

Cite as Det. No. 18-0255, 39 WTD 156 (2020)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 18-0255
)	
...)	Registration No. . . .
)	

[1] RULE 193; RCW 82.04.067: NEXUS – PHYSICAL PRESENCE – MARKETPLACE FACILITATOR. A taxpayer establishes physical presence nexus in Washington through inventory delivered to an online Marketplace Facilitator outside Washington where the taxpayer contractually agreed to permit the Marketplace Facilitator to electronically relocate taxpayer’s inventory, and the Marketplace Facilitator moved taxpayer inventory into Washington.

[2] RULE 228; RCW 82.32.105; RCW 82.32.090: WAIVER OR CANCELLATION OF PENALTIES OR INTEREST – CIRCUMSTANCES BEYOND THE TAXPAYER’S CONTROL – LACK OF KNOWLEDGE. A taxpayer’s misunderstanding or lack of knowledge of its tax liability, are not circumstances beyond its control, and do not allow waiver or cancellation of delinquent penalties or interest.

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.

Davis, T.R.O. – An out of state corporation engaging in online sales to customers in Washington State (Taxpayer) through a third-party online marketplace facilitation service (Facilitator) disputes assessments by the Department of Revenue (Department) based on lack of substantial nexus. Taxpayer contends it has no physical presence or inventory storage in Washington, and it has never maintained a stock of goods in Washington. Taxpayer argues that the digital assignment of third-party inventory located in Washington to Taxpayer by Facilitator’s electronic inventory management system, for purpose of Facilitator’s delivery of orders to Taxpayer’s Washington customers, does not provide sufficient basis for substantial nexus with Washington. We deny Taxpayer’s petition.¹

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

ISSUES

1. Under RCW 82.04.067 and WAC 458-20-193 (Rule 193), does an out of state business selling products in Washington State through an online marketplace facilitator have substantial nexus for business and occupation tax purposes?
2. Under RCW 82.32.090, RCW 82.32.105, and WAC 458-20-228 (Rule 228), does the Department have authority to waive interest and penalties due to Taxpayer's lack of knowledge of its tax reporting requirements?

FINDINGS OF FACT

... (Taxpayer) is an out-of-state corporation engaged in the business of online retailing. Taxpayer's business activities include retail sales of cellphone cases and other electronics accessories. Taxpayer sells its products using both its own website and the website of an e-commerce company (Facilitator). Facilitator provides both marketplace facilitation services to sellers, and an online marketplace for seller products that is accessible via the internet to customers in all states nationwide.

Taxpayer furnished the Department of Revenue (Department) with copies of its signed primary contract agreement (Program Agreement)² with Facilitator for the years 2009, 2012 (signed by Taxpayer only), and 2013, and a copy of a digitally signed online contract addendum (Addendum) for the year 2014.

The Program Agreement discusses the details of how product sales and fulfillment will be conducted between the parties, stating, "Seller will: (a) . . . source and sell [Facilitator]-Fulfilled Products . . . (g) notwithstanding any other provision of this Agreement, ensure that the entity identified as Seller on the cover page of this Agreement itself is the seller of all products made available for listing for sale hereunder." Program Agreement, para. 2.1 (emphasis added).

Generally, Facilitator agrees to provide an online marketplace through its website, and provide several marketplace facilitation services: inventory storage and tracking; advertising, merchandising, and promotion of Taxpayer's products; collection of payment and shipment information from buyer; product fulfillment, shipping, and delivery; and if needed, acceptance and processing of product returns. These services are provided in exchange for a fee paid by Taxpayer. Taxpayer agrees that it will source and sell its products in accordance with the terms of each sales order. Facilitator agrees to remit to Taxpayer the proceeds collected, less fees, from sales of Taxpayer's products on a weekly basis. *See* Program Agreement.

Paragraph 11.2 ("Tax Matters") of the Program Agreement, in all copies Taxpayer provided, states generally that Taxpayer agrees it is responsible for the collection and payment of any and all seller taxes. Specific details regarding the collection and remittance of taxes are governed by an addendum to the agreement, titled "Tax Services Attachment."

² . . . (Program Agreement). Taxpayer provided copies with effective dates of June 30, 2009, October 25, 2012 (copy signed by Taxpayer only), and October 30, 2013.

At its review hearing, Taxpayer stated it has been using Facilitator's inventory management system since January 2011. According to information copied from Facilitator's "seller central" website (Help Topic),³ for sellers who choose to participate, Facilitator will manage all portions of the seller's inventory held by Facilitator. Specifically, Facilitator will commingle items of property that are identified and tracked using manufacturer barcodes in a seller's inventory with items of identical products owned by other third-party sellers who also use manufacturer barcodes for these items. When a customer purchases a product from a seller, Facilitator will ship the item closest to the customer even if the seller's inventory doesn't include any of the items in that fulfillment center. *See* Help Topic.

Facilitator does this by digitally reassigning ownership of the property between the two sellers (the seller that generated the order and the third-party seller whose closer-located item was used to fulfill the order). Facilitator electronically transfers an item from the seller's inventory to the third-party seller whose inventory item is needed to fulfill the order, and the generating seller is credited for the sale. In the event a generating seller has inventory available to fulfill a sale in the nearest fulfillment center, no reassignment is necessary and the seller's original products are used to fulfill the sale directly. *Id.*

Facilitator's inventory control process, as described above, is based on the voluntary use of the manufacturer barcode to identify and track seller inventory. However, sellers may choose not to use this inventory tracking method (or to stop using it) by updating the barcode preference in their Facilitator account. Sellers who 'opt-out' in this manner must then apply a unique Facilitator barcode to the inventory item instead of using the manufacturer barcode. Items tracked with a Facilitator barcode (in contrast with a manufacturer barcode) are not commingled, and ownership is not digitally transferred, so customer orders are fulfilled from the center where they are physically located at the time of the order regardless of shipping distance. *See* Help Topic.

In further explanation of this commingling and transfer of ownership, the Help Topic also states, "if [seller] submit[s] a removal order for inventory tracked using manufacturer barcodes, the items [seller] receive[s] may not be the same ones that [seller] originally sent to [Facilitator]." *Id.*

Taxpayer also provided the Department with two spreadsheets detailing information from Facilitator inventory records (Inventory Sheets).⁴ One of these shows Taxpayer's year-end inventory count held by Facilitator for each of the years 2011 through 2015, and one shows total inventory Taxpayer shipped to Facilitator during each of the years 2011 through 2016. During its in-person review hearing, Taxpayer stated Facilitator maintained detailed inventory records for Taxpayer's account that Taxpayer could access on demand through a login process on Facilitator's website.

According to the Inventory Sheets, during the period from 2011 through 2015, Taxpayer did not directly ship any of its product to Facilitator's Washington warehouse locations. All sales of

³ . . . Seller Central help page, *Use the manufacturer barcode to track inventory*, . . . (last visited Dec. 5, 2017; copy provided to Department by Taxpayer).

⁴ Taxpayer provided this information to the Department, along with some calculated values, in formatted spreadsheets. Taxpayer represented that the basic data shown in these spreadsheets is provided and maintained by Facilitator for Taxpayer's account, and available via login on Facilitator's website.

Taxpayer's products made in Washington through Facilitator's website during these years were fulfilled by Facilitator using the digital swap and ownership rebalancing method described above. In 2016, however, Taxpayer shipped 211 units of its product to Facilitator's warehouses located in Washington State. At the time of shipment, these units represented . . . percent of the total Taxpayer inventory held by Facilitator.

The Inventory Sheets also recorded the number of products held in Facilitator's warehouses that were assigned to Taxpayer on December 31 of each year, for the years 2011 through 2015. These records show that Taxpayer-owned products were digitally assigned, using the method previously described, to Washington State warehouse locations in each of those years, including two products in 2011 (representing . . . percent of Taxpayer's total Facilitator inventory), three products in 2012 (. . . percent), ninety-two products in 2013 (. . . percent), twenty-nine products in 2014 (. . . percent), and one-hundred nineteen products in 2015 (. . . percent).

In March 2016, after observing Taxpayer selling products using Facilitator's online marketplace, the Compliance Division (Compliance) of the Department of Revenue (Department), began an investigation of Taxpayer's business activities to determine Taxpayer's potential tax obligations in Washington.

Compliance mailed Taxpayer a letter of inquiry along with a Washington Business Activities Questionnaire, which Taxpayer completed and returned. On March 28, 2016, Compliance reviewed the completed Questionnaire with Taxpayer's accounting manager, who stated Taxpayer sells products through various online marketplaces and on Taxpayer's own website. Taxpayer's accounting manager also stated to Compliance that when a sale is made, Taxpayer's products are shipped to the buyer either from Taxpayer's own warehouse, or by Facilitator.

In April 2016, Compliance received inventory event detail reports (inventory reports) from Taxpayer by email. The inventory reports showed that Taxpayer's products began to be stored in Washington State on March 17, 2011. On June 24, 2016, the Department registered Taxpayer and issued them an account number (UBI).

As a result of the Compliance investigation, on August 22, 2017, the Department issued two assessments against Taxpayer for the period from March 17, 2011, through March 31, 2016 (assessment period): Document No. . . . (Audit No. . . . ; Invoice . . .) for \$. . . , including retail sales tax of \$. . . , retailing B&O tax of \$. . . , interest of \$. . . , a twenty-nine percent delinquent return penalty of \$. . . , a five percent penalty for substantial underpayment of \$. . . , and a five percent unregistered business penalty of \$. . . ; and Document No. . . . (Audit No. . . . ; Invoice . . .) for \$. . . , including retail sales tax of \$. . . , retailing B&O tax of \$. . . , interest of \$. . . , a twenty-nine percent delinquent return penalty of \$. . . , a five percent penalty for substantial underpayment of \$. . . , and a five percent unregistered business penalty of \$ The total amount assessed was \$. . . , including taxes of \$. . . , interest of \$. . . , and penalties of \$

Taxpayer timely filed for review, seeking cancellation of the assessments. Taxpayer does not contest the Department's calculation of tax, interest, or penalty amounts, or that the sales at issue here were the result of its products being displayed on Facilitator's website to customers in Washington, and admits it sells products to customers located in Washington. Taxpayer also does

not dispute the mechanics of Facilitator's inventory management system, including commingling and reassignment of product inventory among its fulfillment centers. However, Taxpayer contends that it has not established nexus under Washington law because it has no physical presence or inventory storage in Washington. Taxpayer argues that digital assignment of inventory to Taxpayer for certain sales in Washington by Facilitator's inventory management system should not be considered physical storage and cannot cause Taxpayer nexus. Taxpayer also asserts that its product sales and inventory activity in Washington represent such a small portion of its overall inventory and sales that these should be considered *de minimis* and insufficient to be considered significant activity for tax purposes.

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.

Substantial Nexus

RCW 82.04.067 establishes the statutory "substantial nexus" thresholds that apply to persons engaging in business. For persons engaged in the business of making retail sales of tangible personal property, substantial nexus exists if the person has a physical presence in this state, which need only be demonstrably more than a slightest presence. RCW 82.04.067(6).⁵ A person is physically present in this state if the person has property or employees in this state. *Id.* The statute further explains that:

A person is also physically present in this state for the purposes of this subsection 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.

RCW 82.04.067(6).⁶

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. The Rule explains that in order for Washington to impose these taxes, a seller must have nexus with Washington and the sale must occur in Washington. Rule 193(1).

⁵ [SSB 5581 was signed into law on March 15, 2019, and changes the law with respect to physical presence nexus. *See* Laws of 2019, ch. 8. This determination's analysis may not apply for periods covering October 1, 2018 and beyond.]

⁶ In 2016, the Legislature made several changes and updates to RCW 82.04.067, including creation of subparagraphs in RCW 82.04.067(6) to provide for more logical organization, but despite this reorganization, the language of the original statute in paragraph (6) was retained and remains substantially as shown.

Rule 193(102) discusses nexus, in pertinent part, as follows:

(102) **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;

...

(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.

Although we are dealing primarily with the statutory “substantial nexus” thresholds set out in RCW 82.04.067, those thresholds flow from and are consistent with 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 (1977), *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), and other court opinions, as well as in numerous Department determinations. *See, e.g.*, Det. No. 01-074, 20 WTD 531 (2001); Det. No. 96-144, 16 WTD 201 (1996). Under established dormant Commerce Clause case law, nexus can be established in many different ways. For example, nexus can be established by third parties acting on behalf of the taxpayer 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). Nexus sufficient to meet dormant Commerce Clause constraints may also be established through “substantial virtual connections to the State.” *South Dakota v. Wayfair, Inc.*, – U.S. –, 138 S. Ct. 2080 (2018). The simple and overarching inquiry under the dormant Commerce Clause is whether the taxpayer has “avail[ed] itself of the substantial privilege of carrying on business” in the taxing jurisdiction. *Id.* at 2099 (quoting *Polar Tankers, Inc. v. City of Valdez*, 557 U.S. 1, 11 (2009)).

The nexus 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 307.⁷

⁷ In questioning the state’s assertion of nexus in this case, Taxpayer’s arguments do not specifically address potential differences between the nexus limitations pertaining to the Due Process Clause as opposed to the Commerce Clause.

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.

Here, Taxpayer does not contest that sales of tangible personal property to Washington customers occurred in this state, or that the sales in question here were the result of its products being displayed on Facilitator's website to customers in Washington. Nor does it contest the facts regarding the mechanics of Facilitator's commingling of inventory and its digital reassignment process. Rather, Taxpayer asserts that Facilitator's digital reassignment of product ownership from Facilitator's fulfillment centers located out-of-state to its fulfillment centers within Washington was insufficient to create substantial nexus for Taxpayer. Taxpayer also asserts that its product sales and inventory activity in Washington represent such a small portion of its overall inventory and sales that these should be considered *de minimis* and insufficient to be considered significant activity for tax purposes.

Seller Inventory in Washington

Essentially, Taxpayer argues that the goods it entrusts to Facilitator outside of Washington should not be a basis for finding nexus because Taxpayer did not ship the goods into Washington, Facilitator has complete control over the goods once it receives them, and Facilitator processes all sales activity. We disagree.

First, as Rule 193 makes clear, maintaining a stock of goods within the state is sufficient to establish a physical presence. Rule 193(102)(a)(i).

Second, even if Facilitator did have complete physical control over the goods once it received them at its out of state fulfillment center, this does not affect the outcome. Taxpayer was aware that those goods could be relocated to fulfillment centers in other states using the digital reassignment process as discussed in the Program Agreement and other online documents. Taxpayer agreed to Facilitator's use of this digital reassignment by choosing to participate in Facilitator's management of its inventory. Facilitator provided Taxpayer, on demand via login to Taxpayer's account, with a digital "Inventory Event Detail" schedule that informed Taxpayer of the location of the fulfillment center where a particular good was located. Finally, Taxpayer had the ability to "opt out" and choose to have Facilitator manage Taxpayer's inventory separately, with no commingling or digital reassignment. Thus, Taxpayer is unable to show that its goods were sent to, and stored in, this state without its knowledge and consent.

Finally, under the Program Agreement, Facilitator did not take title to the goods. Rather, the goods remained the property of Taxpayer until delivered to the purchaser. The contracts signed by Taxpayer in availing itself of Facilitator's digital marketplace and marketplace services clearly

In light of the recent decision by the United States Supreme Court in *Wayfair*, there may be no material difference between these nexus requirements. However, that is not an issue directly before us in this administrative appeal.

show that Taxpayer agrees it is the seller of record, and Taxpayer is responsible for all taxes due. Facilitator's use of its inventory management system to fulfill Taxpayer's sales by reassignment of ownership within Facilitator's nationwide inventory, at Taxpayer's option and for the convenience and benefit of Taxpayer through cheaper and more efficient processing of its customer orders, resulted in Taxpayer's legal ownership of products that were physically stored in Washington warehouses. Thus, as the records show, Taxpayer owns the goods pre-sale, the goods are undoubtedly physically present in the state at the time of sale, and Taxpayer, not Facilitator, is the seller.

Minimum Quantity Not Required

Taxpayer has also argued that the amount of goods sold in Washington were such a small percentage of its total inventory that they amount to *de minimis* presence and thus cannot be considered substantial enough to provide nexus. We disagree. As discussed above, a person who sells tangible personal property need only have demonstrably more than the slightest physical presence. RCW 82.04.067(6). The demonstrated physical presence and sale of some amount of tangible personal property is sufficient to satisfy this requirement.

The fact that goods owned by the Taxpayer were physically stored in Washington until sale, even briefly via digital reassignment of ownership, is sufficient to establish substantial nexus under RCW 82.04.067 and is sufficient to meet established dormant Commerce Clause and Due Process Clause constraints. Thus, we find that Taxpayer had substantial nexus with Washington during the assessment period.

Interest and Penalties

Persons who engage in taxable activity in Washington have the responsibility to register with the Department, and to accurately report and timely pay taxes. RCW 82.32.030; RCW 82.32A.030(1) and (2). RCW 82.32.050 requires the Department to assess interest when due. RCW 82.32.090 requires the Department to assess penalties when due.

Taxpayer has requested cancellation of interest and of the assessment, late-payment, and unregistered business penalties. Taxpayer's request for penalty relief is based on RCW 82.32.105, which allows for cancellation of penalties if the circumstances that caused the penalties were beyond the control of the taxpayer. Taxpayer maintains that because it was an out-of-state taxpayer with no facilities or employees located within Washington, and because it was unaware that Facilitator had moved a portion of Taxpayer's goods to Washington through the electronic transfer of ownership, it is entitled to waiver of interest and penalties.

Interest

When the Department determines that a tax or penalty has not been paid in full, it will assess the additional amount found to be due and add interest on the tax. RCW 82.32.050(1). The imposition of interest is not discretionary. The Legislature has mandated the imposition of interest where a taxpayer has failed to timely pay the requisite tax. RCW 82.32.050. The Department has the authority to waive interest in two limited circumstances: 1) where the failure to timely pay tax was

the direct result of written instructions given to the taxpayer by the department; or 2) where the extension of a due date for payment of an assessment of deficiency was not at the request of the taxpayer and was for the sole convenience of the department. RCW 82.32.105(3); WAC 458-20-228(10). These limited circumstances were not present in Taxpayer's case. As such, there is no basis to waive the assessed interest.

Penalties

RCW 82.32.090(1) imposes a late-payment penalty:

If payment of any tax due on a return to be filed by a taxpayer is not received by the department of revenue by the due date, there is assessed a penalty of nine percent of the amount of the tax; and if the tax is not received on or before the last day of the month following the due date, there is assessed a total penalty of nineteen percent of the amount of the tax under this subsection; and if the tax is not received on or before the last day of the second month following the due date, there is assessed a total penalty of twenty-nine percent of the amount of the tax under this subsection. No penalty so added may be less than five dollars.

RCW 82.32.090(2) imposes an assessment (substantially underpaid) penalty:

If the department of revenue determines that any tax has been substantially underpaid, there is assessed a penalty of five percent of the amount of the tax determined by the department to be due. . . . No penalty so added may be less than five dollars. As used in this section, "substantially underpaid" means that the taxpayer has paid less than eighty percent of the amount of tax determined by the department to be due for all of the types of taxes included in, and for the entire period of time covered by, the department's examination, and the amount of underpayment is at least one thousand dollars.

RCW 82.32.090(4) imposes an unregistered business penalty:

If the department finds that a person has engaged in any business or performed any act upon which a tax is imposed under this title and that person has not obtained from the department a registration certificate . . . the department must impose a penalty of five percent of the amount of tax due from that person for the period that the person was not registered The department may not impose the penalty . . . if a person who has engaged in business taxable under this title without first having registered . . . , prior to any notification by the department of the need to register, obtains a registration certificate from the department.

(Emphasis added). The Department must impose interest and penalties when the conditions for imposing them are present. RCW 82.32.090(1); Det. No. 01-193, 21 WTD 264 (2002); Det. No. 99-279, 20 WTD 149 (2001). The Department is an administrative agency, and its authority to waive or cancel interest and penalties is restricted to the authority granted by the Legislature. The Legislature has granted the Department limited authority to waive or cancel penalties. RCW

82.32.105 and RCW 82.32A.020. The Department has no discretionary authority to waive or cancel penalties. Det. No. 98-85, 17 WTD 417 (1998); Det. No. 99-285, 19 WTD 492 (2000).

RCW 82.32.105(1) provides, in pertinent part:

If the department of revenue finds that the payment by a taxpayer of a tax less than that properly due or the failure of a taxpayer to pay any tax by the due date was the result of circumstances beyond the control of the taxpayer, the department of revenue shall waive or cancel any penalties imposed under this chapter with respect to such tax.

RCW 82.32.105(1) does not define what the term “circumstances beyond the control of the taxpayer” means, but the Department has explained, and given examples of the term, in WAC 458-20-228(9) (Rule 228). Rule 228(9)(a)(ii) states, in pertinent part:

Circumstances beyond the control of the taxpayer are generally those which are immediate, unexpected, or in the nature of an emergency. Such circumstances result in the taxpayer not having reasonable time or opportunity to obtain an extension of the due date or otherwise time file and pay.

That was not the case here. Here, Taxpayer failed to register and pay Washington tax based on a lack of knowledge or misunderstanding of its Washington tax reporting responsibilities. Rule 228(9)(a) sets out examples of circumstances that ordinarily are, and are not, considered “beyond the control of the taxpayer.” Specifically, Rule 228(9)(a)(iii)(B) includes “A misunderstanding or lack of knowledge of a tax obligation” as an example of circumstances that are generally not considered to be beyond the control of the taxpayer and will not qualify for a waiver or cancellation of penalty. Based upon these provisions, we conclude the Department has no authority under RCW 82.32.105 to cancel the penalties imposed against Taxpayer. Accordingly, we must deny Taxpayer’s petition for cancellation of penalties.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 20th day of September 2018.