Cite as Det. No. 17-0229, 38 WTD 46 (2019)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 17-0229
. . .	)	Registration No. . . .

[1] RCW 82.04.067: B&O TAX – NEXUS WITH WASHINGTON. The standard for determining whether nexus exists is whether the activity is "significantly associated with establishing or maintaining a market within this state."

[2] *Irwin Naturals v. State of Washington*, 195 Wn. App. 788, 382 P.3d 689 (2016); *Avnet, Inc. v. State of Washington, Dep't of Revenue,* 187 Wn.2d 44, 61, 384 P.3d 571, 580 (2016): DISSOCIATION OF SALES MADE IN WASHINGTON. Taxpayers bear the burden of showing lack of connection between its nexus creating activities and the sales it seeks to dissociate. The fact that "sizing nights" may have only affected a certain percentage of sales is insufficient to show a lack of connection between the visits and Taxpayer's internet 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.

Lewis, T.R.O. – Taxpayer, an internet retailer, challenges assessment of business and occupation ("B&O") tax and retail sales tax. Taxpayer disputes that it had sufficient physical presence within Washington to create the substantial nexus to allow Washington to tax its sales. Taxpayer also maintains that certain of its sales should be dissociated from its Washington activity. Taxpayer's petition is denied.[1]

ISSUES:

1. Whether Taxpayer's physical presence within Washington is sufficient to establish substantial nexus with Washington under RCW 82.04.067(6).

2. If so, is Taxpayer eligible to dissociate certain sales from Washington nexus under *Norton Co. v. Dep't of Revenue of State of Illinois*, 340 U.S. 534 (1951)?

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

FINDINGS OF FACT:

Taxpayer is a foreign corporation with its principal place of business located outside Washington. Taxpayer sells sports apparel, equipment, and accessories to consumers through two websites. Taxpayer has no employees or property within Washington. Taxpayer ships all orders from locations outside Washington to customers by common carrier.

During the period examined by the Department of Revenue (Department), a nonresident representative visited Washington two or three times per year for "sizing nights."[2] The representative did not take orders, solicit business, or make sales at these events. The sizing nights allowed members of local sports clubs or teams that had decided to use Taxpayer as their uniform supplier to determine their correct uniform size. Depending on the situation, either the team members would be purchasing the uniforms from Taxpayer or the team would purchase the uniforms from Taxpayer. In either case, when Taxpayer's representative visits the team for sizing night a decision has already been made to purchase the uniforms from Taxpayer. In either case, the uniforms are purchased from Taxpayer through its website.

During June 2015, the Department's Compliance Division ("Compliance") initiated a tax discovery investigation of Taxpayer's business operation. Taxpayer's Chief Financial Officer ("CFO") completed and returned the Washington Business Activity Questionnaire ("WBAQ"). The completed WBAQ disclosed that Taxpayer sold . . . products into Washington.

The WBAQ disclosed that a nonresident representative began visiting Washington in May 2010. The representative visited Washington three times per year for a period of three days per visit. While in Washington, the nonresident representative assisted customers with the correct sizing of their order. The goods were shipped to the customer by common carrier.

Based on the information Taxpayer provided, the Compliance Division ("Compliance") issued two audit reports, which included the period when Taxpayer had a physical presence within Washington. One audit report included the period May 1, 2010, through December 31, 2010. The other audit report included the period January 1, 2011, through December 31, 2015. On August 12, 2016, the Department issued two assessments totaling $ . . . .[3] Taxpayer disagreed with the assessment. On September 15, 2016, Taxpayer filed a petition requesting correction of the assessment. Taxpayer's petition maintained that: 1) Taxpayer did not have substantial nexus with Washington; and 2) Taxpayer was not required to pay tax on sales that were not associated with the representative's in-state activity.

[2] For some years at issue, Taxpayer's representative was a nonresident employee. For other years, Taxpayer's representative was an independent contractor.

[3] The May 1, 2010, through December 31, 2010, audit resulted in a $ . . . assessment consisting of $ . . . in tax, $ . . . in interest, a $ . . . late-payment penalty, a $ . . . assessment penalty, and a $ . . . unregistered business penalty. The January 1, 2011, through December 31, 2015, audit resulted in a $ . . . assessment consisting of $ . . . in tax, $ . . . in interest, a $ . . . late-payment penalty, a $ . . . assessment penalty, and a $ . . . unregistered business penalty.

ANALYSIS:

Washington imposes a B&O tax on "every person that has a substantial nexus with this state . . . for the act or privilege of engaging in business activities" in this state. RCW 82.04.220. The tax is measured by applying particular rates against the value of the products, gross proceeds of sale, or gross income of the business as the case may be. RCW 82.04.220. RCW 82.04.250 imposes the retailing B&O tax on entities making sales at retail. In addition, persons making sales at retail must collect and remit retail sales tax. RCW 82.08.020, RCW 82.08.050.

WAC 458-20-193 ("Rule 193") sets forth administrative guidance regarding the application of the B&O tax and retail sales tax to interstate sales. [I]n order to impose these taxes, Rule 193 [explains] that a seller [must] have nexus with Washington and the sale [must] occur in Washington. Rule 193 deems a person to have "nexus" with Washington if the person has a physical presence in Washington, which need only be demonstrably more than the slightest presence. "A person is physically present in this state if . . . [t]he person, either directly or through an agent or other representative, engages in activities in this state that are significantly associated with the person's ability to establish or maintain a market for its products in Washington[.]" Rule 193(102)(a).[4]

Here, Taxpayer did not contest that its customers received its products in Washington. Rather, Taxpayer asserted that the activities of its representatives on "sizing nights" was insufficient to create substantial nexus.

Nexus requirements flow from limits on a state's jurisdiction to tax found in the Due Process and Commerce Clause provisions of the United States Constitution. The limitations imposed by the two clauses are discussed in depth in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977); *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992); and in the Department's determinations. *See*, e.g., Det. No. 01-074, 20 WTD 531 (2001); Det. No. 96-144, 16 WTD 201 (1996). For Commerce Clause purposes, the nexus limitation requires the activity taxed have "substantial nexus" with the taxing state.[5] Nexus can be established by a taxpayer maintaining employees, offices, or other property in this state, regardless of whether the in-state activities of the taxpayer directly relate to the taxed activity. *National Geographic Soc. v. Bd. of Equalization*, 430 U.S. 560 . . . (1977). Nexus may also be established by third parties acting on behalf of the taxpayer

[4] Rule 193 mirrors the statutory substantial nexus standard pertaining to non-apportionable business activities for purposes of the B&O tax. RCW 82.04.067 as in effect during the audit period stated:

> (6) . . . For purposes of the taxes imposed under this chapter on any activity not included in the definition of apportionable activities in RCW 82.04.460, a person is deemed to have a substantial nexus with this state if the person has a physical presence in this state, which need only be demonstrably more than a slightest presence. . . . A person is also physically present in this state if the person, either directly or through an agent or other representative, engages in activities in this state that are significantly associated with the person's ability to establish or maintain a market for its products in this state.

[5] The limitation imposed by the Due Process Clause is satisfied if "a foreign corporation purposefully avails itself of the benefits of an economic market in the forum state." *Quill Corp.*, 504 at 307. In questioning the state's assertion of nexus in this case, Taxpayer does not differentiate between the nexus limitations pertaining to the Due Process Clause as opposed to the Commerce Clause. Taxpayer does not raise any argument or provide any fact that would suggest it quarrels with the conclusion that it "purposefully availed itself of the benefits" of the Washington economic market. Accordingly, we concentrate on the more relevant, stringent limitation imposed by the Commerce Clause.

where such activities are significantly associated with the seller's ability to establish and maintain a market. *Tyler Pipe Industries, Inc. v. Dep't of Revenue*, 483 U.S. 232, 250 (1987).

The determination of whether in-state activities create nexus looks to the entire collection of a taxpayer's different activities, the totality of which creates substantial nexus. *GMC v. City of Seattle*, 107 Wn. App. 42, 25 P.3d 1022 (2001); *see also General Motors Corp. v Washington*, 377 U.S. 436 (1964), *overruled on other grounds*, *Tyler Pipe*, 483 U.S. at 250 (1987) (holding that it is the bundle of corporate activity that determines whether a taxpayer has nexus with a state); WAC 458-20-193. Thus, establishing taxing nexus requires consideration of the entire bundle of a taxpayer's in-state activities.

As stated, the standard for determining whether nexus exists is not whether the in-state activity directly solicits a sale, but . . . whether this activity is "significantly associated with establishing or maintaining a market within this state." Rule 193(102) (d). *Standard Pressed Steel Co. v. Dep't of Revenue*, 419 U.S. 560 (1975); *National Geographic Soc.*, 430 U.S. 551; Det. No. 15-0151, 35 WTD 182 (2016). In *Standard Pressed Steel*, taxable 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. 419 U.S. at 560. Similarly, 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).

The Washington Supreme Court has found that Commerce Clause requirements were satisfied by "the presence of activities within the state." *Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 850-51, 246 P.3d 788 (2011).[6] In *Lamtec*, a New Jersey corporation ("Lamtec") that manufactures insulation and vapor barriers challenged Washington's assertion of substantial nexus in its case. Lamtec had no offices or agents permanently in Washington State. Lamtec sold its products to wholesale customers in the state who placed orders over the telephone. About two to three times a year, three Lamtec sale employees visited major customers in Washington. During the visits, the employees did not solicit sales directly, but they answered customer questions and provided information about Lamtec products. The court held that these facts were sufficient to withstand Lamtec's Commerce Clause challenge. In doing so, the court noted that "[t]he contacts by Lamtec's sales representative were designed to maintain its relationship with its customers and to maintain its market within Washington state. Nor were the activities slight or incidental to some other purpose or activity." *Id.* at 851.

The court's holding in *Lamtec* [supports] the position taken by the Department in published determinations. *See, e.g.*, Det No. 15-0151, 35 WTD 182 (2016) (out-of-state manufacturer and retailer of party supplies, and fire awareness and education products had substantial nexus with Washington based on regular visits to Washington by independent sales representative to sell products to commercial accounts) and Det. No. 15-0099, 34 WTD 505 (2015) (out-of-state seller of garden supplies had substantial nexus with Washington based on infrequent visits by nonresident employee to maintain customer goodwill).

[6] *Lamtec* involved a challenge to the imposition of the B&O tax. The retail sales tax was not at issue.

Here, Taxpayer argues that the visits to Washington by its representative were insufficient to create nexus with the state. Taxpayer bases this argument on the fact that the employee did not take orders or make sales but only helped to determine the correct size of the uniforms. We reject this argument. The representative's activity was of value to Taxpayer and its customers. The "sizing nights" contributed to Taxpayer's ability to maintain a market for its products in this state. This activity is sufficient to create nexus based on the standard established by *Lamtec* and recognized in applicable Department determinations. Accordingly, we conclude that the representative's activity was sufficient to establish taxing nexus in Washington.

Taxpayer also argues that not all sales should be taxed. Taxpayer essentially asked the Department to "dissociate" the sales related to "sizing nights" from its other retail sales.

In general, nexus for one sale is nexus for all sales. Det. No. 04-0208, 24 WTD 217 (2004), *citing,* Det. No. 94-209, 15 WTD 96 (1994). The Division I Court of Appeals, recently addressed the concept of dissociation in *Irwin Naturals v. State of Washington*, 195 Wn. App. 788, 382 P.3d 689 (2016). In *Irwin*, an out-of-state corporation in the business of developing, marketing, and selling retail and wholesale nutritional products contended that the Commerce Clause prohibited Washington from imposing retail sales tax and B&O tax on its retail sales because the target of its in-state activities was the wholesale market. The Court rejected the taxpayer's attempt to dissociate its retail sales from its wholesale sales for purposes of a nexus determination. The Court held that "[f]or purposes of a sales tax, a substantial nexus exists if the corporation has a presence in the taxing state" and for purposes "of a B&O tax, a substantial nexus exists if the corporation's in-state activity aids in establishing or maintaining a market within the taxing state." *Id.* at 795.[7] The Court concluded that Irwin's in-state wholesale activity satisfied these requirements for purposes of imposing tax on its retail sales. [*Irwin* is controlling here.]

We note that the taxpayer bears the burden of showing a lack of connection between its nexus creating activities and the sales it seeks to dissociate. *Avnet, Inc. v. State of Washington, Dep't of Revenue*, 187 Wn.2d 44, 61, 384 P.3d 571, 580 (2016) (citing *Norton Co. v. Dep't of Revenue of State of Illinois*, 340 U.S. 534, 537 (1951)). Here, Taxpayer's representatives traveled to Washington to assist customers with the correct selection of clothing. This activity created nexus with the state of Washington. The fact that "sizing nights' may have only affected a certain percentage of sales is insufficient to show a lack of connection between the visits and Taxpayer's internet sales in Washington. Accordingly, we are unable to conclude that the activity of Taxpayer's representative during "sizing nights" was not significantly associated with its ability to establish and maintain a market for its products in this state. As such, we sustain the assessment.

[7] In *Irwin*, the Court devoted significant analysis to differentiating between substantial nexus jurisprudence in the area of a sales or use tax as opposed to a B&O tax. In regards to the former, the Court noted the preference established by *Quill* for a bright-line "physical presence" test, which has survived despite "the trend of eschewing formalistic, inflexible rules [.]" *Irwin*, 382 P.3d at 795 (citing *Quill*, 504 U.S. at 314). In this case, Taxpayer established a physical presence in the state through its independent wholesales representative.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 8th day of September 2017.