

Cite as Det. No. 15-0036, 39 WTD 191 (2020)

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. 15-0036
)	
...)	Registration No. . . .
)	

RULE 193; RCW 82.04.067: RETAIL SALES TAX – SUBSTANTIAL NEXUS – TRADE SHOWS. Taxable nexus is created by a taxpayer’s representatives participating in an annual trade show in Washington, where those representatives displayed products, hosted product demonstrations and discussions, and made contact with individuals that used the taxpayer’s product. Those activities are significantly associated with establishing or maintaining a market for the sales of the taxpayer’s products in Washington regardless of whether taxpayer’s representatives actually sold products at the trade show.

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.

Yonker, A.L.J. – An out-of-state video game development company (Taxpayer) protests a tax assessment in which it was assessed retailing business and occupation (B&O) tax and retail sales tax. Taxpayer argued that it was not subject to taxation in Washington because its only in-state activity, participation at an annual three-day trade show in [Washington], did not create substantial nexus with Washington. We deny the petition.¹

ISSUE

Pursuant to WAC 458-20-193 and RCW 82.04.067(6), did Taxpayer establish substantial nexus with Washington when it participated in an annual three-day trade show in [Washington] in 2010, 2011, and 2012?

FINDINGS OF FACT

[Taxpayer] is an out-of-state corporation that develops and publishes a multiplayer, online video game called [Game].² The Game is free to play. Taxpayer’s source of income is exclusively from the sale of [Points], which Taxpayer describes as a virtual currency that Game players purchase

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

² Taxpayer and its Game appear to be referred to interchangeably by online media sources and by the public generally.

online and subsequently redeem online to make “micro-transactions,”³ through which Game players purchase “champions”⁴ or “skins”⁵ that enhance their Game playing experience.

Prior to November 2012, Taxpayer had no employees or representatives, and maintained no physical office or other presence, in Washington on a permanent basis. In November 2012, Taxpayer hired an employee located in Washington and registered permanently with the [Department of Revenue (Department)] for tax reporting purposes. In 2013, the Department’s Compliance Division conducted a review of Taxpayer’s books and records for the time period of January 1, 2010 through September 30, 2012 (review period). During the course of that review, the Compliance Division found that Taxpayer had participated in a trade show devoted to video games called the [Trade Show] in [Washington] during 2010, 2011, and 2012, before Taxpayer permanently registered with the Department in late 2012.⁶

[Trade Show] is a series of “gaming festivals” held annually in four cities worldwide, including . . . Taxpayer described [Trade Show] festivals as follows:

The festivals are attended by industry insiders and the general public and include panels on game topics, exhibitor booths from game developers and publishers, game tournaments, and video game freeplay areas. . . . The [Trade Show] festivals are national industry events, and the festivals in . . . represent the two largest gaming events in North America.⁷

The [Trade Show] festival in [Washington] lasts for three days, and the approximate public attendance at [Trade Show] in [Washington] in 2010 was 67,600 attendees and the approximate public attendance at the 2011 event was over 70,000 attendees.⁸

Based on Taxpayer’s participation in [Trade Show] during 2010, 2011, and 2012, the Compliance Division determined that Taxpayer’s online sales to Washington residents were taxable under the retailing B&O tax classification, and were also subject to retail sales tax in Washington. On April 1, 2014, the Department issued a tax assessment for \$. . . , which included \$. . . in uncollected retail sales tax, \$. . . in retailing B&O tax, a \$. . . delinquent penalty, a \$. . . five-percent assessment penalty, and \$. . . in interest. Taxpayer appealed the full amount of the tax assessment, asserting its participation at [Trade Show] during the review period did not create substantial nexus and, therefore, Taxpayer was not subject to taxation in Washington during the review period.⁹

³ A “micro-transaction” refers to the purchase of in-game content or premium account features.

⁴ A “champion” refers to an on-screen virtual character that a Game player controls while playing the Game.

⁵ A “skin” refers to a special color scheme or design that enhances the appearance of a Game player’s champion in the Game.

⁶ Taxpayer had obtained a temporary registration with the Department to cover its participation at [Trade Show] in 2011 and 2012. For 2011, Taxpayer did not report any income as a result of its participation in that year. For 2012, Taxpayer represented on appeal that it likewise did not have any income to report as a result of its participation in that year, and stated that a “third party” had sold some Game merchandise. According to Department records, Taxpayer’s temporary registration was under the name . . . who appears to be affiliated in some way with Taxpayer. Department records indicate that a tax liability of \$. . . was reported under that temporary registration, including \$. . . in retailing B&O tax and \$. . . in retail sales tax.

⁷ See also . . . and . . . , both last visited on February 10, 2015.

⁸ Found at . . . , last visited on February 10, 2015. No attendance numbers were given for 2012.

⁹ Taxpayer conceded that it had substantial nexus with Washington after November 2012, when it hired an employee that resided in Washington.

On appeal, Taxpayer represented that its participation at [Trade Show] during the review period consisted of (1) demonstrating the Game at another exhibitor's booth and (2) giving away a limited number of free "skins" to public attendees of [Trade Show]. Taxpayer specifically represented that it did not sell any merchandise or other products at [Trade Show] during the review period and did not maintain its own booth at [Trade Show].

Taxpayer's online postings, as well as other online media sources, described Taxpayer's participation at [Trade Show] in more detail for each year during the review period. According to those sources, in 2010, Taxpayer's participation at [Trade Show] also included the following:

- Hosting a [game] on the first day of [Trade Show] with Taxpayer's game developers where the general public was . . . waiting to participate in the game;
- Hosting a game tournament on the second day that lasted eight hours in which 64 teams of public attendees participated;
- Hosting a game tournament on the third day in which eight teams of public attendees participated;
- Hosting a meet-and-greet panel discussion with Taxpayer's game developers;
- Giving away "skins" to any fans that met Taxpayer's representatives.¹⁰

In 2011, according to online sources, Taxpayer's participation at [Trade Show] also included the following:

- Introducing a new [game] called . . . to the public attendees to test out;
- Hosting [a booth]¹¹

And in 2012, according to online sources, Taxpayer's participation at [Trade Show] also included the following:

- Hosting a booth that was . . . at [Trade Show];
- Hosting the . . . , a large competition of the Game;
- Hosting a question-and-answer panel discussion with Taxpayer's game developers.¹²

Another online media source reporting on Taxpayer's participation at [Trade Show] in 2012 described Taxpayer's presence there as follows:

. . .

. . .¹³

While Taxpayer specifically denied selling any merchandise at [Trade Show], and represented that only a "third party" sold Game merchandise at [Trade Show] and only in 2012, Department records

¹⁰ Found at . . . , last visited on February 10, 2015.

¹¹ Found at . . . , last visited on February 10, 2015.

¹² Found at . . . , last visited on February 10, 2015.

¹³ Found at . . . , last visited on February 10, 2015.

indicate that Taxpayer, under its temporary registration account, reported some retail sales at [Trade Show] in 2012.

ANALYSIS

Washington imposes a B&O tax on “every person that has a substantial nexus” with Washington “for the act or privilege of engaging in business” in this state. RCW 82.04.220(1). The B&O tax is “extensive and is intended to impose . . . tax upon virtually all business activities carried on in the State.” *Analytical Methods, Inc. v. Dep’t of Revenue*, 84 Wn. App. 236, 241, 928 P.2d 1123 (1996) (quoting *Palmer v. Dep’t of Revenue*, 82 Wn. App. 367, 371, 917 P.2d 1120 (1996)). “Business” is defined broadly to include “all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly.” RCW 82.04.140. The B&O tax measure and rate are determined by the type or nature of the business activity in which a person is engaged. Chapter 82.04 RCW. Persons engaged in making retail sales are taxable under the retail B&O tax classification on their gross proceeds of sales. RCW 82.04.250(1). In addition, retail sales tax is imposed under RCW 82.08.020 on sales of tangible personal property to consumers. Taxpayer does not dispute that it engaged in a retailing business activity during the review period, but maintains that it did not have the requisite “substantial nexus” with Washington during that time, and, therefore, is not subject to B&O tax under 82.04.220 or retail sales tax under RCW 82.08.020.

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 (1992); Det. No. 05-0376, 26 WTD 40 (2007). 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, 246 P.3d 788 (2011) (“A tax on an out-of-state corporation must satisfy by the requirements of the due process clause of the Fourteenth Amendment and the commerce clause.”); Det. No. 01-188, 21 WTD 289 (2002). Here, 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 Taxpayer challenges is the first element, “substantial nexus.”

WAC 458-20-193 (Rule 193) defines nexus in the context of inbound sales from out of state as “the activity carried on by the seller in Washington which is significantly associated with the seller’s ability to establish or maintain a market for its products in Washington.” Rule 193(2)(f). This definition of substantial nexus was cited with approval by the United States Supreme Court in *Tyler Pipe*, 483 U.S. at 250. On June 1, 2010, the Washington legislature enacted RCW 82.04.067(6), which provides a statutory definition for “substantial nexus” [for non-apportionable

activities]¹⁴ that mirrors the definition of that term in both Rule 193(2)(f) and *Tyler Pipe* for persons like Taxpayer that are engaged in retailing, wholesaling, and manufacturing business activity:

[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 National Geographic Society v. California Bd. Of Equalization*, 430 U.S. 551, 556, 97 S.Ct. 1386 (1977); *Quill*, 505 U.S. at 315, n.8. . . .

Here, Taxpayer’s representatives entered Washington to participate in the [Trade Show in Washington] in 2010, 2011, and 2012. Our recent holding in Determination No. 14-0062, 33 WTD 439 (2014) is instructive here. In that case, we considered whether a taxpayer that participated in four trade shows each year in Washington during most of the relevant time period, and eleven trade shows in Washington in one year, had substantial nexus with Washington. *Id.* The taxpayer in that case did not sell any merchandise or write any orders during the trade shows, but, instead, the taxpayer in that case “displayed its product at the trade shows, made contact with potential buyers, discussed its service model with potential buyers, and distributed its catalogs.” *Id.* at 440. We concluded in that case that the taxpayer had substantial nexus with Washington because the taxpayer “engaged in those activities to increase familiarity with its brand and, in turn, promote the sales of its products.” *Id.* at 443.

We conclude that the activities in which Taxpayer engaged at [Trade Show] each year are analogous to many of the activities in which the taxpayer in 33 WTD 439 was engaged. First, like the taxpayer in that earlier case, Taxpayer “displayed its product” by hosting the Game demonstrations and competitions; by showcasing new Game features to the public attendees; and by maintaining some significant floor space at the trade show. In addition, Taxpayer “made contact with potential buyers” by encouraging the public attendees to meet its representatives and to participate in its events; and by giving away free “skins” to public attendees. Finally, Taxpayer “discussed its service model with potential buyers” through discussion panels attended by the public attendees.¹⁵

We further conclude that, like the taxpayer in 33 WTD 439, Taxpayer engaged in those activities at [Trade Show] “to increase familiarity with” Taxpayer’s Game and, in turn, “promote the sales” of [Points]. Clearly, Taxpayer’s participation in [Trade Show] each year was aimed at increasing exposure or “familiarity” of Taxpayer’s Game. Indeed, in addition to media attendees, between

¹⁴ Substantial nexus for apportionable activities as defined in RCW 82.04.460, is not dependent upon a physical presence and may be established by certain economic criteria. *See* RCW 82.04.067(1).

¹⁵ There is some dispute as to whether Taxpayer also made sales of merchandise at [Trade Show] in at least 2012. Department records indicate that Taxpayer reported retail sales from [Trade Show] in that year, but Taxpayer has denied on appeal that it sold any such merchandise in 2012, and maintained that it was a third party that made such sales. Because we conclude that there is substantial nexus even without any actual sales, we will proceed with our analysis as if Taxpayer did not make sales of merchandise at [Trade Show].

60,000 and 70,000 people attended [Trade Show] each year during the review period. It stands to reason that by participating in [Trade Show in Washington], Taxpayer received increased exposure through both the media reporting on Taxpayer and through the sheer numbers of public attendees, many of which were likely Washington residents given the location of [Trade Show]. Such exposure was clearly meant to “promote the sales” of [Points] everywhere, including in Washington, which sales, in theory, would increase due to the added exposure at [Trade Show] and due to the increased number of Game players Taxpayer clearly hoped to achieve through its participation at [Trade Show]. As such, we conclude that Taxpayer’s participation in [Trade Show] in 2010, 2011, and 2012 was “significantly associated” with Taxpayer’s ability “to establish or maintain a market for its products” in Washington pursuant to RCW 82.04.067(6), Rule 193(7), and the associated case law.

Taxpayer argues that “the small quantity of visits” to Washington is insufficient to create substantial nexus. We disagree. We have consistently held that infrequent in-state visits by employees of an out-of-state business can establish nexus. *See* Det. No. 08-0117, 27 WTD 239 (2008) (holding that two one-day sales visits by employees to Washington over a four-year period created nexus); Det. No. 97-061, 18 WTD 211 (1999) (holding that two annual visits by employees to Washington lasting no more than two days each created nexus). Here, Taxpayer’s representatives entered Washington for three visits that lasted three days each over the course of three years. As RCW 82.04.067(6) makes clear, the physical presence in Washington “need only be demonstrably more than a slightest presence.” We hold that Taxpayer’s physical participation in three trade shows over a three-year period that lasted three days each is not too “small” to constitute substantial nexus.

As discussed earlier, Taxpayer maintains that it did not sell any products or merchandise at [Trade Show], and, therefore, participation in [Trade Show] in the absence of sales-related activity cannot create substantial nexus. Again we disagree.¹⁶ We have frequently held that other activities in Washington besides sales-related visits established nexus. *See* 33 WTD 439, discussed *supra*; Det. No. 00-003, 19 WTD 685 (2000) (finding that dealer training, supporting promotional efforts at trade shows, introducing and promoting new products, and establishing a network of independent contracts in Washington for repair work were all activities that were significantly associated with the ability to establish and maintain a market in Washington, even where there was no solicitation of sales in Washington). In other cases, we have held that occasional visits by nonresident employees who do not solicit sales can establish substantial nexus with this state. *See* Det. No. 91-213, 11 WTD 239 (1991) (holding that substantial nexus existed where nonresident employees made occasional visits to this state to show product samples and to explain the taxpayer’s policies); Det. No. 88-368, 6 WTD 417 (1988) (holding that occasional visits by nonresident employees to provide advice on the safe handling of products provided substantial nexus). As such, we conclude that Taxpayer’s activities at [Trade Show], which we treat as not including actual sales of products or merchandise, nevertheless were activities significantly associated with Taxpayer’s ability to establish or maintain a market in Washington.

Taxpayer directs our attention to some of our past decisions. . . .

¹⁶ As discussed earlier, there is some dispute over whether Taxpayer sold merchandise at [Trade Show] in 2012. Because we conclude actual sales are not necessary to establish substantial nexus in this case, we proceed with our analysis as if Taxpayer did not have actual sales at [Trade Show].

...

Taxpayer also cites a number of our previous decisions in support of its argument that attendance at an annual trade show without some other activity is not sufficient to create substantial nexus.¹⁷ Taxpayer stated that “[i]n none of these cases has substantial nexus been found based upon one visit per year consisting of solely participating in a trade show in Washington.” We do not disagree with Taxpayer’s statement. However, in all but one of the cases Taxpayer cited, there happened to be additional activities in Washington beyond participation in trade shows. *See* Det. No. 96-144, 16 WTD 201 (1996); Det. No. 00-003, 19 WTD 685 (2000); Det. No. 04-0208, 24 WTD 217 (2005). Even so, none of these cases state that the trade show activity alone would not have created substantial nexus. Nor do we find any support for such a limitation for trade show participation in the definitions of substantial nexus under Rule 193(2)(f) and RCW 82.04.067(6), or the associated court decisions, which require only that the activity be “significantly associated with the person’s ability to establish or maintain a market for its products” in Washington. Because we have already concluded that Taxpayer’s activity in [Trade Show] had such significant association, we conclude that no additional activity is required to create substantial nexus.

Finally, Taxpayer points out that a number of other jurisdictions have declared through law or otherwise that participation in trade shows may not create nexus. We believe our recent decision in 33 WTD 439 is again instructive. We held there that “there is no ‘trade show’ exemption in any Washington statute or rule.”¹⁸ *Id.* at 443. As we stated in that case, “the existence of these statutes in other jurisdictions simply highlights the fact that” no such exemption exists in Washington. *Id.*

Ultimately, we conclude that Taxpayer’s activity at [Trade Show] in 2010, 2011, and 2012, was sufficient to create substantial nexus with Washington pursuant to Rule 193(2)(f), RCW 82.04.067(6), and the relevant court decisions. None of Taxpayer’s arguments persuade us that Taxpayer’s activity at [Trade Show] did not rise to the level of substantial nexus as those authorities have defined it.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 17th day of February 2015.

¹⁷ *See* Det. No. 96-144, 16 WTD 201 (1996); Det. No. 00-003, 19 WTD 685 (2000); Det. No. 04-0208, 24 WTD 217 (2005); Det. No. 99-063, 24 WTD 1 (2005).

¹⁸ [Subsequent to the issuance of this decision, the Department amended Rule 193 to provide that nexus may be established by: “Having an exhibit at a trade show to maintain or establish a market for one’s products in the state (but not merely attending a trade show).” Rule 193(102)(d)(v).]