

Cite as Det. No. 18-0302, 40 WTD 064 (2021)

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. 18-0302
)	
... )	Registration No. . . .
)	

RCW 82.04.280; Rule 182: B&O TAX – CLASSIFICATION OF INCOME – WAREHOUSING. A taxpayer operating a distribution center that, among other things, handles the receipt, repackaging, storage, and shipment of retail apparel, accessories, and associated products on behalf of several affiliated entities failed to qualify for the preferential warehousing classification for purposes of the B&O tax. This preferential rate applies only to those operating storage warehouses, meaning warehouses in which items are received for storage for compensation and not to distribution centers providing a broader array of services.

RCW 82.04.460; Rule 19402: APPORTIONMENT OF INCOME – RECEIPTS FACTOR –BENEFIT OF A TAXPAYER’S SEVICES – DISTRIBUTION CENTERS – DISTRIBUTION CONTINUUM. An out-of-state distribution center, which provides a host of services to affiliated entities, including the receipt, repackaging, storage, and shipment of tangible personal property, must apportion its income based on the nature of the specific services it offers along what may be deemed a “distribution continuum.” This endeavor, in turn, requires separate analyses of each specific service provided by the distribution center to its affiliated customers to determine whether these customers may fairly be said to have received the benefit of the distribution center’s services in Washington.

RCW 82.04.070: RETAIL SALES TAX – RETAILING B&O TAX – GROSS PROCEEDS OF SALES – ESTIMATION. In the absence of any controverting evidence, the Department did not err when it estimated the gross proceeds of a taxpayer’s sales based on the taxpayer’s federal income tax returns.

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.

L. Roinila, T.R.O. – An affiliate company of an international clothing retailer challenges the business and occupation (B&O) tax classification and apportionment to Washington of certain intercompany allocations received from its parent company and a sister company, and further maintains that commercially-generated sales reports more accurately capture the value of catalog

and internet sales made by the affiliate Taxpayer into Washington than do the affiliate Taxpayer's [51-State Apportionment Schedule]. Petition granted in part and denied in part.<sup>1</sup>

### ISSUES

1. What is the proper tax classification of Taxpayer's income under Chapter 82.04 RCW?
2. Whether, under RCW 82.04.462 and WAC 458-20-19402 (Rule 19402), certain intercompany allocations received by Taxpayer from affiliated entities are attributable to the Washington retail outlets of the affiliated entities for apportionment purposes?
3. Whether, under RCW 82.04.070, the use of Taxpayer's [51-State Apportionment Schedule] was the appropriate source for determining Taxpayer's gross income from catalog and internet sales sourced to Washington, when Taxpayer maintains that another source ultimately provides a more accurate measure?

### FINDINGS OF FACT

. . . Taxpayer, a wholly owned subsidiary of . . . (Parent),<sup>2</sup> is headquartered in [out-of-state], where it operates a distribution center that, among other things, handles the receipt, repackaging, storage, and shipment of retail apparel, accessories, and associated products on behalf of affiliated entities. In addition, Taxpayer is the entity within the corporate structure responsible for processing and shipping all catalog and Internet sales group-wide. As a result of this activity, Taxpayer collects and remits retail sales tax and pays retailing B&O tax on all sales sourced to Washington that both it makes and that its affiliates make.

. . . .

As part of its operation, Taxpayer has entered into a Distribution Services Agreement with [Affiliate 1], one of the numerous sister companies within [Parent's] corporate structure. This agreement delineates Taxpayer's "core" services as follows:

- "Receiving" consists of the following: (a) receipt of Specialty Retail Products from domestic or foreign vendors; (b) interaction with affiliates of [Affiliate 1] regarding logistics, tracking and customs compliance associated with the receipt of Specialty Retail Products; (c) inspections and acceptance or rejection of Specialty Retail Products received; and (d) coordination of incoming transportation deliveries.
- "Repackaging" consists of the following: (a) organizing recapping stations within distribution facilities; (b) opening received packages of Specialty Retail Products; (c) sorting Specialty Retail Products and repackaging Specialty Retail Products as required to fulfill orders of retail stores affiliated with [Affiliate 1] and the catalogue and Internet orders received by [Affiliate

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

<sup>2</sup> [Parent] is a [out-of-state]-based specialty retailer that owns a series of retail stores across the United States, including . . . .

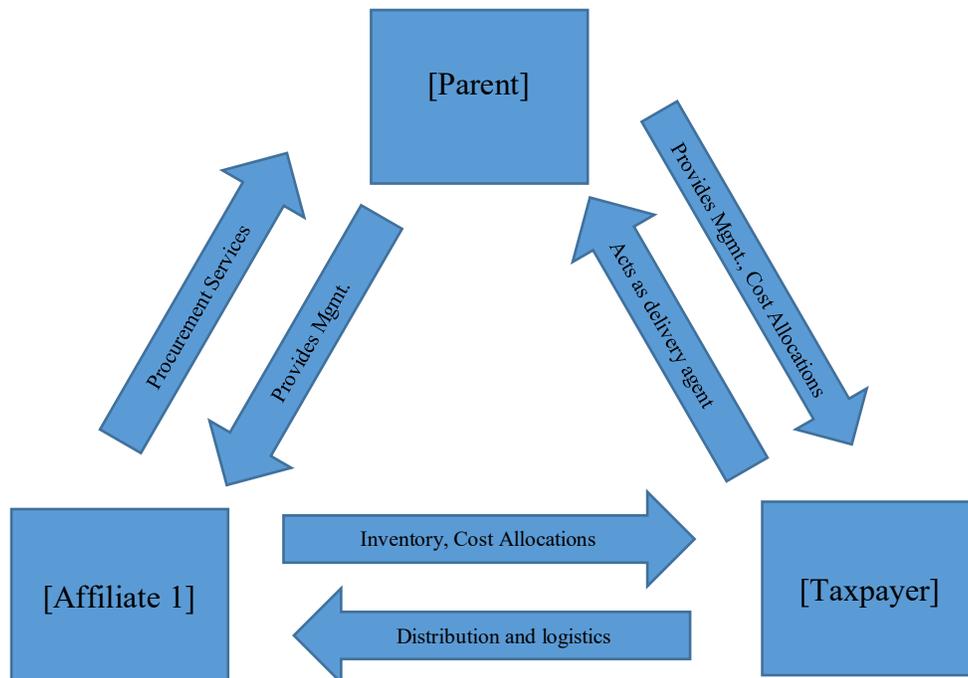
1]; and (d) labeling of products and packages in a manner that complies with applicable regulations by [Affiliate 1].

- “Sorting” consists of the following: (a) organizing storage space within distribution facilities; (b) retaining Specialty Retail Products for future repackaging and shipping; (c) securing Specialty Retail Products within distribution facilities; and (d) delivering storage of Specialty Retail Products to off-site locations if necessary.
- “Shipping” consists of the following: (a) coordinating outgoing transportation deliveries; (b) interacting with [Affiliate 1] and affiliated parties of [Affiliate 1] regarding the payment of any highway use taxes, fuel taxes or other taxes, insurance claims or other costs incurred in shipping; (c) interacting with [Affiliate 1] and affiliated parties of [Affiliate 1] regarding the receipt of Specialty Retail Products by [Affiliate 1], by the retail stores and by direct customers of the catalog and Internet operations of [Affiliate 1]; and (d) interacting with [Affiliate 1] and affiliated parties of [Affiliate 1] regarding goods damaged in transit or otherwise rejected goods transferred between retail stores, goods transferred between [Affiliate 1] and retail stores or goods subsequently sold to third parties.

In addition, Taxpayer has entered into a “Merchandise Inspection Agreement” with its Parent. By the terms of this agreement, Taxpayer performs the following services for the Parent:

- 1) Accepts delivery of goods on behalf of [Parent] at [Taxpayer’s] or an affiliated entity’s shipping dock immediately prior to pick up by common carrier for delivery to [Parent];
- 2) Inspects the goods; and
- 3) For purposes of such delivery, accepts or rejects such goods.

The following diagram represents the synergistic effect of the agreements:



Both the Distribution Agreement and the Merchandise Inspection Agreement create agency relationships under which [Affiliate 1], in the former, and the Parent Company, in the latter, act as principal and Taxpayer as agent.

In 2014, the Department's Audit Division (Audit) commenced a review of Taxpayer's books and records for the period of February 1, 2009, through December 31, 2012 (audit period). During the course of that review, Audit made a number of findings, two of which are relevant here. First, Audit found that the Taxpayer had failed to report any of the income it received through intercompany charges, which, in Audit's view, should have been reported under the service and other activities B&O tax classification. Second, Audit found that the Taxpayer had underreported its retail sales on its combined excise tax returns since these amounts proved lower than the amount of retail sales Taxpayer reported on its federal income tax returns.

On March 31, 2016, as a result of the Audit Division's review, the Department issued a tax assessment for \$ . . . , which includes \$ . . . in retail sales tax, \$ . . . in retailing B&O tax, \$ . . . in service and other activities B&O tax, and \$ . . . in interest.

Taxpayer then petitioned us for review of the full amount of the tax assessment. In support of its petition, Taxpayer raised two exceptions. First, Taxpayer asserted that the Department had incorrectly sourced the intercompany allocations Taxpayer had received from affiliated entities to Washington, on one of two grounds. In Taxpayer's view, Audit improperly classified its business activities to the services and other activities B&O tax classification, and then apportioned Taxpayer's income, when, in reality, Taxpayer's services belong under the warehousing B&O tax classification; and, since Taxpayer's warehouse is located outside of Washington, those services are beyond this state's authority to tax. Or, alternatively, even if the Department was correct in its B&O tax classification of the Taxpayer's services, the intercompany allocations should still be apportioned outside of Washington since the benefit of the services is received at each affiliate's corporate headquarters location outside of Washington.

Finally, Taxpayer asserted that the Department's use of Taxpayer's [51-State Apportionment Schedule] to calculate sales subject to Washington's retail sale tax was inappropriate because the . . . sales reports (commercially-generated sales reports) used by the company in preparing its excise tax returns are the most accurate source of [Taxpayer's] sales.

## ANALYSIS

### 1. Classification of Taxpayer's Income

In Washington, "there is levied and collected from every person that has a *substantial nexus* with this state a [B&O] tax for the act or privilege of engaging in business activities." RCW 82.04.220 (emphasis added). The B&O tax measure is "the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be." *Id.* The applicable rate is determined by the type of activity in which a taxpayer engages. *See generally* Chapter 82.04 RCW. A taxpayer's B&O tax classification is determined by the nature of the business activity it conducts, not by labels or terms that a taxpayer may choose to employ in its business records.

Contradictory labels or terms are not relevant if they do not accurately represent the actual nature of the business activity being taxed. RCW 82.04.290(2)(a); Det. No. 17-0231, 37 WTD 088 (2018).

Income from any business activity that is not expressly classified in Chapter 82.04 RCW is taxed under the “catch all” service and other activities B&O tax classification. RCW 82.04.290(2). This tax equals a business’ gross income multiplied by 1.5 percent. RCW 82.04.290(2)(a).

Here, Taxpayer disagrees with the Audit Division’s classification of its unreported business activity associated with the intercompany charges it received from other affiliated companies under the “catch all” service and other activities B&O tax classification, and argues, instead, that its business activity is expressly classified as warehousing under RCW 82.04.280, and cannot, therefore, be subject to the “catch-all” service and other activities B&O tax classification.

RCW 82.04.280(1) does, indeed, expressly classify the business of storage warehousing. Thus, “every person engaging within this state in the business of . . . (d) operating a . . . storage warehouse” is subject to B&O tax equal to the gross income of the business multiplied by a rate of 0.484 percent. (Emphasis added). RCW 82.04.280(2)(b) defines “storage warehouse” as follows:

[A] building or structure, or any part thereof, in which goods, wares, or merchandise are received for storage for compensation, except field warehouses, fruit warehouse, fruit packing plants, warehouses licensed under chapter 22.09 RCW, public garages storing automobiles, railroad freight sheds, docks and wharves, and “self-storage” or “mini storage” facilities whereby customers have direct access to individual storage areas by separate entrance . . . .

WAC 458-20-182 (Rule 182), the Department’s administrative rule addressing warehousing, provides the following additional guidance:

(2) **Business and occupation tax.** Warehouse businesses are taxable according to the nature of their operations and the specific kinds of goods stored, as follows:

(a) Persons engaged in operating any “storage warehouse” . . . are subject to tax under the warehousing classification, measured by the gross income of the business. (See RCW 82.04.280.)

(b) "Storage warehouse" means a building or structure, or any part thereof, in which goods, wares, or merchandise are received for storage for compensation . . . .

(c) Persons engaged in operating any warehouse business, other than those of (a) and (b) of this subsection, are subject to tax under the service classification, measured by the gross income of the business. (See RCW 82.04.290.) . . . .

. . .

Rule 182(2)(a) does not say that those engaged in operating a warehouse business are subject to tax under the warehousing B&O tax classification. Instead, it states that “[p]ersons engaged in operating any ‘storage warehouse’ . . . as defined herein, are subject to tax under the warehousing classification.” It is a well-established rule of statutory construction that “[s]tatutes must be interpreted and construed so that all the language used is given effect, with no portion rendered meaningless or superfluous.” *Whatcom County v. City of Bellingham*, 128 Wn.2d 537, 546, 909 P.2d 1303 (1996). The preferential rate applies to those operating storage warehouses, which are warehouses where items “are received for storage for compensation.” RCW 82.04.280(2)(b). In this case, the items are not received for storage for compensation. Affiliates are storing their own items in warehouses that they control, and Taxpayer is compensated for providing distribution services in connection with operating the warehouses, but not for storage.<sup>3</sup>

Because the warehouses at issue are not places where items are received for storage for compensation, the warehouses do not meet the definition of “storage warehouses” under RCW 82.04.280, and Taxpayer does not qualify for the preferential rate. Accordingly, Taxpayer’s business activities are properly classified in the service and other activities B&O tax classification set forth in RCW 82.04.290(2).

## 2. Apportionment of Income

Taxpayer further asserts that, even if Audit correctly classified its income under the service and other activities B&O tax classification, as we have determined to be the case, this income still lies beyond Washington’s authority to tax. Taxpayer argues that since the benefit of the services

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<sup>3</sup> These additional activities belie the differences that exist between traditional warehousing, on the one hand, and distribution or fulfillment centers, on the other. As Clifford F. Lynch, a logistics and supply chain management consultant and adjunct professor of business at the University of Memphis, has written in describing these differences:

- **A distribution center offers value-added services:** Rather than simply offering static storage, DCs provide a myriad of services for clients, whether those customers are external or internal company departments and functions. A well-organized and managed distribution center will provide such services as transportation, cross-docking, order-fulfillment, labeling and packaging along with whatever services are necessary to complete the order cycle, including order processing, order preparation, shipping, receiving, transportation, returned goods processing and performance measurement.
- **A distribution center is customer focused:** While a warehouse is focused on the most efficient cost effective methods of storing products within its walls, a distribution center's sole mission is to provide outstanding service to its customers.
- **A distribution center is technology-driven:** The distribution center of today must have in place state-of-the-art order processing, transportation management and warehouse management systems if it is to receive, scan bar codes, locate and store product efficiently, pick/pack and process orders, and plan loads.
- **A distribution center is relationship-centric:** Whether its clients are outside companies or other intra-company units, a distribution center must remain focused on its customers' requirements. A distribution center is the principal link between suppliers and customers, and its management must be conversant not only with the customers' needs but also with the most efficient and cost-effective methods of meeting those needs. By contrast, a storage warehouse is so inwardly focused, in most cases, that there is very little understanding of what customer service really means.

Cited in Cliff Holste, Logistics News: *Warehouse or Distribution Center: What is it really?*, Supply Chain Digest, (Aug. 13, 2018, 2:38 PM), [http://scdigest.com/assets/Experts/Holste\\_09-12-16.php](http://scdigest.com/assets/Experts/Holste_09-12-16.php). We find Taxpayer operates a distribution center, not a warehouse.

Taxpayer provides [Affiliate 1] and Parent are received by these affiliated companies at their respective corporate headquarters, outside of Washington, the intercompany allocations Taxpayer received must also be apportioned outside of this state . . . .

Effective June 1, 2010, the method of apportioning gross income for taxpayers that earn income under the service & other activities B&O tax classification changed from cost apportionment to a method referred to as “single-factor” apportionment.

Thus, beginning June 1, 2010, RCW 82.04.460(1) provides as follows:

Except as otherwise provided in this section, any person earning apportionable income taxable under this chapter and also taxable in another state must, for the purpose of computing tax liability under this chapter, apportion to this state, in accordance with RCW 82.04.462, that portion of the person’s apportionable income derived from business activities performed within this state.

To determine taxable income in such cases, a taxpayer’s total apportionable income is multiplied by a fraction referred to as the “receipts factor.” RCW 82.04.462(3)(a). The numerator of the receipts factor is Washington apportionable receipts and the denominator is the worldwide apportionable receipts minus “throw-out income.” *See id.*; Rule 19402(402). During the relevant time period, RCW 82.04.462(3)(b) provided that, in calculating a receipts factor, gross income is to be attributed to the state in which a taxpayer’s customers “received the benefit of the taxpayer’s service.” RCW 82.04.462(3)(b)(i). RCW 82.04.462(3)(b) provides:

[F]or purposes of computing the receipts factor, gross income of the business generated from each apportionable activity is attributable to the state:

- (i) Where the customer received the benefit of the taxpayer's service or, in the case of gross income from royalties, where the customer used the taxpayer's intangible property. When a customer receives the benefit of the taxpayer's services or uses the taxpayer's intangible property in this and one or more other states and the amount of gross income of the business that was received by the taxpayer in return for the services received or intangible property used by the customer in this state can be reasonably determined by the taxpayer, such amount of gross income must be attributed to this state.
- (ii) If the customer received the benefit of the service or used the intangible property in more than one state and if the taxpayer is unable to attribute gross income of the business under the provisions of (b)(i) of this subsection (3), gross income of the business must be attributed to the state in which the benefit of the service was primarily received or in which the intangible property was primarily used.

Likewise, RCW 82.04.462(3)(viii) defines the word, “customer,” for these purposes to mean the “person or entity to whom the taxpayer makes a sale or renders services or from whom the taxpayer otherwise receives gross income of the business . . . .” Rule 19402, the Department’s

administrative rule implementing RCW 82.04.462, further clarifies the definition, stating that for purposes of single factor apportionment, a “customer” is the:

[P]erson or entity to whom the taxpayer makes a sale, grants the right to use intangible property, or renders services or from whom the taxpayer otherwise directly or indirectly receives gross income of the business. If the taxpayer performs apportionable services for the benefit of a third party, the term "customer" means the third party beneficiary.

Rule 19402(106)(e). Rule 19402 provides further guidance regarding the attribution of apportionable income, including the following:

Receipts are attributed to states based on a cascading method or series of steps. The department expects that most taxpayers will attribute apportionable receipts based on (a)(i) of this subsection because the department believes that either the taxpayer will know where the benefit is actually received or a “reasonable method of proportionally attributing receipts” will generally be available. These steps are:

- (a) Where the customer received the benefit of the taxpayer’s service . . . ;
  - (i) If a taxpayer can reasonably determine the amount of a specific apportionable receipt that relates to a specific benefit of the services received in a state, that apportionable *receipt is attributable to the state in which the benefit is received*. When a customer receives the benefit of the taxpayer's services in this and one or more other states and the amount of gross income of the business that was received by the taxpayer in return for the services received by the customer in this state can be reasonably determined by the taxpayer, such amount of gross income must be attributed to this state. This may be shown by application of a reasonable method of proportionally attributing the benefit among states. The result determines the receipts attributed to each state. Under certain situations, the use of data based on an attribution method specified in (b) through (f) of this subsection may also be a reasonable method of proportionally attributing receipts among states (see Examples 4 and 5 below).

Rule 19402(301) (Emphasis added.). The administrative rule then proceeds to describe additional cascading steps in the series that a taxpayer is to follow if either (a)(i) or (a)(ii) are not feasible. These additional steps mirror the steps described in RCW 82.04.462(3)(b)(iii) – (vii).

The phrase “benefit of the taxpayer’s service” is not statutorily defined. Nevertheless, Rule 19402(303) does provide the following guidance, which depends on the factual circumstances involved:

**Benefit of the service explained.** The first two steps (subsection (301)(a)(i) and (ii) of this rule) used to attribute apportionable receipts to a state are based on where

the taxpayer's customer receives the benefit of the service. This subsection explains the framework for determining where the benefit of a service is received.

**(a) If the taxpayer's service relates to real property, then the benefit is received where the real property is located. The following is a nonexclusive list of services that relate to real property:**

- (i) Architectural;
- (ii) Surveying;
- (iii) Janitorial;
- (iv) Security;
- (v) Appraisals; and
- (vi) Real estate brokerage.

**(b) If the taxpayer's service relates to tangible personal property, then the benefit is received where the tangible personal property is located or intended/expected to be located.**

- (i) Tangible personal property is generally treated as located where the place of principal use occurs. If the tangible personal property is subject to state licensing (e.g., motor vehicles), the principal place of use is presumed to be where the property is licensed; or
- (ii) If the tangible personal property will be created or delivered in the future, the principal place of use is where it is expected to be used or delivered. The following is a nonexclusive list of services that relate to tangible personal property:
  - (A) Designing specific/unique tangible personal property;
  - (B) Appraisals;
  - (C) Inspections of the tangible personal property;
  - (D) Testing of the tangible personal property;
  - (E) Veterinary services; and
  - (F) Commission sales of tangible personal property.

**(c) If the taxpayer's service does not relate to real or tangible personal property, the service is provided to a customer engaged in business, and the service relates to the customer's business activities, then the benefit is received where the customer's related business activities occur.** The following is a nonexclusive list of business related services:

- (i) Developing a business management plan;
- (ii) Commission sales (other than sales of real or tangible personal property);
- (iii) Debt collection services;
- (iv) Legal and accounting services not specific to real or tangible personal property;
- (v) Advertising services; and
- (vi) Theater presentations.

(Emphasis in original). Accordingly, determining where the Affiliates receive the benefit of Taxpayer's services largely depends on the nature of the specific service it provides. Here, we have determined Taxpayer's services relate to articles of clothing and accessories, which is to say,

tangible personal property. Thus, Taxpayer's customers receive the benefit of these services in the states in which that tangible personal property is, or is expected to be, located.

In this case, the tangible personal property to which Taxpayer's services relate is undeniably located in [out-of-state] at the time Taxpayer provides the majority of its services in connection with that property. Presumably, however, that same property will, at some point, be destined for, and therefore reasonably can be expected to be in, other locations. Accordingly, the question before us is at what point in the distribution process should the receipt of the benefit of Taxpayer's services be measured for purposes of apportionment? To answer this question, we must look to the specific nature of the services at issue, as delineated in the respective agreements presented in this case.

First, the Taxpayer performs a host of services on behalf of its Parent company pursuant to the Merchandising Inspection Agreement, including:

- 1) Accepting delivery of goods on behalf of [Parent] at [Taxpayer's] or an affiliated entity's shipping dock immediately prior to pick up by common carrier for delivery to [Parent];
- 2) Inspecting the goods; and,
- 3) For purposes of such delivery, accepting or rejecting such goods.

Second, Taxpayer also performs a variety of services on behalf of its Affiliates pursuant to the Distribution Services Agreement. These services include:

- (a) receipt of Specialty Retail Products from domestic or foreign vendors; (b) interaction with affiliates of [Affiliate 1] regarding logistics, tracking and customs compliance associated with the receipt of Specialty Retail Products; (c) inspection and acceptance or rejection of Specialty Retail Products received; and (d) coordination of incoming transportation deliveries.

In return for this performance, Taxpayer receives gross income from its Parent and affiliated companies. In each of these instances, we believe the affiliated entities for whom the services are rendered represent Taxpayer's "customer" in connection with these, specific services.<sup>4</sup> It follows then that, at this early stage along what may be envisioned as a "distribution continuum," Taxpayer's affiliated entities receive the benefit of Taxpayer's services at the location of the tangible personal property's primary use. Taxpayer's customers are deriving (or using) the benefit of Taxpayer's services in connection with tangible personal property at the location of the distribution center, in this instance in [out-of-state].

At the other end of the distribution continuum, however, Taxpayer derives further income from its Affiliates in return for Taxpayer's provision of shipping related services.<sup>5</sup> At this point in the

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<sup>4</sup> Indeed, at this stage in the distribution process, we believe it is highly unlikely that Taxpayer has any idea where each individual piece of subject property will ultimately end up. Thus, all that can be fairly said at this point in the process is that the property is located in [out-of-state] and, while that property might reasonably be expected to be *somewhere else* eventually, its specific future destination (or future customers) remain unknown.

<sup>5</sup> Described in the Distribution Services Agreement as follows:

process, the destination of the related tangible personal property will likely be known to a certainty. As a result, we believe that with respect to income derived in connection with these services, Taxpayer's customers are the specific Affiliates to whom the tangible personal property is being shipped. Thus, under Rule 19402(303)(b)(ii), each specific Affiliate receives the benefit of Taxpayer's services in the location to which this property is destined, that is to say, where the property is intended or expected to be. Accordingly, that income is apportioned based on the property's intended destination, which, for some property, will include Washington.

Finally, Taxpayer also performs other, non-shipping related services for the benefit of its Affiliates pursuant to Distribution Services Agreement. For example, this agreement specifically obligates Taxpayer to perform various "repackaging"<sup>6</sup> and "sorting"<sup>7</sup> services. Since the record does not contain sufficient information to determine whether these particular services are performed at a point where Taxpayer knows where the property will be delivered or is expected to be delivered, we are unable to determine how much services will be apportioned under Rule 19402(303). Therefore, we remand this income to Audit to determine how to apportion it. Absent additional facts or documentation from Taxpayer regarding this income, . . . Audit [is entitled] to assume such income is earned when Taxpayer knows where the tangible personal property is expected to be delivered.

We also note that it is unclear in this case whether the income in question represents all or a portion of the amounts taxed in the assessment at issue. Accordingly, . . . this issue [is remanded] to Audit to recalculate the service and other activities B&O tax assessed against Taxpayer on Taxpayer's income from operating the distribution center in [out-of-state] consistent with this determination. If there are additional sources of income that were included in this assessment, we ask Taxpayer to provide documentation related to this income to Audit for review.

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"Shipping" consists of the following: (a) coordinating outgoing transportation deliveries; (b) interacting with [Affiliate 1] and affiliated parties of [Affiliate 1] regarding the payment of any highway use taxes, fuel taxes or other taxes, insurances or other costs incurred in shipping; (c) interacting with [Affiliate 1] and affiliated parties of [Affiliate 1] regarding the receipt of Specialty Retail Products by [Affiliate 1], by the retail stores and by direct customers of the catalog and Internet operations of [Affiliate 1] and (d) interacting with [Affiliate 1] and affiliated parties of [Affiliate 1] regarding goods damaged in transit or otherwise rejected goods transferred between retail stores, goods transferred between [Affiliate 1] and retail stores or goods subsequently sold to third parties.

<sup>6</sup> For the reader's convenience, the Distribution Services Agreement defines these services as follows:

"Repackaging" consists of the following: (a) organizing recapping stations within distribution facilities; (b) opening received packages of Specialty Retail Products; (c) Sorting Specialty Retail Products and repackaging Specialty Retail Products as required to fulfill orders of retail stores affiliated with [Affiliate 1] and the catalogue and Internet orders received by [Affiliate 1]; and (d) labeling of products and packages in a manner that complies with applicable regulations by [Affiliate 1].

<sup>7</sup> Delineated as follows:

"Sorting" consists of the following: (a) organizing storage space within distribution facilities; (b) retaining Specialty Retail Products for future repackaging and shipping; (c) securing Specialty Retail Products within distribution facilities; and (d) delivering storage of Specialty Retail Products to off-site locations if necessary.

*Id.*

### 3. Use of [51-State Apportionment Schedule]

Washington imposes a retail sales tax on each retail sale within this state. RCW 82.08.020. The term “retail sale” is defined in RCW 82.04.050(1) and includes “every sale of tangible personal property to all persons . . .” The seller must collect the retail sales tax from the buyer and remit it to the Department. RCW 82.08.050(1), (2). If any seller fails to collect retail sales tax, or remit collected retail sales tax to the Department, it is personally liable to the Department for the amount due. RCW 82.08.050(3).

On March 22, 2007, the Governor signed the Streamlined Sales and Use Tax Agreement (SSUTA) into law and changed the manner in which sales taxes are sourced in the state of Washington. *See* Substitute Senate Bill (SSB) Laws of 2007, ch. 6. This change is codified in RCW 82.32.730, and provides, in pertinent part:

(1) Except as provided in subsections (5) through (7) of this section, for purposes of collecting or paying sales or use taxes to the appropriate jurisdictions, all sales at retail shall be sourced in accordance with this subsection . . .

(a) When tangible personal property, an extended warranty, or a service defined as a retail sale under RCW 82.04.050 is received by the purchaser at a business location of the seller, the sale is sourced to that business location.

(b) When the tangible personal property, extended warranty, or a service defined as a retail sale under RCW 82.04.050 is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser or the purchaser’s donee, designated as such by the purchaser occurs, including the location indicated by instructions for delivery to the purchaser or donee, known to the seller . . .

RCW 82.32.730(1)(a), (b). In addition, RCW 82.04.050 imposes B&O tax on every retail sale sourced to the state, in the manner described. The measure against which both the retail sales and retailing B&O tax are imposed are the “gross proceeds of sales,” defined to mean:

[T]he value proceeding or accruing from the sale of tangible personal property, digital goods, digital codes, digital automated services, and/or for other services rendered, without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

RCW 82.04.070. In this case, Taxpayer does not argue that it is not subject to Washington’s retail sales and retailing B&O tax on the sales it makes into the state. Rather, Taxpayer disagrees with the manner in which Audit measured the gross proceeds of those sales. Audit contends that [the 51-State Apportionment Schedule] is the best measure. Taxpayer, on the other hand, maintains that commercially generated sales reports prove more accurate. This assertion aside, however, the

Department routinely relies on taxpayers' federal income tax returns, which are filed under penalty of perjury. Det. No. 87-354, 4 WTD 293 (1987); Det. No. 92-061, 12 WTD 119 (1993). Furthermore, we do not have at our disposal any evidence to suggest that Taxpayer's commercially-prepared sales reports are more accurate than the amounts that it claimed to other government entities represented its sales into Washington State. Finally, we note that, under RCW 82.32.070 and WAC 458-20-254, the burden of providing records sufficient to establish a taxpayer's sales into Washington rests on the Taxpayer.

#### DECISION AND DISPOSITION

We deny Taxpayer's petition in part, and grant the Taxpayer's petition in part. We deny Taxpayer's petition with respect to the classification of its income, concluding that it is properly taxable under the services and other B&O tax classification. We also deny Taxpayer's petition with respect to the use of . . . sales reports, as opposed to Taxpayer's [51-State Apportionment Schedule], for purposes of determining its Washington sourced retail sales. We grant and remand Taxpayer's petition with respect the apportionment of Taxpayer's distributions services income earned on and after June 1, 2010 . . . .

Dated this 14th day of November 2018.