

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Correction of	)	<u>D E T E R M I N A T I O N</u>
Interpretation for	)	
	)	No. 97-235
	)	
. . .	)	Registration No. . . .
	)	Correction of Interpretation
	)	

- [1] RULE 193: B&O TAX -- NEXUS ESTABLISHED. The presence of a sales manager in Washington establishes nexus.
- [2] RULE 193: B&O TAX -- NEXUS DURATION. Once established, nexus continues throughout the statutory period for up to five years after the activity that established nexus ceased.
- [3] RULE 193: B&O TAX --NEXUS -- DISASSOCIATION -- PROOF. The taxpayer bears the burden of proof to disassociate telephone and mail order sales from the activities of an instate employee. The presence of a sales manager who may have been available to assist customers, resolve difficulties, or maintain goodwill will not be disassociated merely because the taxpayer is unaware of any contacts by the manager even if he does not earn a commission from pre-existing customers.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

An out-of-state corporation appeals the interpretation that business and occupation tax is due on sales made in Washington.<sup>1</sup>

FACTS:

Pree, A.L.J. -- The taxpayer designs and manufactures connectivity devices for computer networks at an out-of-state location. It sells the devices to distributors. It does not make any retail sales. Common carriers ship the devices from out-of-state to the taxpayer's Washington customers.

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410

Prior to March 1996, the taxpayer did not have any employees or agents working on its behalf in Washington. Its 1995 calendar year sales to Washington customers totaled \$89,000. For the first quarter of 1996, those sales totaled \$25,000. In March 1996, the taxpayer hired a Washington resident as its Western Regional Sales Manager who worked out of his home. Washington sales for the second quarter of 1996 fell to \$10,000. The sales manager quit in July 1996. Since then, the taxpayer has not had an employee or agent operating in Washington.

The taxpayer wrote to the Department of Revenue (Department) on September 12, 1996. On October 1, 1996, the Department's Taxpayer Information and Education Section (TI&E) replied to the taxpayer. That letter stated that because orders were solicited by a representative of the taxpayer in Washington, the taxpayer had sufficient nexus for business and occupation (B&O) tax to apply. Once nexus was established, the letter stated that nexus continues for five years and all sales to Washington customers are subject to B&O tax unless the taxpayer establishes that its instate activities were not associated in any way with the sales into this state.

The taxpayer states that it established a market for its products in Washington long before the sales manager was hired. The taxpayer contends that the activity of the manager was not significantly associated with its sales into Washington. Even if nexus was established, the taxpayer contends that there is no basis for it to continue five years. Finally, the taxpayer states that it should be able to exclude sales made to customers with whom the sales manager had no contact.

As proof, the taxpayer provided a one-page letter of engagement, designating the new employee, "Western Regional Sales Manager." The letter specifies a base salary with quotas and specifies commission rates and bonuses. The new manager was also eligible for a long term incentive stock option package. It does not address the employee's duties. Nor does the letter mention existing customers.<sup>2</sup>

The taxpayer provided a worksheet showing the calculation of commissions earned by the sales manager. There was only one sale to a Washington customer (the only other sale was to a customer located in Alaska). The taxpayer states that the sales manager only earned commissions on sales that it solicited from new customers.

Because of the commission arrangement, the taxpayer reasons that the sales manager would not call upon existing Washington clients. In fact, according to the taxpayer, the manager's only commission was for a sale to someone who had not been a prior customer of the taxpayer. The taxpayer considers this proof sufficient to disassociate the manager's activity from the telephone and mail-order sales.

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<sup>2</sup> The taxpayer states that one of its main customers in Washington is headquartered out-of-state. According to the taxpayer, it has never had to direct marketing activities towards Washington in order to make sales.

## ISSUES:

1. Were the manager's contacts sufficient to create nexus?
2. Once a taxpayer establishes nexus, how long does it continue?
3. Did the taxpayer disassociate its mail order and telephone sales from those of the sales manager?

## DISCUSSION:

Washington imposes the wholesaling B&O tax on interstate sales of goods into Washington per RCW 82.04.220, RCW 82.04.270, and WAC 458-20-193 (Rule 193). Taxes on interstate commerce are constitutional if the activity has a "substantial nexus" with the taxing state. Subsection (2)(f) of Rule 193 defines "nexus" as:

. . . the activity carried on by the seller in Washington which is significantly associated with the seller's ability to establish or maintain a market for its products in Washington.

Subsection (7)(c) of the Rule provides:

(c) If a seller carries on significant activity in this state and conducts no other business in the state except the business of making sales, this person has the distinct burden of establishing that the instate activities are not significantly associated in any way with the sales into this state. Once nexus has been established, it will continue throughout the statutory period of RCW 82.32.050 (up to five years), notwithstanding that the instate activity which created the nexus ceased. Persons taxable under the service B&O tax classification should refer to WAC 458-20-194. The following activities are examples of sufficient nexus in Washington for the B&O tax to apply:

...

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

...

(v) The out-of-state seller, either directly or by an agent or other representative, performs significant services in relation to establishment or maintenance of sales into the state, even though the seller may not have formal sales offices in Washington or the agent or representative may not be formally characterized as a "salesperson".

[1] The taxpayer's Western Regional Sales Manager solicited an order for goods in Washington. That activity was significant in relation to establishing sales into Washington. While the taxpayer states that it only intended that the employee would earn commissions on sales to new customers,

not sales to existing customers, the letter of engagement gave the employee a title of manager and a base salary. When sales fell, the employment relationship ended.

While the letter did not address duties, it appears based upon the title, payment arrangement, and ultimate termination of the employee, that he was expected to maintain the taxpayer's sales into the state. The manager's presence in Washington clearly established nexus.

[2] The taxpayer contends that there is no substantive basis for the presumption that nexus, once established, continues for any particular period. The taxpayer states that the statutory period from RCW 82.32.050 (up to five years) is a procedural provision, which provides no basis for concluding that nexus continues.

RCW 82.32.300 directs the Department to make and publish rules. Rule 193 is the Department's lawfully promulgated Rule pertaining to nexus. It has the same force and effect as law. It has not been declared invalid by the judgment of a court of record.

The five year period is reasonable. Once a customer is contacted and establishes a relationship with a company, that relationship will continue for a period after the contact. That relationship can last years (in the case of a mortgage) or a life-time (life insurance).

While the taxpayer is critical of the Department's authority for a five year period, the taxpayer does not provide authority for a shorter period. It is reasonable that the manager's physical presence in the state will establish the taxpayer's sales relationships with customers that could last five years. Under subsection (7)(c) of Rule 193, once nexus has been established, it will continue throughout the statutory period of RCW 82.32.050 (up to five years), notwithstanding the fact that the in-state activity which created the nexus ceased. Nexus continues through December 31, 2000.

[3] Example (g) in subsection (11) appears similar to the situation described by the taxpayer:

(g) Company W with its main office in Ohio has one employee working from the employee's home located in Washington. The taxpayer has no offices, inventory, or other employees in Washington. The employee calls on potential customers to promote the company's products and to solicit sales. On June 30, 1990 the employee is terminated. After this date the company no longer has an employee or agent calling on customers in Washington or carries on any activities in Washington which is significantly associated with the seller's ability to establish or maintain a market for its products in Washington. Washington customers who had previously been contacted by the former employee continue to purchase the products by placing orders by mail or telephone directly with the out-of-state seller. The nexus which was established by the employee's presence in Washington will be presumed to continue through December 31, 1994 and subject to B&O tax. Nexus will cease on December 31, 1994 if the seller has not established any new nexus during this period. Company W may disassociate and exclude from B&O tax sales to new customers who had no contact with the former employee. The burden of proof to disassociate is on the seller.

We have found that the taxpayer has established nexus and that will continue through December 31, 2000. The taxpayer contends that the manager's activities can be disassociated from its telephone and other sales into Washington. As proof, the taxpayer states only that the manager would not earn commissions on sales to existing customers. The taxpayer states: "The company is not aware that the sales representative had contacts with any other potential customers, that resulted in sales, and it has not paid commissions to the sales representative [manager] other than those already disclosed." The letter of engagement, does not discuss the manager's duties.

The burden to disassociate sales is exclusively that of the taxpayer and it is not easily satisfied. Det. No. 86-31ER, 13 WTD 001 (1993). A taxpayer claiming immunity from a tax has the burden of establishing his exemption. Norton Company v. Illinois Department of Revenue, 340 U.S. 534, 537 (1951). When considering the issue of disassociation, the Courts have placed the burden of coming forth with sufficient facts that would establish disassociation, upon the taxpayer. See, B.F. Goodrich v. State, 38 Wn.2d 663, 672, 231 P.2d 325 (1951).

In considering whether sales contracts entered into outside of Washington were taxable here, the Washington Supreme Court stated:

CBI's local involvement in site preparation and overall supervision of the contracts contradicts any disassociation argument. Moreover, although the Seattle sales office was not involved in the contract procurement, it was involved in the passive sense of being present, aware of the transaction, and available to assist if necessary. Local CBI personnel were also available to resolve any difficulties with the product and maintain the goodwill of the customer. We find that these activities had a substantial relation to the establishment and maintenance of the sales upon which the tax was measured.

Chicago Bridge v. Department of Rev. , 98 Wn.2d 814, 828, 659 P.2d 463 (1983).

While the taxpayer states that the sales manager did procure more than one Washington sale, the taxpayer cannot say what noncommissioned calls the manager made or state unequivocally that the manager did not contact the taxpayer's other customers. The title, Western Regional Sales Manager, implies that the Washington employee was involved or available, at least in the passive sense, to assist or resolve difficulties with the taxpayer's products and maintain the goodwill of the taxpayer's customers. The taxpayer has not met its burden of disassociating the noncommissioned sales.

#### DECISION AND DISPOSITION:

We deny the taxpayer's petition. The TI&E letter is sustained.

DATED this 25th day of November, 1997.