

Cite as Det. No. 15-0321, 36 WTD 330 (2017)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 15-0321
)	
...)	Registration Nos. . . .

RCW 82.04.067: NEXUS. An out-of-state online retailer of brand name products does not have substantial nexus with Washington where its wholesaling affiliate promotes the sale of the same brand name products to Washington retailers, the wholesale product packaging contains the online retailer affiliate’s website, and the online retailer affiliate’s website contains a retail “store locator.”

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.

Eckholm, A.L.J. – An out-of-state online retailer of brand name apparel and accessories (and its successor) appeals assessments of retailing business and occupation (B&O) and retail sales tax, asserting that the Washington activities of its wholesaling affiliate are insufficient to establish taxable nexus. Held: A wholesaling affiliate’s promotion to third-party retailers of the same brand name products sold by an online retailer affiliate, wholesale product packaging containing the online retailer affiliate’s website, and the existence of a retail “store locator” on the online retailer affiliate’s website, are insufficient activities to create taxable nexus for the online retailer. The taxpayer’s petition is granted.¹

ISSUE

Whether, under RCW 82.04.067(6), an out-of-state online retailer of brand name products has substantial nexus with Washington where its wholesaling affiliate promotes the sale of the same brand name products to Washington retailers, the wholesale product packaging contains the online retailer affiliate’s website, and the online retailer affiliate’s website contains a retail “store locator.”

FINDINGS OF FACT

During the period at issue in this appeal (assessment period), [Taxpayer] was an out-of-state online retailer of . . . apparel and related items via its website The taxpayer’s affiliate . . . (wholesaling affiliate), was a wholesaler of the same . . . brand name products. The taxpayer and

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

the wholesaling affiliate were subsidiaries of . . . Corporation, a global apparel and footwear company. In June 2014, the taxpayer merged into the wholesaling affiliate, which then merged into . . . (the taxpayer's successor), another subsidiary of . . . Corporation. The taxpayer's successor also operates . . . retail stores in Washington. Following the merger, the taxpayer's successor began reporting retailing B&O tax and retail sales tax on its online sales to Washington customers.

The taxpayer's sales to Washington residents during the assessment period were made online via the . . . website and delivery was made by common carrier. Products were shipped with a return label and included directions for product return by mail to the . . . distribution center located [out-of-state]. The taxpayer indicates its website contained the same directions regarding returns, as represented currently on the website.² The website includes a "store locator" search tool that identifies third-party retail outlet locations of . . . products, including locations in Washington.³

The wholesaling affiliate contracted with an independent representative to work in Washington to solicit wholesale sales of . . . products to third-party retailers, maintain relationships with the third-party retailers that purchased the wholesale products, and apprise the retailers of new products. The independent representative is paid commission based on its wholesale sales. The wholesaling affiliate also employed a Washington resident responsible for meeting with third-party wholesale customers to maintain the wholesale relationship and educate retail staff on the wholesale products. The wholesaling affiliate did not operate any retail brick and mortar stores in Washington. The packaging of the brand name products that the wholesaling affiliate sold to the third-party retailers contains the taxpayer's website The taxpayer does not have any relationship with the wholesaling affiliate's Washington employee or the independent representative.

The Department of Revenue (Department) Tax Discovery Section of the Compliance Division (Compliance Division) initiated an investigation of the taxpayer and the wholesaling affiliate's Washington activities for the period January 1, 2008, through December 31, 2013. Based on its investigation, the Compliance Division determined that the wholesaling affiliate's marketing of . . . brand products was extensive and contributed to establishing and maintaining a market for the taxpayer's online sales of . . . products in Washington. The Compliance Division concluded that the marketing activities of the two affiliates complemented each other in an effort to foster the sales of the brand name products in Washington for both entities, based on the following: both the taxpayer and the wholesaling affiliate sold the same brand name products; the packaging of the products for wholesale and online sales was indistinguishable; the packaging contained the website of the taxpayer; the taxpayer's website displayed a "store locator" search tool that identified third-party retail outlet locations of . . . products, including locations in Washington; the taxpayer's website included extensive information regarding . . . products that "showroomed" the products for the wholesaling affiliate; and the taxpayer's website referenced the . . . guarantee for return of products purchased at the third-party retail stores or online.⁴ As a result, the Compliance Division issued assessments against the taxpayer of retailing B&O tax, retail sales

² See . . . (last accessed November 2, 2015).

³ See . . . (last accessed November 2, 2015).

⁴ See Compliance Division supplemental response, July 13, 2015; . . . (last accessed November 2, 2015).

tax, penalties, and interest, in the total amount of \$⁵ The taxpayer appealed the assessments, asserting that the activities of the wholesaling affiliate were insufficient to establish the taxpayer's nexus with Washington.

On appeal, the taxpayer provided additional information regarding the wholesaling affiliate's activities in Washington in relationship to the taxpayer. The taxpayer provided the agreement between the wholesaling affiliate and its independent representative, and a sample agreement between the wholesaling affiliate and a third-party retailer. In addition, the taxpayer provided responses to a list of detailed questions regarding the wholesaling affiliate's and its representatives' communication with third-party retailers (and their customers) in relation to the taxpayer and its website. All the information provided by the taxpayer indicated that the third-party retailers were not required to, and as a practice did not, accept returns of products purchased online by Washington customers, and that the wholesaling affiliate in no way encourages third-party retailers to make purchases or returns via the taxpayer's website, or directs their retail customers to use the taxpayer's website for purchases or returns, or for any purpose.

In response to this additional information provided by the taxpayer, the Compliance Division filed a supplemental response. With its response, the Compliance Division included a declaration of one of its representatives regarding his purchase of a . . . product from the taxpayer's website and return of that product to a retail store in Washington in June of 2015, and described the transactions as follows:

[T]he Department purchased a . . . product via Taxpayer's website. . . . Retail sales tax was collected during the transaction and the product was delivered via USPS. The Department took the product to an affiliate in-state company . . . and was informed that the product could be exchanged for another . . . product. The product was exchanged for another . . . product of lesser value and a refund was received for the price difference. . . . The employee also stated that the product purchased from [Taxpayer's website] had scanned into their inventory and showed no difference from any other . . . product in their current inventory. The employee stated that because of the identical product line, without a receipt, they would have no way to substantiate if the product was originally purchased from [Taxpayer's website] or from their retail location. . . .⁶

The taxpayer points out that the purchase and return occurred in June 2015, well after the assessment period and after the taxpayer had merged with the wholesaling affiliate and the taxpayer's successor, which operates . . . retail stores. The online sales now operate through a corporate division of the taxpayer's successor, an entity that concedes nexus with Washington

⁵ Document No. . . . , for the period January 1, 2009, through December 31, 2013, included assessments of retail sales tax of \$. . . , retailing B&O tax of \$. . . , delinquency penalty of \$. . . , interest of \$. . . , and assessment penalty of \$. . . , for a total amount of \$ Document No. . . . , for the period January 1, 2008, through December 31, 2008, included assessments of retail sales tax of \$. . . , retailing B&O tax of \$. . . , delinquency penalty of \$. . . , interest of \$. . . , and assessment penalty of \$. . . , for a total amount of \$ The assessments were subsequently assumed in Warrant No. . . . , filed November 10, 2014. On November 13, 2014, an Assessment of Successorship Liability, for the amounts contained in Warrant No. . . . , was issued against . . . as successor to the taxpayer The taxpayers do not dispute . . . liability as a successor.

⁶ Compliance Division supplemental response, dated July 13, 2015, at page 4.

and is reporting tax on its online sales to Washington customers. The taxpayer also notes that the described return was contrary to the return policy of . . . , but in any event, the transaction occurred after the described mergers and the taxpayer's successor's concession of nexus.

ANALYSIS

The B&O tax is imposed 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 sale, or gross income of the business as the case may be. RCW 82.04.220. Persons making retail sales are subject to retailing B&O tax on the gross proceeds of sales. RCW 82.04.050; RCW 82.04.250. All sales of tangible personal property to consumers in the state of Washington are subject to retail sales tax, unless the state is prohibited from taxing the sale under the constitution of this state or the federal constitution, or there is some other specific statutory exception or exemption from the tax. RCW 82.08.020; RCW 82.04.050; RCW 82.08.0254. The retail sales tax is required to be collected by the seller. RCW 82.08.050.

A state cannot tax transactions that do not have a sufficient connection or "nexus" with that state. *See, e.g., Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977); *Tyler Pipe Industries, Inc. v. Dep't. of Revenue*, 483 U.S. 232, 250, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987); *Quill Corp. v. North Dakota*, 504 U.S. 298, 305, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992); Det. No. 08-0128, 28 WTD 9, 13 (2008). This nexus requirement flows from limits on a state's jurisdiction to tax found in both the Due Process Clause and the Commerce Clause of the United States Constitution. *Quill*, 504 U.S. at 305; *Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 843, 246 P.3d 788 (2011); Det. No. 01-188, 21 WTD 289 (2002). Here, the taxpayer has only raised the issue of lack of nexus under the Commerce Clause.

The United States Supreme Court has identified certain requirements under the Commerce Clause for a state to impose tax on an out-of-state business. In *Complete Auto*, 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. Here, the only element under the *Complete Auto* test that the taxpayer challenges is the first element, "substantial nexus."

RCW 82.04.067(6) sets forth the definition of "substantial nexus," consistent with that stated in *Complete Auto* and *Tyler Pipe*, for persons like the taxpayer that are engaged in retailing, wholesaling, and manufacturing business activity, as follows:

[A] person is deemed to have substantial nexus with this state if the person has physical presence in this state, which need only be demonstrably more than a slightest presence. For purpose 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). *See also* WAC 458-20-193(102) (Rule 193(102)). We also note that “[n]exus for one sale is nexus for all sales” Det. No. 04-0208, 24 WTD 217, 224 (2005) (citing Det. No. 94-209, 15 WTD 96 (1994)). In other words, once substantial nexus is established for a particular taxpayer, that nexus generally extends to all of that taxpayer’s sales that are received in Washington, unless some specific exception applies.

The taxpayer maintains that the wholesaling affiliate was a separate legal entity and was not acting as the taxpayer’s representative, and that the activities of its wholesaling affiliate were not significant in relation to establishing or maintaining a market for the taxpayer’s goods to merit a finding of nexus with Washington.

We agree that mere affiliation or common ownership of corporations is, independently, insufficient to link the activities and tax liabilities of one entity to the other. . . . Det. No. 96-046, 16 WTD 074 (1996) (citing WAC 458-20-203 and quoting *American Sign & Indicator v. State*, 93 Wn.2d 427, 429, 610 P.2d 353 (1980) and *Rena-Ware Distribs., Inc. v. State*, 77 Wn.2d 514, 463 P.2d 622 (1970)); *see also* 28 WTD 9 at 16. The existence of an affiliate doing business in a state alone is insufficient to establish nexus for the out-of-state affiliate. 28 WTD at 16; *see, e.g., SFA Folio Collections, Inc. v. Bannon*, 217 Conn. 220, 585 A.2d 666, 668 (1991) (refusing to impute in-state presence of Saks Fifth Avenue stores to affiliated SFA Folio catalogue corporation); *Bloomingtondale’s By Mail, Ltd. v. Pennsylvania Dep’t of Revenue*, 130 Pa.Cmwlt. 190, 567 A.2d 773 (1989), *aff’d per curiam*, 527 Pa. 347, 591 A.2d 1047 (1991) *cert. denied*, 504 US 955, 112 S. Ct. 2299 (1992) (refusing to impute in-state presence of Bloomingtondale’s stores to affiliated Bloomingtondale’s by Mail catalogue sales).

However, despite the fact that Washington respects the independence of corporate entities, any activity performed by an employee, agent, or other representative on behalf of a seller that is significantly associated with establishing or maintaining a market within this state, is sufficient to establish nexus. Rule 193(102)(a)(iii); *Standard Pressed Steel v. Dep’t of Revenue*, 419 U.S. 560, 95 S. Ct. 706, 42 L. Ed. 2d 719 (1975); *Nat’l Geographic Society v. California Bd. Of Equalization*, 430 U.S. 551, 556, 97 S. Ct. 1386, 51 L. Ed. 2d 631 (1977)⁷; *Scripto, Inc. v. Carson*, 362 U.S. 207, 80 S. Ct. 619, 4 L. Ed. 2d 660 (1960); *Borders Online, LLC v. State Bd. of Equalization*, 129 Cal. App. 4th 1179, 29 Cal. Rptr. 3d 176 (2005); *Scholastic Book Clubs, Inc., v. State Bd. of Equalization*, 207 Cal. App. 3d 734, 255 Cal. Rptr. 77 (1989); *see also* Det. No. 04-0148, 6 WTD 417 (1988).

For example, in *Borders Online*, the California Court of Appeals held that the activities of related brick and mortar stores, which operated through a separate but affiliated entity, established nexus for the online retailer, even though the online company did not have direct activities in California. *Borders Online*, 129 Cal. App. 4th at 1191-1192. The California court

⁷ As the U.S. Supreme Court emphasized in *Nat’l Geographic*:

[T]he relevant constitutional test to establish the requisite nexus for requiring an out-of-state seller to collect and pay the use tax is not whether the duty to collect the use tax relates to the seller’s activities carried on within the State, but simply whether the facts demonstrate “some definite link, some minimum connection, between the State and the person . . . it seeks to tax.

430 U.S. at 561 (internal quotations omitted).

concluded that the advertising and solicitation activities performed by the affiliated company made the affiliate the online entity's representative, which established nexus. *Id.* The court based this conclusion on the fact that the affiliate's separately owned brick and mortar stores accepted returns and exchanges of merchandise purchased online and promoted the website. *Id.* The *Borders Online* court held that easy returns "undoubtedly made purchasing merchandise on the website more attractive to California customers, as they would know that returning or exchanging any unwanted items would be far simpler than if they purchased items from an e-commerce retailer with no presence in California." *Id.* at 1193-1194.

The *Borders Online* court then went on to link the cross return policy between the affiliates with what it described as "cross-selling synergy" activities, including the sharing of market and financial data, use of similar brand logos, and sponsored weblinks, in stating:

We have already determined that Online's return policy was part of its strategy to build a market in California. We further note that Borders's efforts on Online's behalf were not limited to accepting returns from—and providing exchanges and credit card refunds to—Online customers. 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."

Id. at 1199 (internal citations omitted.)

A similar holding was reached in *New Mexico Taxation and Revenue Dep't v. Barnesandnoble.com LLC*, 303 P.3d 824 (N.M. 2013). In *Barnesandnoble.com*, the New Mexico Supreme Court determined that an in-state brick and mortar retailer established nexus for an out-of-state affiliate online retailer where the two affiliates used common branding and the in-state retailer: accepted returns of online purchases, sold gift cards that contained the online affiliate's web address and could be used to make purchases online, sold memberships in a loyalty program that gave customers a discount in making purchases from the online retailer, and shared with the online affiliate customers' email addresses. *Id.* at 827-828.

In both *Borders Online* and *Barnesandnoble.com*, the activities of the in-state affiliate that established nexus for the out-of-state affiliate included something more than the display of the out-of-state affiliate's web address and use of common branding.

The reasoning in *Borders Online* was discussed in 28 WTD 9, where the Department determined that the activities of an in-state distribution affiliate were insufficient to create nexus for an out-of-state retailer of the same consumer brand name goods sold over the Internet and through telephone, and television infomercial marketing. 28 WTD at 14-16. Here, both the taxpayer and the Compliance Division cite 28 WTD 9 in support of their positions. We agree that the

reasoning and holding in 28 WTD 9 applies in this case, and also agree with the taxpayer that 28 WTD 9 supports a determination that the activities of the wholesaling affiliate have not established nexus for the taxpayer.

The assertions of the Department's Compliance Division in 28 WTD 9 are similar to those presented here. In 28 WTD 9, the Compliance Division asserted that the distribution affiliate sold and marketed the same brand name products as the taxpayer, and that the packaging of the brand name products sold by both entities displayed the out-of-state affiliate's web address. 28 WTD at 14. The Compliance Division also asserted in 28 WTD 9 that the affiliated companies engaged in collective and coordinated efforts to promote and sell the same brand name products, and that these efforts served to establish and maintain a market for the online affiliate taxpayer's goods in Washington. *Id.* [In 28 WTD 9, we] did not find that such coordinated efforts were sufficient to support a finding of nexus.

[We noted in 28 WTD 9] that even though the products sold by the distribution affiliate shared the same brand name as the out-of-state affiliate's products, and the retail packaging also carried the brand name and web address, the brand name similarity and connections between the affiliates were significantly different from that in *Borders Online* where the commonly branded local retail outlets were directly promoting and supporting sales of the Internet affiliate. *Id.* [We] also noted that the Washington retail outlets where the brand name products were sold were independent, third-party stores, and that though it was conceivable that the presence of a particular brand name product on the shelf of a retail store—especially where there was an indication that the product had been advertised on TV—may contribute to a customer subsequently watching an infomercial and making a purchase, this was, at best, an indirect form of marketing. 28 WTD 9 at 16. [We] held that the activities of the distribution affiliate's sales representative in Washington to facilitate wholesale sales were not comparable to the type of in-state representation afforded by a commonly branded local retail outlet (as in *Borders Online*), and were not significantly associated with establishing or maintaining a market for the out-of-state affiliate's products in Washington. *Id.* at 17.

Here, as in 28 WTD 9, the . . . brand name products were sold at independent, third-party retail stores. In addition, the presence of the taxpayer's web address on the wholesale product packaging is insufficient to amount to the type of "cross-selling synergy" activities described in *Borders Online*. In 28 WTD 9, the Department concluded that even the in-state retail store displays indicating that the same product had been advertised on TV (by the out-of-state affiliate) was insufficient to amount to the type of significant activity required to establish nexus for the out-of-state affiliate. 28 WTD 9 at 16. There is also no evidence, here, of a cross return policy as in *Borders Online* and *Barnesandnoble.com*. The Compliance Division's evidence of the return of the . . . product purchased online to . . . store occurred after the assessment period, and after the taxpayer's corporate merger, so it is irrelevant to the determination of nexus for the taxpayer during the assessment period. There is also no evidence of cross promotional activities as in *Barnesandnoble.com* where there was a shared customer rewards program, sale of gift cards that could be used for purchases from the online affiliate, and sharing of customer information between affiliates. *See Barnesandnoble.com*, 303 P.3d at 827-828.

As in 28 WTD 9, we conclude that despite the brand name overlap, the activities of the wholesaling affiliate with conceded taxing nexus are not significantly associated with establishing or maintaining a market for the taxpayer's products in Washington sufficient to create nexus for the taxpayer.

DECISION AND DISPOSITION

The taxpayer's petition is granted.

Dated this 19th day of November 2015.