Cite as Det. No. 00-003, 19 WTD 685 (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. 00-003
. . .	)	
	)	Registration No. . . .

[1] RULE 193; RCW 82.04.220; U.S. CONST. ART. I, § 8, CL. 3: B&O TAX -- COMMERCE CLAUSE -- NEXUS -- TRADE SHOWS -- DEALER TRAINING. The Commerce Clause requires, inter alia, that there be substantial nexus before the state can impose B&O taxes on an out-of-state business. When a taxpayer's in-state activities are significantly associated with its ability to establish and maintain a market in this state, substantial nexus is established. A taxpayer engages in activities significantly associated with its ability to establish and maintain a market when it provides, on a regular and recurring basis, in-state training and promotional support for products sold in Washington.

[2] RULE 193; RCW 82.04.220; U.S. CONST. AMEND. XIV: B&O TAX – DUE PROCESS CLAUSE – RATIONAL RELATION -- TRADE SHOWS -- DEALER TRAINING. In addition to some minimal connection or "nexus" between the interstate activities and the taxing state, there must be a rational relation between the income attributed to the state and the intrastate value of the enterprise. Washington's B&O tax by its nature is proportioned to in-state activities, because it is collected only upon the gross proceeds of sales in Washington.

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.

Mahan, A.L.J. – Out-of-state corporation that sells motor homes to dealers in Washington contends it neither has Commerce Clause nexus nor does its activities in Washington meet due process requirements for the imposition of Washington's wholesaling business and occupation (B&O) tax.[1]

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

ISSUES:

1. Whether a wholesaler of motor homes has substantial nexus with this state for B&O tax purposes when, on a regular and recurring basis, it attends in-state trade shows in support of its Washington dealers, provides in-state training to its Washington dealers, its employees deliver some of the motor homes into Washington, and its authorized dealers provide warranty work in Washington.

2. Under the Due Process Clause, whether the state's imposition of B&O tax resulted in the taxpayer's gross receipts being taxed out of all appropriate proportion to the business transacted in Washington.

FACTS:

The taxpayer, an out-of-state corporation, manufactures and sells motor homes and travel trailers to various authorized dealers located in the state of Washington. In 1993, the taxpayer completed a Master Business Application, applied to the Secretary of State for a Certificate of Authority to do business in Washington, and filed a Vehicle Manufacturer's License Bond with the Department of Licensing. In that same year, it wrote to the Department of Revenue (Department) and requested that it be listed as a "no nexus" account. It explained that it did not directly solicit sales in this state.

In a letter to the taxpayer, the Department concluded the taxpayer had taxable nexus with Washington. The question of taxpayer's nexus to Washington originally came before the Appeals Division on an appeal of this letter from the Department. For purposes of that appeal, the taxpayer supplied information concerning trips made by the taxpayer's employees to the State of Washington in 1994 and 1995. Based on this information, we held that sufficient nexus existed. Det. No. 96-144, 16 WTD 201 (1996).[2] This matter comes back before us based on two assessments, one dated November 30, 1998 for the 1994 through 1997 period in the amount of $. . ., and one dated March 2, 1999 for 1998 in the amount of $. . . .

As discussed in Det. No. 96-144, the taxpayer's employees provide dealers, on the dealer's premises, with training on the taxpayer's products. It also attends "trade shows" in Washington. At those trade shows, the taxpayer's employees "work with the dealerships with on-site and off-site retail sales promotions as factory trained representatives in order to answer any questions a retail customer may have in regard to the construction, features and benefits" of the taxpayer's products. The employees also bring with them brochures and other promotional and training materials on trips into Washington.

In 1994, the taxpayer made seven trips into Washington for approximately nineteen days of promotional efforts and training. In 1995, it made eight trips into Washington for approximately twenty-three days of promotional efforts and training. In 1996, it made eight trips into Washington

[2] The taxpayer appealed Det. No. 96-144 to the State of Washington Board of Tax Appeals, No. 50315. By order dated May 11, 1998, the Board dismissed the appeal on jurisdictional grounds. The Department had neither issued an assessment nor denied a refund claim, and such departmental actions are necessary to give the Board subject matter jurisdiction. *See* RCW 82.03.190; 82.32.190.

for approximately twenty-seven days of promotional efforts and training. In 1997, it made three trips into Washington for approximately six days of promotional efforts and training. In 1998, it made four trips into Washington for approximately six days of promotional efforts and training.

The taxpayer states that it did not employ any independent contractors in Washington during the 1994-1998 period for the purpose of soliciting business, providing product information, providing training, providing consulting services, or assisting with sales in Washington. It further states it did not own any tangible property located or stored in Washington State during the 1994-1998 period, and it did not retain title or an ownership interest in any of the motor homes or travel trailers delivered to dealers in Washington. It also did not own or lease any real property in Washington.

During the 1994-1998 period, the taxpayer's sales into Washington averaged $[several million] per year, not including freight. This accounted for an average of 6.26% of the taxpayer's total sales.

During the 1994-1998 period, the taxpayer averaged 198 deliveries per year into Washington. Although common carriers delivered most of the motor homes and travel trailers into Washington, the taxpayer's employees made approximately 16% of the deliveries.

Under the terms of the taxpayer's Retail Sales and Service Agreement, the taxpayer appoints a dealer as an "authorized" dealer. The dealer purchases the taxpayer's products at wholesale and agrees to maintain a minimum inventory of new products for sale to the public. The dealer agrees to actively promote the taxpayer's products, including agreeing "to conduct an advertising program and promotions and to represent [the taxpayer] at shows and exhibitions which may affect the market for [taxpayer's products] in all market areas defined in the Dealer Data Sheet."

The taxpayer's agreement with dealers also required the dealers to maintain a stock of parts and to employ trained service personnel to perform repairs and service on the taxpayer's products. For repairs under the taxpayer's express written warranties, the taxpayer relies on twenty-two independent authorized dealers in Washington. Warranty repairs in Washington averaged over . . . million dollars per year during the 1994-1998 period.

ANALYSIS

Washington imposes its B&O tax for the "act or privilege of engaging in business activities" in Washington. RCW 82.04.220. The taxpayer contends the state's imposition of wholesaling B&O tax (RCW 82.04.270) on the taxpayer's sales in Washington placed an undue burden on interstate commerce, in violation of both the Commerce Clause of the United States Constitution, Art. I, § 8, cl. 3, and the Due Process Clause of the United States Constitution, Amend. XIV. In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the U.S. Supreme Court discussed the differences between the Due Process Clause and the Commerce Clause. Although the two clauses are closely related, the "two constitutional requirements differ fundamentally, in several ways" and "are

analytically distinct." *Id.* at 305. We will separately address the taxpayer's due process and Commerce Clause claims.

1. Commerce Clause.

The Commerce Clause grants Congress the power "to regulate commerce among the several states." The United States Supreme Court in numerous decisions has interpreted the Commerce Clause to prohibit, by negative implication, state taxes that unduly burden or discriminate against interstate commerce. *See, e.g., Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 289 (1977). In *Complete Auto* the court adopted a four-part test under the Commerce Clause 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.

See also American National Can v. Dept. of Rev., 114 Wn.2d 236, 241, 787 P.2d 545 (1990). We are concerned here only with the substantial nexus part of the *Complete Auto* test.

It is well settled that the nexus part of the test is satisfied by the in-state solicitation of orders by either an independent contractor or an employee of the out-of-state manufacturer or retailer. *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960); *Tyler Pipe Industries, Inc. v. Washington State Dept. of Rev.*, 483 U.S. 232 (1987). Moreover, it is not necessary for the independent contractor or employee to be engaged in the direct solicitation of orders for nexus purposes. *Standard Pressed Steel Co. v. Department of Revenue*, 419 U.S. 560 (1975); *National Geographic Society. v. California Bd. of Equalization*, 430 U.S. 551 (1977); *see also Arizona Dept. of Rev. v. O'Connor, Cavanagh, Anderson, Killingworth & Beshears, P.A.*, 192 Ariz. 200; 963 P.2d 279 (1997).

In *Standard Pressed Steel* an employee worked out of his home. He did not solicit business and only consulted with an in-state customer regarding its needs and requirements. The court held that this activity provided sufficient nexus for the imposition of the B&O tax on sales by an out-of-state manufacturer to its Washington customer. In *National Geographic*, the court upheld a use tax collection obligation with respect to mail order subscriptions sent to an out-of-state office based on the physical presence of two advertising sales offices located in the taxing state. The court held that the in-state activity did not have to be directly related to the activity being taxed, but that the vendor had to have a physical presence in the taxing state, which must be more than the "slightest presence." *National Geographic*, 430 U.S. at 556.

In *Tyler Pipe*, the court affirmed the imposition of B&O tax when the taxpayer's independent contractor solicited orders and visited with customers in Washington state, although the company maintained no office, owned no property, and had no employees within the state. The court concluded:

> 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.[3]

In applying this test in the present case, we find the taxpayer engaged in significant local economic activities in relation to creating and maintaining a market in this state for its wholesale sales of motor homes and trailers. It did this through the in-state training of dealers, supporting dealers' promotional efforts at in-state trade shows, introducing and promoting new products in Washington, establishing a network of independent contractors in Washington to satisfy the taxpayer's obligations under its written warranties, and delivering products into Washington. Such activities were regular and recurring. The totality of taxpayer's efforts resulted in a significant amount of sales in Washington. Overall, the nature and extent of the taxpayer's activities in Washington satisfy traditional commerce clause nexus concerns.

The taxpayer's activities in Washington also do not fall within the safe harbor identified in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). Although abandoning a physical presence requirement for Due Process purposes, the *Quill* Court retained the requirement for Commerce Clause purposes, at least in cases involving the collection of use tax or retail sales tax. It did so in order to provide a "bright-line" test or safe harbor with respect to certain interstate transactions. It also affirmed that more than the "slightest presence" was required to establish substantial nexus in use tax and retail sales tax collection cases. *Id.* at 305, n.8. The *Quill* decision effectively set a bright line test as to who cannot be taxed (vendors, like Quill, whose only contacts are through mail order or common carrier) but left open the question as to which vendors can be taxed when local activities go beyond merely mail order or common carrier deliveries.

In Det. No. 96-144, we concluded that, once the activities of a company go beyond purely mail order activities, and it has demonstrably more than the slightest presence in the state, substantial nexus is established. In reaching this conclusion, we relied on the reasoning in *Matter of Orvis Co., Inc. v. Tax Appeals Tribunal*, 86 N.Y.2d 165, 630 N.Y.S.2d 680, 654 N.E.2d 954 (1995).

In *Orvis*, the court held that an average of four visits per year over three years by a mail order company's employees to visit nineteen customers in New York created substantial nexus for use tax collection purposes. The employees solicited business, communicated with retailers about various problems, and inspected the retail stores where products bearing the Orvis trademark were sold. The

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[3] In a similar fashion, by administrative rule, WAC 458-20-193 (Rule 193), the Department defines the term "nexus" for B&O tax purposes to mean:

> [T]he activity carried on by the seller in Washington which is significantly associated with the seller's ability to establish or maintain a market for products in Washington.

WAC 458-20-193(2)(f); *see also* Det. No. 93-281, 14 WTD 035 (1994).

same was true for a second taxpayer before the court, a mail order computer supplier that sent technicians into New York on forty-one occasions for trouble-shooting purposes during a three-year audit period. The court reasoned that a substantial presence was not required under Quill, but only more than the slightest presence.

> While a physical presence of the vendor is required, it need not be substantial. Rather it must be demonstrably more than a "slightest presence" [citations omitted] . . . . And it may be manifested by the presence in the taxing State of the vendor's property or the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf.

654 N.E. 2d at 960-61.

Since deciding Det. No. 96-144, courts in several other states have followed the holding in *Orvis* and sustained either the imposition of tax or the duty to collect taxes. *See, e.g., Magnetek Controls, Inc. v. Revenue Div., Department of Treasury*, 221 Mich. App 400; 562 N.W. 2d 219 (1997); *Hi-Tech Housing, Inc., Petitioner, v. State of Michigan Dept. of Treasury Rev. Div.*, No. 241717 (Mich. Tax Tribunal 1999) ("Petitioner's employees conducted business activities in Michigan on its behalf and . . . independent contractors . . . performed services in Michigan to satisfy Petitioner's obligations under its express written warranty"); *Brown's Furniture, Inc. v. Wagner*, 171 Ill. 2d 410, 665 N.E. 2d 795 (1996); *see also G&C Properties, Inc. v. Department of Rev.,* No. 49874 (Wn. Bd. of Tax Appeals 1996).[4]

At issue in *Magnetek* was the application of the "throwback" provision of the Michigan Single Business Tax and whether sales from foreign states outside of Michigan were correctly excluded in determining Magnetek's tax liability.[5] MCL 208.52(b); MSA 7.558(520(b). In determining the taxpayer had substantial nexus in other jurisdictions, the *Magnetek* court identified various activities that provided substantial nexus with foreign states, including meetings with sales representatives to improve sales, conducting group seminars for potential customers, attending trade shows, assessing competitors' products, giving representatives feedback and suggestions, and accompanying representatives on sales calls to certain customers. *Id*. at 403-404. The court concluded that such economic activities in the other states where Magnetek conducted business along with activities by part-time independent sales persons constituted demonstrably more than the slightest presence in the other states. As such, Michigan's throwback provision did not apply to the income derived from activities in these other states.

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[4] The taxpayer cited several cases from other jurisdictions where the courts did not find substantial nexus. Those cases are distinguishable on the facts and the reasoning employed by the court. See Florida Dept. of Revenue v. Share International, Inc., 667 So. 2d 226 (Fla. 1995), *aff'd*, 676 So. 2d 1362, *cert. denied*, 519 U.S. 1056 (1997) (in-state physical presence limited to a single three-day visit to attend a trade show, with retail sales tax collected on sales generated at the trade show but not through mail orders); *In re Petition of NADA Services Corp.*, No. 810592 (N.Y. Div. Of Tax Appeals 1996) (no product oriented visits for either sales or technical support). In contrast to those cases, the taxpayer on a regular, recurring, and systematic basis entered Washington to engage in economic activities significantly related to its business activities in Washington.

[5] The court also concluded that *Quill's* Commerce Clause analysis applies to cases involving both the imposition of taxes and the collection of use tax. 562 N.W. 2d at 221, n. 3.

The Illinois Supreme Court in *Brown,* following the *Orvis* rationale, found that Brown's Furniture had a substantial nexus with Illinois although Brown's Furniture had no property, offices, or employees within the state. Brown's Furniture conducted extensive advertising in Illinois and made deliveries to Illinois on a regular basis. These periodic deliveries were found to be neither occasional nor sporadic and, thus, the sales revenues gained from transactions with Illinois customers were subject to Illinois income tax. In levying the income tax, the court found that a substantial physical presence of a vendor was not required, but only a physical presence more than the "slightest" presence was required.

Consistent with this line of cases, we find the taxpayer's local economic activities manifest more than slightest presence in Washington. The in-state training of dealers, the support of dealers' promotional efforts at in-state trade shows, the introduction and promotion of new products in Washington, the establishment of a network of independent contractors in Washington to satisfy the taxpayer's obligations under its written warranties, and the delivery of products into Washington by the taxpayer show more than the slightest presence in Washington. Although the present case does not involve the use of in-state independent sales personnel, as occurred in some of the cited cases, the presence of such persons is not controlling. *See Standard Pressed Steel, supra.*

Overall, we find taxpayer's in-state economic activities satisfy the Commerce Clause's substantial nexus requirement, and we find no basis to overrule Det. No. 96-144.[6] Accordingly, we sustain the Department's imposition of B&O tax and deny the taxpayer's Commerce Clause claim.

2. Due Process.

The Due Process clause of the Fourteenth Amendment imposes two requirements on a state before it can tax income generated in interstate commerce: (1) some minimal connection or "nexus" between the interstate activities and the taxing state and (2) a rational relation between the income attributed to the state and the intrastate value of the enterprise. *Quill Corp. v. North Dakota*, 504 U.S. 298, 311 (1992); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978).[7] The

[6] Taxpayer also argues that a lower nexus threshold is required in use tax collection cases than in tax imposition cases (referred to as "indirect" v. "direct" taxation cases). We do not address this argument, because the nexus at issue here concerns only the imposition of Washington's excise tax and not the collection of use tax. We do not need to decide whether a use tax collection case would withstand scrutiny under a lower standard than what we apply in the case before us. *See Arizona Dept. of Rev. v. O'Connor, Cavanagh, Anderson, Killingworth & Beshears, P.A.*, 192 Ariz. 200, 963 P.2d 279, 284, n. 6 (1997).

[7] In *Quill* the U.S. Supreme Court was concerned with the first element and stated, at 310:

> Due process centrally concerns the fundamental fairness of governmental activity. Thus, at the most general level, the due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him. We have, therefore, often identified "notice" or "fair warning" as the analytical touchstone of due process nexus analysis.

The taxpayer concedes that it has due process nexus with Washington.

taxpayer contends Washington's imposition of B&O in the present case violates the second element of this test.

With respect to the second element, wide latitude is given to a state's selection of a method for attributing value. This selection will not disturbed except when a taxpayer has "proved by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportion to the business transacted . . . in that State' or has 'led to a grossly distorted result.'" *Moorman*, 437 U.S. at 274 (citations omitted). The second element is met if the state's taxing formula is not inherently arbitrary and does not tax a portion of the taxpayer's income out of all appropriate proportion to the business transacted in that state. *Exxon Corp. v. Department of Rev.*, 447 U.S. 207, 227 (1980).

The Washington Supreme Court has held that the State of Washington's B&O tax on interstate sales, by its nature, satisfies the second prong of this due process test.

> Washington's B & 0 tax on interstate businesses has previously been held valid under this due process test. *See General Motors Corp. v. Washington, supra*. The formula is neither arbitrary nor all out of proportion to the business activities within the state, for it is collected only upon the gross proceeds of sales "in this state". WAC 458-20-193B. No such tax is assessed against interstate sales to other states. Hence the tax is inherently proportioned to in-state activities.

Chicago Bridge & Iron Co. v. Department of Rev., 98 Wn.2d 814, 824, 659 P.2d 463 (1983).

The taxpayer has presented no facts or authority by which to reach a different result.[8] The state provided the taxpayer with a stable and secure environment for it to conduct business in Washington. By imposing a B&O tax only on the taxpayer's business activity in Washington, this state did not tax the taxpayer's income out of all appropriate proportion to the business transacted in Washington. Accordingly, we sustain the Department's imposition of B&O tax and deny taxpayer's Due Process Clause claim.

ORDER

The taxpayer's petition is denied.

Dated this 24th day of January 2000.

[8] Taxpayer does refer to various cases in Washington where the courts have, by analogy, utilized due process concepts in setting limits on the ability of a city in Washington to impose the city's excise tax on activities occurring outside the city's jurisdiction. *See, e.g., Dravo Corp. v. Tacoma*, 80 Wn.2d 590, 496 P.2d 504 (1972). Those cases are of little or no relevance in addressing the application of the Due Process clause to interstate transactions, such as are at issue in the present case.