There are other exceptions. The taxpayer relies solely on the resale exemption, therefore it is the only one which will be addressed. We have not addressed the possible use of the Direct Seller's Representative exemption from the B&O tax because the taxpayer has not only refused to provide the names of its agents or the actual contracts with those agents, but has also declined to argue that issue.