Cite as Det. No. 99-100, 19 WTD 440 (2000)

BEFORE THE 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. 99-100
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .
	)	FY. . ./Audit No. . . .

[1] RULE 193: B&O TAX – NEXUS – TRAINED CLIENT EMPLOYEES – AGENTS -- CONTRACTUAL RESPONSIBILITIES. Where a management consultant firm trains client employees to train other client employees on management . . . concepts and also enters into a written agreement with those Trainers, conferring upon them certain rights and responsibilities, the training activities of the Trainers is sufficient to establish nexus between Washington and the out-of-state firm.

[2] RULE 211; RCW 82.04.050: B&O & RETAIL SALES TAX – TANGIBLE OBJECT & RIGHT TO REPRODUCE—TRUE OBJECT TEST -- END USER. Where a taxpayer sends a single copy of training material to a client with the right to reproduce a specified number of additional copies for use in conducting training classes, the true object of the transaction is the acquisition of tangible teaching materials.

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 consulting firm protests business and occupation (B&O) taxes assessed on training fees and retailing B&O and retail sales taxes assessed on sales of training products.[1]

FACTS:

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

Okimoto, A.L.J. -- . . . (Taxpayer) is a . . . management instructional business based [out of state]. Taxpayer's books and records were examined by a Multi-state tax auditor (Audit) acting on behalf of the Washington State Department of Revenue (Department) for the period January 1, 1989 through December 31, 1994. As a result of this examination, Document FY. . . was issued on September 20, 1995 assessing additional taxes and interest in the amount of $. . . . Taxpayer protested the assessed amounts and they remain due.

Taxpayer generates its income by providing on-site seminars, training courses, and management workshops . . . for businesses throughout the United States. It offers workshops to the public as well as on-site training and consulting. In addition Taxpayer sells a wide range of books, videos, and other promotional items related to its training.

Taxpayer markets its products to medium and large sized businesses. The initial contact is made through telemarketing. Once an appointment is set up, Taxpayer sends an account representative to visit the potential client's premises and to make a sales presentation. Taxpayer also sometimes performs business reviews and consulting services for a negotiated fee. Approximately 50 percent of Taxpayer's revenues are generated by seminars, 40 percent from sales of hard products, i.e. books, videos, and other training material, and 10 percent from consulting and business reviews.

Schedule 2: Reconciliation of Washington Sales

In this schedule, Audit assessed retailing B&O and retail sales tax on all sales of hard products to Washington clients.

Audit concluded that Taxpayer had nexus with Washington for the following reasons.

1) Audit examined employee travel vouchers and account receivable billings records for a mutually agreed test period. The test revealed that Taxpayer's employees often traveled to Washington to make sales presentations and to conduct revenue producing seminars, consulting sessions, and business reviews at a client's site.

2) Audit also stated that client employees who had initially been trained and licensed by Taxpayer to instruct classes on Taxpayer's . . . concepts (Trainers), individually entered into written agreements with Taxpayer to train other client employees. These Trainers were required to follow Taxpayer's strict guidelines as to the method of training, materials used, and all other matters related to training.

3) Audit also stated that training materials sold to clients and used in the training seminars were ordered exclusively through these pre-trained Trainers. Audit considered these pre-trained client employees to be agents of Taxpayer whose primary purpose was to perform training services in addition to selling books and other training materials to Taxpayer's clients.

Audit believed that the Trainers' activities established nexus between Washington and Taxpayer because they helped Taxpayer establish or maintain a market in Washington.

During the hearing, Taxpayer conceded that its current activities of sending its own instructors to Washington to hold seminars and to train client employees were sufficient to establish nexus with the State of Washington, but objected to Audit's conclusion that nexus existed throughout the audit period. Taxpayer pointed out that Audit's examination of employee travel records could only identify eight days in 1994 where Taxpayer's employees physically entered the State of Washington. Taxpayer questions whether it had nexus prior to that time.

Taxpayer also acknowledged that it made sales or leases of tangible personal property of books, videos, and training materials to some Washington clients and that they have been correctly subjected to retailing B&O and retail sales tax. Taxpayer contends, however, that the tax assessment figures also include transactions where Taxpayer only sent a single copy of the tangible training materials together with a license to reproduce an additional 60 copies (one for each person being trained). Taxpayer emphasizes that the Trainer or client, itself, actually made the additional copies of the training material. Taxpayer argues that these were not sales of tangible personal property, but leases of books and materials together with an intangible license to reproduce 60 copies. Taxpayer concedes that the original rental is subject to retail sales tax, but argues that the intangible license to reproduce is not.

Finally, Taxpayer states that some of its clients have already self-reported use tax on these training materials, either through an audit, or a tax return. Taxpayer asks that these sales be deleted from its tax assessment.

ISSUES:

1) Where a Taxpayer trains client employees to train other client employees on Taxpayer's . . . concepts and also enters into a written confidentiality and non-competition agreement with them, are their training activities sufficient to establish nexus between Washington and the out-of-state taxpayer?

2) Where a taxpayer sends a single copy of training material to a client with the right to reproduce a specified number of additional copies for use in conducting a training class, is the amount charged subject to use tax?

DISCUSSION:

[1] Nexus:

Washington imposes the wholesaling or retailing B&O tax on interstate sales of goods into Washington pursuant to RCW 82.04.220, RCW 82.04.270 and WAC 458-20-193 (Rule 193). However, these taxes may not be constitutionally imposed on interstate commerce unless a taxpayer has nexus with the taxing state. Rule 193(2)(f) 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.

Rule 193(7) describes the types of nexus-creating activities, when performed by a seller or its representative, that ". . . establish or maintain a market for its products in this state." These include activities where:

> (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".

The laws and regulations of the State of Washington do not require a seller's agent or other representative to reside in Washington for the B&O tax to apply. Soliciting orders by a representative or any significant activity which establishes or maintains a market within this state is sufficient. In addition, the representative's activity does not have to be the most important factor, but it is sufficient that it has an impact on sales. The Department has held in prior published determinations that "if the in-state activity is economically meritorious for a taxpayer (if it is worth spending budget dollars to do it), then the activity is market driven and it generally establishes nexus with the state of Washington." Det. No. 87-286, 4 WTD 51 (1987).

Under this reasoning, the Department has held infrequent visits to Washington customers by nonresident employees constituted sufficient nexus to allow the taxation of sales even though the employees were not salespersons. Det. No. 88-368, 6 WTD 417 (1988). Where employees provided advice to customers regarding the safe handling of a product, such activity was also found to be important in maintaining sales into the state. Det. No. 91-213, 11 WTD 239 (1991). See also Standard Pressed Steel Co. v. Washington Revenue Dept., 419 U.S. 560 (1975), where nexus was established through the presence of a resident employee engineer who was not involved in sales, but only consulted with the customer regarding the customer's product needs. This activity did not directly establish sales, but only helped to maintain the market.

In Taxpayer's case, Audit contends that the client's trained Trainers act as Taxpayer's agents or other representative in performing significant services to establish or maintain a market within this state. Taxpayer disputes Audit's claim.

The term "agency" is not defined in the Revenue Act. Absent a contrary definition in a statute, words are given their ordinary and common meaning, which can be found in dictionaries. John H. Sellen Constr. v. Department of Rev., 87 Wn.2d 878, 558 P.2d 1342 (1976). Black's Law Dictionary contains the following definition of "agency":

> Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act. Restatement, Second, Agency §. 1. . . . Black's Law Dictionary, at 58 (5th ed. 1979).

In applying the above definition of agency to Taxpayer's case, we first note that each of client's trained Trainers are required to sign an "Instructor Confidentiality and Non-Competition Agreement" with Taxpayer. This agreement states in part:

> . . . [Taxpayer] agreement with Client recognizes the unique relationship which will exist between you (Trainer) and [Taxpayer]. You will be trained by [Taxpayer] to present [Taxpayer's] specialized and unique . . . management courses and strategies to Client's employees.
>
> …
>
> In consideration for [Taxpayer] allowing you to attend [Taxpayer's] educational courses and have access to the Confidential Information, you have agreed to enter into this Agreement.
>
> You agree that you will teach and instruct [Taxpayer's] educational course in accordance with the methods and systems developed by [Taxpayer] and only with reference to the Materials provided by [Taxpayer]. You may personalize your presentation to Client's employees by using names and examples relevant to Client, but may not use with the Materials any substantive materials or techniques prepared or developed by you or any third party.
>
> You will at all times keep the Confidential Information in strict confidence; notify [Taxpayer] immediately of any known unauthorized reproduction, copying, possession or use of the Materials or the Confidential information; assist in preventing the occurrence of any such unauthorized reproduction, copying, possession or use; and, at the expense of [Taxpayer], cooperate in any litigation against third parties brought to protect [Taxpayer] or . . .'s rights in the Materials or the Confidential Information.
>
> . . .
>
> You hereby assign to [Taxpayer] the copyright and all other rights in and to any and all material developed by you which are based on or incorporate any part of the Materials or the Confidential Information, and you agree to execute and deliver all documents necessary or

> convenient to evidence such transfer when requested [Taxpayer]. (Brackets and parentheses added.)

The Instructor Agreement clearly establishes a fiduciary relationship between Taxpayer and the client's trained Trainer. It also indicates that the Trainers are required to act on Taxpayer's behalf to insure the confidentiality of proprietary trade secrets and other training material, develop copyrighted material relating to training, and through actually training Taxpayer's . . . concepts to other client employees. Furthermore, each agreement is signed by both the Trainer and Taxpayer, evidencing consent by both parties to the establishment of this fiduciary relationship. The agreement also reflects Trainer's consent to being under Taxpayer's control. Since all of the necessary elements are contained in the agreement, we find that an agency relationship exists between Taxpayer and the Trainers.

We further find that the client Trainer's activities of teaching Taxpayer's . . . Concepts in Washington, facilitating the enrollment of new training classes, and the reproduction of training materials, all constitute significant services in relation to the establishment or maintenance of sales into the state. Such activities are sufficient to establish nexus with the State of Washington. Taxpayer's petition is denied on this issue.

[2] Sale of property and license to reproduce a specified number of copies:

The sale or transfer of a copyrighted object consists of both the tangible personal property containing the copyrighted item and the bundle of copyrights related to them. Each is separately identified and can be treated differently for purposes of taxation. See generally, Nimmer on Copyrights, § 8.12 (1997).

When determining whether a retail sale of tangible personal property or some other type of property or service has been purchased, the Department has frequently focused on the "true object" of the transaction sought to determine the proper tax classification. Det. No. 89-009A, 12 WTD 1 (1992) (discount memberships); Det. No. 94-115, 15 WTD 019 (1994) (food demonstrations). See also WAC 458-20-211, ETA 520.04.211, and ETA 573.04.224. In Taxpayer's case, it is clear that when Taxpayer supplies a single tangible copy of books and/or other training material to an end user of the training material (the client), together with a limited license to reproduce a specified number of copies, the true object of the client-user is to acquire the tangible training material being reproduced. Whether the physical item being shipped is 60 sets of printed training material, or one set with a right to reproduce 59 additional sets, the true object of this transaction is the same. It is the tangible training material to be used in the classroom. Accordingly, we find these items to be tangible personal property and fully subject to the retail sales tax under RCW 82.08.050.

Finally, we will address Taxpayer's claim that some clients have already directly paid use tax to the State of Washington. RCW 82.08.020 imposes a retail sales tax upon "each retail sale in this state." RCW 82.08.050 provides that primary liability for payment of the sales tax lies upon the buyer of the property or services. It states:

> The tax hereby imposed shall be paid by the buyer to the seller, and each seller shall collect from the buyer the full amount of the tax payable in respect to each taxable sale. . . . The tax required by this chapter, to be collected by the seller, shall be deemed to be held in trust by the seller until paid to the department . . . . (Emphasis added.)

RCW 82.08.050 goes on to clarify that even though the burden of paying the retail sales tax is upon the buyer, the seller has a duty to collect the tax for the state. In the event that the seller fails to collect the tax, it is personally liable for the tax. RCW 82.08.050. In addition, where the buyer has failed to properly pay the retail sales tax, the Department may, at its discretion, proceed directly against the buyer.

After considering the language in RCW 82.08.050, we believe that Taxpayer, as seller of the products, may be relieved from its duty to collect and remit retail sales tax if Taxpayer can document that a buyer has either paid use tax directly to the state, or that a buyer has been subjected to an unqualified audit by the Department for the period of the sales transaction. Accordingly, Taxpayer will be allowed 90 days, or such additional period as Audit shall allow, to obtain the proper use tax affidavits from its clients and submit them to Audit.

DECISION AND DISPOSITION:

Taxpayer's petition is denied in part and remanded in part.

Dated this 22nd day of April 1999.