Cite as Det No. 10-0057, 30 WTD 82 (2011)

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. 10-0057
. ..	)	
	)	Registration No. . . .
	)	Document No. . . ./Audit No. . . .
	)	
	)	Docket No. . . .
	)	

Rule 193: B&O TAX – RETAIL SALES TAX - NEXUS – AFFILIATED CORPORATION AS TAXPAYER'S REPRESENTATIVE. An out-of-state mail order retailer was found to have substantial nexus with Washington where an in-state affiliate sold gift cards to customers that could be used to place catalog orders, distributed the out-of-state company's catalogs, and assisted the out-of-state company's customers. The in-state affiliate's activities were significantly associated with the out-of-state company's ability to establish and maintain a market in this state and therefore create nexus.

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.

Chartoff, A.L.J. (successor to Moore, ALJ) – An out-of-state mail order retailer with a related corporation operating retail stores in this state, petitions for cancellation of an assessment of business and occupation (B&O) tax and retail sales tax on mail order sales to Washington customers, contending it does not have substantial nexus with Washington State. We conclude the related corporation performs activities on behalf of the taxpayer that are significantly associated with the seller's ability to establish or maintain a market in this state for the sales, and therefore, establish nexus for the taxpayer in this state. We sustain the assessment.[1]

ISSUE

Under WAC 458-20-193, does an out-of-state mail order retailer have substantial nexus to Washington where related in-state retail stores distribute the taxpayer's catalogs free of charge,

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

provides some limited assistance to taxpayer's customers regarding returns, and sells gift cards that can be redeemed by mail order?

FINDINGS OF FACT

The taxpayer . . . is an out-of-state corporation that sells . . . supplies by mail order catalog. The taxpayer was incorporated as a wholly owned subsidiary of [a parent company] ("the parent") [in] 2003.

Before [taxpayer was incorporated], the parent corporation sold . . . supplies through mail order catalog, retail stores, and online . . . . The parent [then] reorganized the business by creating four wholly owned subsidiary corporations and dividing its operations amongst the four subsidiaries. The four subsidiaries are: the taxpayer, which owns and operates the catalog orders and sales; [a second company that] owns and manages the retail stores; [a third company], which owns and manages the internet operations, and [a fourth company] which publishes and distributes a . . . supply magazine.

All three retail subsidiaries continued do business under the [parent company name]. The three retail subsidiaries all carried the same merchandise, although the stores carried an abbreviated selection. The three retail subsidiaries and the parent continued to share the same offices, and shared the same Chief Executive Officer, Secretary, and President. Pursuant to a shared services agreement, the parent provided the following services to the retail subsidiaries: executive management, financial services, advertising services, management information system services, regulatory affairs, procurement of all inventory items which are resold by the subsidiaries, management of gift card program, and miscellaneous other services.

The taxpayer operates from offices [outside of Washington] and has no employees or inventory in Washington State. However, the taxpayer's sister corporation . . . operates two retail stores in Washington State. At issue in this case is whether [taxpayer's sister corporation] performs significant services on behalf of the taxpayer in relation to establishment or maintenance of the taxpayer's sales into the state. We find that [taxpayer's sister corporation] engages in the following activities in this state with respect to the taxpayer.

[Taxpayer's sister corporation] purchases the taxpayer's catalogs for [a] nominal cost from the parent, and then distributes them free of charge to customers at its retail stores in Washington.

[Taxpayer's sister corporation] sells gift cards at its Washington retail stores that can be redeemed by mail order, online, or at retail locations. The parent manages the gift card program for the subsidiaries as follows:

> During the Audit period, [the company's] gift cards were sold through its various operating subsidiaries. When the gift cards were sold, the cash was received by and recorded in the financial records of the subsidiary. The cash receipts and liability for the card was subsequently transferred to the parent company . . . through intercompany

> transaction. The transfer was in accordance with [the parent company's] centralized cash management policies.
>
> Upon redemption, the intercompany liability on the financial records of [the parent company] was relieved, with the sales recorded on the financial records of the subsidiary.

The taxpayer states that the parent has no method for determining which subsidiary sold the gift card being redeemed.

The taxpayer's return policy is to direct customers to mail returns to its . . . offices [outside of Washington]. The taxpayer does not advertise that returns will be accepted at [taxpayer's sister company's retail] locations. [Taxpayer's sister company's retail] locations do routinely accept returns for full refund of items purchased by catalog, if the items are carried in the store. However, the taxpayer asserts that, to the extent a store accepts returns, it is at the store's own cost, and is not recorded as a return on the taxpayer's books. [Taxpayer's sister company's] written policy is that the retail store may not accept returns of items purchased by catalog or online. However, the policy states that [taxpayer's sister company] will provide limited assistance to customers in routing the purchase back to the appropriate location. The policy states:

> If you have a customer returning a catalog or internet purchase at the store, you are to explain that we are unable to accept returns from those business units due to tax purposes. You may offer free postage to have the product returned . . . .
>
> To do so, contact Customer Services at . . . or email . . . to arrange for a return service label to be sent to the customer's home address. They may then use that label to return the product free of charge. This would allow the customer 24/7 access to the ability to arrange a return.

The Taxpayer Account Administration Division (TAA) of the Department of Revenue (the Department) performed a desk examination of the taxpayer's account for the period of August 1, 2003 through July 31, 2006. TAA determined that the taxpayer was engaged in taxable business in Washington State and was not properly registered or filing returns. TAA issued an assessment of $. . ., consisting of retail sales tax, retailing B&O tax, wholesaling B&O tax, interest, and penalties. The taxpayer petitioned to the Appeals Division of the Department for cancellation of the assessment, arguing the taxpayer does not have substantial nexus with Washington State, and that TAA overstated the gross sales amount.[2] TAA replied that it is possible gross sales were overstated, and that TAA could further examine this claim on remand.

[2] The taxpayer states that "Upon calculating the gross retail sales, the Department did not offset wholesale sales amounts from the total gross sales. As a result, the Department overstated the gross sales amounts on the schedules that pertain to the Retailing B&O Tax and the Retail Sales Tax."

ANALYSIS

Washington imposes the B&O tax on every person for the act or privilege of engaging in business activities in Washington. RCW 82.04.220. The tax is measured by applying particular rates against the value of products, gross proceeds of sales, or gross income of the business as the case may be. *Id*. The gross proceeds from the sale of tangible personal property to consumers in this state are taxable under the retailing or wholesale classification of the B&O tax. RCW 82.04.250; RCW 82.04.270; RCW 82.04.050; WAC 458-20-103. The retail sales tax is levied and required to be collected on each retail sales in this state. RCW 82.08.020.

WAC 458-20-193 (Rule 193) explains Washington's B&O tax application to interstate sales of tangible personal property. It states, in relevant part:

> (7) **Inbound sales.** Washington does not assert B&O tax on sales of goods which originate outside this state unless the goods are received by the purchaser in this state and the seller has nexus. There must be both the receipt of the goods in Washington by the purchaser and the seller must have nexus for the B&O tax to apply to a particular sale. The B&O tax will not apply if one of these elements is missing. . . .
>
> (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:
>
> (i) The goods are located in Washington at the time of sale and the goods are received by the customer or its agent in this state.
>
> (ii) The seller has a branch office, local outlet or other place of business in this state which is utilized in any way, such as in receiving the order, franchise or credit investigation, or distribution of the goods.
>
> (iii) The order for the goods is solicited in this state by an agent or other representative of the seller.
>
> (iv) The delivery of the goods is made by a local outlet or from a local stock of goods of the seller in this state.
>
> (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".

(vi) The out-of-state seller, either directly or by an agent or other representative in this state, installs its products in this state as a condition of the sale.

With respect to the duty to collect retail sales tax or use tax, "substantial nexus" includes a requirement of some physical presence (more than the "slightest presence") in the state. *Quill Corp. v. North Dakota*, 504 U.S. 298, 315, (1992). In Det. No. 96-144, 16 WTD 201 (1996), 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.

Nexus may be established through the activities of the seller's employees or independent contractor representatives. Rule 193(7); *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960); *Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue*, 483 U.S. 232 (1987).[3]

It is not necessary for the employee or independent contractor to be engaged in the direct solicitation of orders for nexus purposes. Any activity performed in this state on behalf of the seller that is significantly associated with the seller's ability to establish or maintain a market in this state for the sales establishes nexus over the seller. Rule 193(7); *Standard Pressed Steel Co. v. Department of Rev.*, 419 U.S. 560 (1975); *National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551 (1977).

The applicable example of sufficient nexus listed under Rule 193(7)(c) in this case is example (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.'" Services in the state in relation to sales that fit that description will also meet the demonstrably more than the slightest presence requirement of *Quill*.

In the present case, the taxpayer does not have a sales office or employees in Washington State. The taxpayer's employees take orders from Washington customers by phone or mail order from its offices [outside of Washington], and deliver the orders to Washington solely by common carrier.

The issue presented in this appeal is whether the activities performed in this state by [taxpayer's sister corporation] are sufficient to establish nexus to tax the taxpayer. . . . In order for the activities of [taxpayer's sister corporation] to establish nexus for the taxpayer, [it] must act on the

[3] In *Scripto*, a Georgia corporation's only connection with Florida was that it had ten wholesalers, jobbers, or "salesmen" conducting continuous local solicitation in Florida and forwarding the orders from Florida to the Georgia seller for shipment. The court held that Florida could constitutionally impose upon the Georgia seller the duty of collecting Florida's use tax upon goods shipped to customers in Florida. In *Tyler Pipe,* the court held that Washington had sufficient nexus with an out-of-state seller whose only connection with Washington was the use of independent contractors in the state who acted daily on its behalf to solicit sales, call on customers, and maintain and improve the seller's goodwill, customer relations, and name recognition.

taxpayer's behalf as an agent or representative, and the activity must be significantly associated with taxpayer's ability to establish or maintain a market in Washington for its sales.

The facts establish that [taxpayer's sister company's] retail stores in this state perform activities significantly associated with the taxpayer's ability to establish or maintain a market in Washington for its sales. First, and most significantly, [taxpayer's sister company's] retail stores sell gift cards that may be redeemed by the customer at the taxpayer's mail order store. Under the gift card program, managed by the parent, proceeds from the subsidiaries' sales of gift cards and passed through to the parent, and when redeemed, the sale is recorded in the financial records of the appropriate subsidiary. In this way, [taxpayer's sister company] actually facilitates or makes sales on behalf of the taxpayer. As a result, we conclude that the activity of selling gift cards which can be redeemed by mail order is significantly associated with the taxpayer's ability to establish or maintain a market in Washington.

In addition, [taxpayer's sister company's] retail stores distribute the taxpayer's catalogs free of charge to customers, and assist customers in returning catalog purchases by calling or emailing customer service to request a free shipping label be sent to the customer.

The taxpayer cites *Bloomingdale's By Mail, Ltd. v. Com., Dept. of Revenue* 130 Pa. Commw. 190, 567 A.2d 773 (Pa. Commw. 1989), *SFA Folio Collections, Inc. v. Tracy*, 652 N.E.2d 693, 697 (Ohio 1995), and *SFA Folio Collections, Inc. v. Bannon*, 585 A.2d 666 (Conn. 1991), for its position that the presence of an in-state affiliated retail store does not create nexus for the out-of-state mail order company. In these cases, courts did not find substantial nexus where the affiliated in-state retailer accepted returns according to the retail location's own policy or as an aberration from the store's policy or normal practice. In *SFA Folio v. Tracy*, the affiliated in-state retailer also distributed a small number of mail order catalogs to customers. In that case, the court concluded that the presence of 200 catalogs in Ohio was a tenuous thread on which to base nexus. We find the above cited cases are not persuasive in the present case because [taxpayer's sister company's] activities are more extensive. In the present case, not only does [taxpayer's sister company] distribute catalogs and accepts returns, but it sells gift cards that can be redeemed for merchandise in those catalogs.

The taxpayer also argues that [taxpayer's sister company] buys the catalogs from the parent and therefore is a customer of the taxpayer rather than an agent. The creation of an agency or representative relationship can be implied based on conduct, circumstances, or ratification. Recently, in *Borders Online, LLC v. State Bd. of Equalization*, 129 Cal. App. 4th 1179, 29 Cal. Rptr.3d 176 (Cal. App. 2005), the California Court of Appeals held that Borders retail stores in California (Borders) were engaged in selling property as authorized representatives of Borders Online (Online), an out-of-state internet retailer, and therefore established nexus for Online. While there was no written agreement between Borders and Online evidencing an agency or representative relationship, the court found that such agreement was implied, reasoning, in part: "Online announced on its website that Borders was authorized to accept Online's merchandise for return, or that Borders would provide customers with an exchange, store credit, or a credit card credit. By accepting Online's merchandise for return, Borders acted on behalf of Online as its agent or representative in California." *Id*. at 1190. Additional factors evidencing an agent or representative relationship were that:

> Borders's receipts were sometimes imprinted with "Visit us online at www.Borders.com," and Borders's employees were encouraged to refer customers to Online to find merchandise not available at Borders stores. The cross-selling synergy was also maintained by the use of similar logos, by the link to Borders' website from Online's website, and by the sharing of some market and financial data between the two entities. Online generated more than $1.5 million in sales in California in 18 months. These facts amply support the conclusion that Online had a representative with a physical presence in the State and the representative's activities were "significantly associated with [Online's] ability to establish and maintain a market in [the] state for the sales."

. . . Similarly, in the present case, the "cross-selling synergy" was maintained by operating under the same business name, selling the same merchandise, distributing catalogs at the retail store, [and] selling gift cards that can be redeemed by mail order, online or at the retail store. . . . Under the facts, we find that [taxpayer's sister company] acts as the taxpayer's authorized representative in this state, and that [taxpayer's sister company's] activities were significantly associated with the taxpayer's ability to establish or maintain a market for sales in this state. In addition, we question the business purpose for buying a competitor's catalog and distributing it free of charge to customers, and also note that the taxpayer does not purchase and distribute any other competitor's catalogs. We find the taxpayer's claim that [taxpayer's sister company] is the customer of the taxpayer is not credible, under the circumstances.

We conclude that [taxpayer's sister company's] sale of gift cards to customers that can be used to place catalog orders, as well as the distribution of catalogs, and assistance of taxpayer's customers are significantly associated with the taxpayer's ability to establish and maintain a market in this state and therefore confers nexus. Accordingly, we sustain the assessment but remand for TAA to review the gross income amounts on which tax was calculated to determine if they were overstated.

DECISION AND DISPOSITION

The taxpayer's petition is denied in part and remanded in part. The taxpayer's claim that it does not have substantial nexus with Washington State is denied. The taxpayer's claim that gross income amounts were overstated is remanded to TAA for review.

Dated this 18th day of February 2010.