

Cite as Det. No. 15-0302, 36 WTD 222 (2017)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund)	<u>D E T E R M I N A T I O N</u>
)	
)	No. 15-0302
)	
...)	Registration No. . . .
)	

[1] RCW 82.04.067(6); Rule 193(102)(a)(ii): SUBSTANTIAL NEXUS – ENGAGING IN BUSINESS. When a person has either property or employee in this state, we do not need to further inquire whether the person’s “activities in Washington are significantly associated with the person's ability to establish or maintain a market for its products in this state.”

[2] RCW 82.04.220; RCW 82.08.020: RETAILING B&O TAX & RETAIL SALES TAX. The retail sales tax and the retailing B&O tax imposed on the taxpayer do not violate the fourth prong of the Complete Auto Transit test because the taxes are fairly related to the services provided by this State. The retailing B&O tax and the retail sales tax are not taxes on the benefits the taxpayer receives from the State. The retail sales tax is imposed on Washington customers rather than on the taxpayer. With respect to the retailing B&O tax, the focus is not on the actual value of the services in relation to the actual taxable activities engaged in. Because the retailing B&O tax is measured by the amount of sales made to Washington customers, the measure of the tax is reasonably related to the taxpayer's activities within the State.

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.

Callahan, A.L.J. – A limited liability company (“Taxpayer”) that sells non-prescription dietary supplements and health foods through its internet website requests a refund for the taxes it paid to the Department of Revenue (the “Department”), arguing that it does not have nexus with Washington State, and that the taxes imposed on it violate the fourth prong of the test in *Complete Auto Transit v. Brady*, 430 U.S. 274, 97 S. Ct. 1076, 51 L.Ed.2d 326 (1977) by not being fairly related to the services provided by this State. We deny the petition.¹

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

ISSUES

1. Does Taxpayer have substantial nexus with Washington under RCW 82.04.067(6) and WAC 458-20-193 (Rule 193), through the presence of its resident employees in Washington State?
2. Are the taxes imposed on Taxpayer unconstitutional pursuant to Article 1, Section 8, Clause 3 of the U.S. Constitution, because the imposition violates the fourth prong of the test in *Complete Auto Transit v. Brady*, 430 U.S. 274, 97 S. Ct. 1076, 51 L.Ed.2d 326 (1977) by not being fairly related to the services provided by this State?

FINDINGS OF FACT

Taxpayer is an out-of-state limited liability company that sells non-prescription dietary supplements and health foods. Taxpayer registered with the Department on April 1, 2013, as an annual filer. Taxpayer acknowledged on its business license application that it employed one employee, who resides in . . . , Washington to provide customer service to Taxpayer's customers in Washington.

The Department did not receive Taxpayer's annual 2013 combined excise tax return by the due date. On June 25, 2014, the Department's Compliance Division ("Compliance") mailed Taxpayer a letter informing Taxpayer to file its annual 2013 combined excise tax return by July 7, 2014. The Department received Taxpayer's annual 2013 combined excise tax return on September 29, 2014, without payment. Taxpayer reported its income under the retailing business and occupation (B&O) tax classification, and reported retail sales tax.² On October 3, 2014, the Department received Taxpayer's payment for its 2013 taxes, in the amount of \$ There was a delinquent penalty in the amount of \$. . . imposed on Taxpayer because it did not submit its 2013 payment by the due date. Taxpayer requested the Department to waive the delinquent penalty. The Department granted Taxpayer's request under the "first-time filer waiver rule," pursuant to RCW 82.32.105(2)(b).³

Taxpayer then requested a refund for the 2013 taxes paid, asserting that it does not have nexus with the State, and thus, it does not owe tax on sales to Washington customers. Compliance denied Taxpayer's refund request because Compliance determined that Taxpayer's resident employee in Washington creates substantial nexus with the State. On November 5, 2014, Taxpayer petitioned for correction of the refund denial to the Department's Appeals Division.

² Specifically, Taxpayer reported retailing B&O tax of \$. . . , retail sales tax of \$. . . , local and regional tax of \$. . . , and litter tax of \$. . . *Id.*

³ RCW 82.32.105(2)(b) authorizes the Department to waive the late payment penalty imposed under RCW 82.32.090(1) if "[t]he taxpayer has timely filed and remitted payment on all tax returns due for that tax program for a period of twenty-four months immediately preceding the period covered by the return for which the waiver is being requested." Taxpayer was an annual filer when it filed its 2013 annual return. The delinquent penalty that covered the period qualified for the penalty waiver was the entire tax year of 2013. *See* Compliance's response dated November 26, 2014, Exhibit L.

Taxpayer acknowledges that it employs four persons in Washington, its Vice President of Technology-Engineering and three customer care representatives.⁴ The Vice President manages and directs Taxpayer's technology use, creates technology budgets and deadlines, investigates and negotiates technology mergers/joint ventures with economic partners, analyzes new technology, and represents Taxpayer in technology matters. The customer care representatives respond to general inquiry calls placed by the general public through Taxpayer's toll-free number. Taxpayer provides the representatives with scripts to answer the inquirers' questions. Taxpayer provides computers and related accessories, such as headsets, to the representatives to perform their work at their own homes in Washington. Taxpayer maintains that the value of the property (computers and related accessories) and the employees located in Washington are not "material to its overall operations, including within the state of Washington" to create substantial nexus with Washington State.⁵

Taxpayer asserts that RCW 82.04.067(6) does not "operate to overcome the constitutional hurdle of being acceptable under the tests clearly laid out by the Supreme Court." Taxpayer relies on *Dep't of Revenue v. Sage V Foods, LLC*, Thurston County Superior Court case no. 12-2-0189-3 (2013); *Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 850-51, 246 P.3d 788, 795 (2011), and *Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue*, 483 U.S. 232 (1987), and contends that unlike the taxpayer in *Lamtec Corp.*, Taxpayer's employees' activities in Washington do not enhance or contribute to Taxpayer's "ability to establish or maintain a market for its products in Washington" under RCW 82.04.067(6). Taxpayer argues its employees have immaterial contacts with persons located in this State and the employees do nothing to advance Taxpayer's market in Washington State. Taxpayer asserts all of its customers' purchases are fulfilled from a location [out-of-state], it does not have any sales forces reside in Washington State, and it does not send any representatives to Washington to solicit sales.

Taxpayer also argues that the tax imposed violates the fourth prong of the *Complete Auto Transit* test, because it does not benefit from the services provided by Washington State related to the tax. Specifically, Taxpayer asserts that it does not have any offices in Washington State, and its employees "are only receiving the same state services as they would as residents, that the tax imposed on [Taxpayer] is not related to the services provided."

ANALYSIS

Washington imposes a B&O tax "for the act or privilege of engaging in business" in this state. RCW 82.04.220. Persons engaged in making sales at retail are subject to the B&O tax under the retailing tax rate on the gross proceeds of sales of the business. RCW 82.04.250. With respect to the retail sales tax, Washington imposes retail sales tax on sales in this state of tangible personal property, unless the property is purchased for resale or otherwise exempt. RCW 82.08.020; *see also* RCW 82.04.050.

⁴ Petition dated November 5, 2014. Taxpayer initially acknowledged on its business license application that it employed one customer care representative in Washington. *See* FN4.

⁵ Specifically, Taxpayer argues that only 1.5% (89 out of the 5,701) of all calls from Washington area codes were answered by its representatives located in Washington. Petition dated May 15, 2015.

Here, when Taxpayer sells tangible personal property in this state, it will be subject to Washington taxes if it has substantial nexus with the state. RCW 82.04.220, RCW 82.04.067(6).

Physical presence through resident employees in this state:
RCW 82.04.067(6) provides:

[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. For purposes of this subsection, a person is physically present in this state if the person has property or employees in this state. 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.

(Emphasis added.) WAC 458-20-193(102) (Rule 193) provides:⁶

Nexus. A person who sells tangible personal property is deemed to have nexus with Washington if the person has a physical presence in this state, which need only be demonstrably more than the slightest presence. RCW [82.04.067\(6\)](#).

(a) **Physical presence.** A person is physically present in this state if:

(i) The person has property in this state;

(ii) The person has one or more employees in this state; or

(iii) 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 Washington.

(b) **Property.** A person has property in this state if the person owns, leases, or otherwise has a legal or beneficial interest in real or personal property in Washington.

(c) **Employees.** A person has employees in this state if the person is required to report its employees for Washington unemployment insurance tax purposes, or the facts and circumstances otherwise indicate that the person has employees in the state.

(d) **In-state activities.** Even if a person does not have property or employees in Washington, the person is physically present in Washington when 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 Washington. It is immaterial that the activities that establish nexus are not significantly associated with a particular sale into this state.

(Emphasis added.)

Here, it is undisputed that Taxpayer has employees in Washington State. Therefore, Taxpayer is physically present in Washington State through its employees in this State. RCW 82.04.067(6). Accordingly, all of the Taxpayer's sales in this state are subject to the retailing B & O tax and retail sales tax. RCW 82.04.250; RCW 82.08.020.

⁶ The Department amended Rule 193 in 2015 to provide further guidance on how Washington's B&O tax and retail sales taxes apply to interstate sales of tangible personal property.

Taxpayer asserts that its employees' activities do not enhance or contribute to Taxpayer's "ability to establish or maintain a market for its products in Washington" under RCW 82.04.067(6), because its employees have immaterial contacts with persons located in this State and they do nothing to advance Taxpayer's market in Washington State.

Taxpayer's arguments that none of those employees takes orders from Taxpayer's customers and they make no sales to the customers are immaterial, because the mere presence of Taxpayer's resident employees in Washington alone is sufficient to create substantial nexus with the State. RCW 82.04.067(6). When a person has either property or employees in this state, we do not need to further inquire whether the person's "activities in Washington are significantly associated with the person's ability to establish or maintain a market for its products in this state." RCW 82.04.067(6); *see* Rule 193(102)(a)(ii).

None of the cases (i.e., *Sage V Foods*, *Lamtec*, and *Tyler Pipe*) Taxpayer relies on had resident employees in Washington State. In addition, we do not have the authority to declare whether a statute is constitutional. *Bare v. Gorton*, 84 Wn.2d 380, 383, 576 P.2d 379 (1974) ("An administrative body does not have the authority to determine the constitutionality of the law it administers; only the courts have that power."); *see also* Det. No. 98-083, 17 WTD 271 (1998).

Is the tax imposed on Taxpayer "fairly related to the services provided by the state?"

Taxpayer also argues the retail sales tax and retailing B&O tax imposed violates the fourth prong of the *Complete Auto Transit* test, because it does not benefit from the services provided by Washington State related to the tax imposed on it.⁷

In *Complete Auto Transit*, the U.S. Supreme Court articulated a four-pronged test that a state tax must satisfy to withstand a Commerce Clause challenge to its jurisdiction to tax. The Court held that the Commerce Clause requires that the tax: (1) be applied to an activity with "substantial nexus" with the taxing state, (2) be fairly apportioned, (3) not discriminate against interstate commerce, and (4) be fairly related to the services provided by the state. *Complete Auto*, 430 U.S. at 279.

The purpose of the fourth prong of the *Complete Auto* test (that the tax be fairly related to the services provided by the state) is to ensure that a state's tax burden is not placed upon persons who do not benefit from services provided by the State. *Goldberg*, 488 U.S. at 266-67 (citing *Commonwealth Edison v. Montana*, 453 U.S. 609 at 627 (1981)). The tax which may be imposed on a particular interstate transaction need not be limited to the cost of the services incurred by the state on account of that particular activity. *Id.* at 267 (citing *Commonwealth Edison*, 453 U.S. at 627). On the contrary, interstate commerce may be required to contribute to the cost of providing all governmental services, including those services from which it arguably receives no direct benefit. *Id.* (citing *Commonwealth Edison*, 453 U.S. at 627); *see also Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 199 (1995).

⁷ Taxpayer recognizes that the second and third prongs of the *Complete Auto Transit* test are met because the Washington retail sales tax and retailing B&O tax are fairly apportioned, and nondiscriminatory with respect to interstate commerce. Petition dated May 15, 2015, p.7.

We explained the application of the fourth prong of the *Complete Auto Transit* test in Det. No. 93-120, 14 WTD 007 (1993):

The fourth prong is the requirement that the tax be fairly related to the services provided by the state. This requirement does not address the rate or amount of the tax, nor does it look to the actual value of the services in relation to the actual taxable activities engaged in. *Commonwealth Edison*, 453 U.S. at 622. Instead, it is closely connected to the nexus prong. It requires that the measure of the tax, as well as its incidence, “be tied to the earnings which the state ... has made possible”. *Commonwealth Edison*, at 626 quoting *Wisconsin v. J.C. Penney*, [fill in full citation].

(Emphasis added.)

As we explained previously, a tax is not an assessment of benefits:

A tax is not an assessment of benefits. It is, as we have said, a means of distributing the burden of the cost of government. The only benefit to which the taxpayer is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes. Any other view would preclude the levying of taxes except as they are used to compensate for the burden on those who pay them, and would involve abandonment of the most fundamental principle of government — that it exists primarily to provide for the common good.”

Det. No. 87-286, 4 WTD 51 (1987) (quoting *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495, 521-23 (1937) (citations and footnote omitted)).

In a recent determination, Det. No. 14-0094, 34 WTD 92 (2015), we explained “the Due Process Clause of the United States Constitution, . . . has been interpreted to require a substantial connection between a state’s taxing authority and the person the state seeks to tax. *See* Det. No. 87-195, 3 WTD 195 (1987) (citing *Chicago Bridge and Iron Co. v. Dep’t of Revenue*, 98 Wn.2d 814, 820, 659 P.2d 463 (1983)).”

The retailing B&O tax and the retail sales tax are not taxes on the benefits Taxpayer receives from the State. The retail sales tax is imposed on Washington customers rather than on Taxpayer. With respect to the retailing B&O tax, the focus is *not* on “the actual value of the services in relation to the actual taxable activities engaged in.” 14 WTD 007. “Because the retailing B&O tax is measured by the amount of sales made to Washington customers, the measure of the tax is reasonably related to the taxpayer’s activities within the State.” 4 WTD 51. Here, Taxpayer employs Washington resident employees for business purposes, i.e., to provide customer services to Washington customers related to its sales. Government services, including police and fire protection, were provided by this State to the resident employees. Therefore, the retail sales tax and the retailing B&O tax do not violate the fourth prong of the *Complete Auto Transit* test.

We deny the petition.

DECISION AND DISPOSITION

We deny Taxpayer's petition.

Dated this 5th day of November 2015.