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IN THE SUPREME COURT
OF THE STATE OF WASHINGTON
Supreme Court No. 102824-5

(Court of Appeals No. 57127-7-II)

CITIBANK (SOUTH DAKOTA), NATIONAL ASSOCIATION,

Petitioner,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

ON PETITION FOR REVIEW FROM COURT OF APPEALS, DIVISION II

CITIBANK (SOUTH DAKOTA), NATIONAL ASSOCIATION'S PETITION FOR REVIEW

Richard A. Leavy
(*pro hac vice* application pending)
Robin Wechkin
(WSBA No. 24746)
SIDLEY AUSTIN LLP
8426 316th Place Southeast
Issaquah, WA 98027
Telephone: (415) 439-1799
Facsimile: (415) 772-1273

Attorneys for Petitioner Citibank (South Dakota), National Association

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I. INTRODUCTION

This petition for review of a decision of the Court of Appeals is made under RAP 13.4(b) on the bases that it (i) is in conflict with a decision of the Supreme Court; (ii) presents a significant question of law under the Constitution of the State of Washington or of the United States; and (iii) involves an issue of substantial public interest that should be determined by the Supreme Court.

Substantively, this petition raises statutory and constitutional tax nexus (presence) issues, tax imposition (trigger) issues, and tax measurement (apportionment) issues in the application of the Washington business and occupation tax (the "Tax").

The underlying dispute arises from a Washington Department of Revenue (the "Department") audit assessing a deficiency of Tax against Citibank (South Dakota), National Association ("Citi") for the January 1, 2007 through May 31, 2010 tax period (the "Period").

Citi is an out-of-state financial institution that commenced filing Tax returns in 2010 as a result of the adoption by Washington State Legislature (the "Legislature") of a change in law imposing what the Legislature and the Department described as a new economic nexus standard of taxability that replaced what had been the prior physical presence requirement for taxability.

Before the Court of Appeals the Department argued that the Tax assessment was proper because no physical presence was required to impose the Tax for periods prior to June 1, 2010 (the decision of the Court of Appeals (the "Opinion") ruled otherwise) and, alternatively, that the physical presence standard was satisfied by the in-state presence in Washington of credit card customers, third-party retailers, and collection attorneys with which Citi contracted did business (the Opinion agreed).

The Opinion allowing these facts alone to form the basis for the finding of a taxable nexus and apportionment of Citi's

gross income to Washington is, however, tantamount to the Opinion retroactively applying the 2010 legislative change to adopt an economic nexus standard; this position is contrary to the express provisions of the Washington Revised Code in effect for the tax periods at issue, the express statements of intent by the Legislature, and the published statements of the Department. In so holding, the Opinion announced new law when it reached the novel and incorrect conclusion that the Department may impose Tax on a service business that carries on all of the activities in the generating its gross income at locations outside of Washington for years prior to the legislative enactment of the economic nexus standard.

Moreover, the application of a "market based" gross income sourcing methodology to Citi results in what is a clearly an unconstitutional imposition based upon the nature of the Tax as imposed on business activities and the undisputed and stipulated facts that establish that Citi carried on no business activities whatsoever in Washington.

These issues meet the standards for review under RAP 13.4(b).

II. IDENTITY OF PETITIONER

The petitioner is Citibank (South Dakota), National Association.

III. COURT OF APPEALS DECISION

Citi seeks review of the unpublished decision of the Court of Appeals in *Citibank (South Dakota), National Association v. State of Washington Department of Revenue*, No. 57127-7-II (Wash. Ct. App. Div. II, Nov. 14, 2023), *reconsideration denied* (Jan. 23, 2024).

A copy of the Opinion is provided in the Appendix, at Appendix A (the denial of reconsideration is at Appendix B).

IV. ISSUES PRESENTED FOR REVIEW

1. May the Department retroactively apply the Legislature's elimination of the physical presence requirement for periods beginning June 1, 2010, such that an out-of-state financial institution can be subject to Tax for periods prior to June 1,

2010 on the basis of Washington borrowers, use of the Washington courts, or the in-state presence of third-party business partners?

2. If the in-state activities of a third-party that is not an agent or authorized representative can satisfy the physical presence prerequisite to taxability under the Tax for periods prior to June 1, 2010, can those same third-party activities also be the basis for the apportionment of the putative taxpayer's gross income?

3. Can formulary apportionment be used to impose the Tax on the business activities of a service provider stipulated to have been performed entirely outside of Washington?

V. STATEMENT OF THE CASE

The relevant stipulated facts are set forth in the Opinion.

During the Period, Citi was a commercial bank with its headquarters in South Dakota. Citi had no place of business, employees, or property within Washington. Opinion pp. 2-3.

Citi carried on business as an issuer of credit cards, issuing general credit cards (i.e., Visa and MasterCard) that could be used at any location that accepted those network cards. Opinion pp. 2-3. Citi also issued store-branded private label credit cards usable at a specific retailer pursuant to a governing "program agreement" that was entered into between Citi and the retailer, which agreement was negotiated and entered into outside of Washington. Opinion pp. 2-3.

Citi generated four different types of income: (i) interest from cardholders; (ii) fee income for the provision of services to cardholders; (iii) interchange fee and other fee income for the provision of services to retailers and issuing banks; and (iv) income from trading and investment activities. Opinion pp. 3-4.

Citi transacted business with cardholders, retailers, other financial institutions, and trading and investing counterparties from a place of business outside of Washington. Opinion pp. 3-4. Citi's employees were all located outside of Washington and

they used real and personal property outside of Washington. Opinion pp. 3-4.

VI. ARGUMENT

A. The Opinion is in conflict with decisions of the Washington Supreme Court and United States Supreme Court by redefining the physical presence that satisfies the pre-2010 Tax nexus standard.

The Court of Appeals issued the Opinion on an unpublished basis, suggesting that it was nothing more than an unnoteworthy application of existing law to facts within the scope of prior cases. As a companion to the motion for reconsideration made under RAP 12.4, Citi also moved for publication of the Opinion under RAP 12.3(e). Notably, while the Court of Appeals denied both motions, the Department did not oppose the motion for publication of the Opinion, stating that "[t]he Court's opinion meets the criteria in RAP 12.3(e)(5) as the Court's analysis of the various issues raised by Citibank are matters of general public interest."

This acknowledgement of the importance of the Opinion is consistent with the reality that the Opinion materially departed from the reasoning in *Lamtec Corp. v. Department of Revenue*, 170 Wn.2d 838, 246 P.3d 788 (2011) and *Tyler Pipe Industries v. Department of Revenue,* 483 U.S. 232, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987) in holding that Citi, as a service provder, satified the then in effect physical presence standard for imposing the Tax. The Opinion mischaracterized the taxability standards set forth by the Washington Supreme Court and U.S. Supreme Court and created a new, more lenient standard for satisfying the physical presence requirement to render it meaningless in the context of a service provider and the Tax.

In both *Lamtec* and *Tyler Pipe*, which dealt with sellers of tangible personal property, the sale generating the gross income to be taxed occurred in Washington with title to the property sold passing in Washington; the taxpayers also had employees or agents in Washington whose actions directly and substantially contributed to the taxpayer's business of making

sales. In relying on these inapposite authorities, the Opinion overlooked or misapprehended the clear provisions of Washington law, which is that the Tax on service providers is based on a "trigger/event" that differs from that used for sellers of goods.

For sellers of tangible personal property, the Tax is imposed on the "sale" which leads to the location of the delivery to the customer generally determining where the sale occurs. RCW 82.04.040(1).

In contrast, for the services and other business activities classification, the Tax is imposed on "every person engaging within this state in any business activity," which is measured by the gross income arising from "such activities" to the extent that they take place within Washington. RCW 82.04.290(2)(a). It is only a result of the 2010 law change that Washington purports to now impose the Tax on gross income arising from a Washington "source" without regard to where the services were performed.

In *Tyler Pipe Industries v. Department of Revenue,* 483 U.S. 232, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987)*,* the U.S. Supreme Court determined that the activities of sales representatives "adequately support the State's jurisdiction to impose its wholesale tax on Tyler." In so determining, the Supreme Court relied upon regular and systematic in-person market-making and market-maintaining activities that were directly related to the generation of sales. *Id.* at 249-250.

In *Lamtec Corp. v. Department of Revenue*, 170 Wn.2d 838, 851, 246 P.3d 788 (2011), the Washington Supreme Court relied upon *Tyler Pipe* to reach a similar result because "Lamtec's practice of sending sales representatives to meet with its customers within Washington was significantly associated with its ability to establish and maintain its market." The Washingtion Supreme Court reached this conclusion based on the integral and necessary role that Lamtec's in-state employees performed in its business of selling goods and the underlying

facts as to the extent of their in-state activities, which were described in the lower court decision.

151 Wash. App. 451, 454, 215 P.3d 968 (2009).

In the context of *Tyler* and *Lamtec*, the Opinion represents a wholesale expansion of the the market-making and market-maintaining standard. The Opinion concluded Citi had sufficient physical presence in Washington to support the imposition of the Tax based on three express "factors." Opinion pp. 12-14. The first two factors were based on Citi's "contractual relationships" with three retailers who had stores within Washington whereby: (1) "Citibank was working with Washington stores and Washington store employees to sign up Washington residents for its credit cards" and (2) "retailers [were authorized] to accept payments from its customers on behalf of Citibank on amounts the customers owed to Citibank" Opinion pp. 12-13. The third basis was the in-state presence of Washington attorneys who "file[d] more than 3,000 lawsuits against

Washington residents in Washington courts to recover unpaid debts." Opinion p. 13.

The Opinion concluded that "together, these factors show that Citibank was physically present in Washington" purportedly rising to the level of market-making or market-maintaining activities as set forth in *Tyler Pipe* and *Lamtec*. Opinion p. 14. However, even a cursory comparison of the facts of this case to those in *Tyler Pipe* and *Lamtec* show how insignificant and unrelated the activities conducted by third parties in Washington were in relation to the generation of gross income by Citi's credit card business.

Furthermore, without directly stating it, the Opinion acknowledged that it was creating new law. For example, the Opinion notes that the in-state retailers' activities "<u>may not</u> have risen to the level of the activities of the sales representatives in *Lamtec* or the local agents in *Tyler Pipe*" and that "[t]o the extent that [*Lamtec* requires] that activities must help establish or maintain a market in order to constitute a physical pres-

ence, collecting unpaid debts could be considered maintaining an existing market." Opinion pp. 13-14 (emphasis added).

Furthermore, the Opinion ignores the fact that *Tyler Pipe* and *Lamtec* dealt with sellers of tangible personal property, that the sales occurred in Washington, and that the physical presence in those cases was by sales representatives hired specifically for the conduct of regular and systematic in-person market-making and market-maintaining activities that were directly related to the generation of sales sought to be taxed.

Moreover, the Opinion made the paradoxical determination that the in-state attorneys engaged by Citi to collect outstanding receivables "clearly were acting on behalf of Citibank, akin to the local sales agents in *Tyler Pipe*" noting only the almost "daily basis" on which law suits were filed without any examination of the function they performed, which was separate and apart from Citi's service business. Opinion p. 13.

In *Tyler Pipe* it was not the mere daily presence of sales representatives in Washington that gave rise to taxability but

their "long-established and valuable relationships with Tyler Pipe's customers" that was vital to Tyler Pipe's business, an inconvenient fact overlooked by the Opinion.

The Opinion further obfuscates the physical presence standard and issues raised in this matter in its discussion of *Department of Revenue v. J.C. Penney Co., Inc.,* 96 Wn. 2d 38, 633 P.2d 870 (1981). Opinion pp. 11-13.

Like the instant matter, *J.C. Penney* involved a private label credit card lending business. However, unlike Citi, that private label credit card lending business was carried on by the same legal entity that operated the retail stores in Washington that made the sales being financed.

In evaluating the taxability of the J.C. Penney private label credit card lending activities, the Washington Supreme Court evaluated both the presence of the putative taxpayer (i.e., taxpayer nexus) and also the presence of the business activities sought to be taxed (i.e., the transactional nexus). As made clear in *Tyler Pipe* and *Lamtec*, the Washington Supreme Court

proceeded on the basis that merely establishing transactional nexus by passing title to or possession of goods in Washington is not enough to impose the Tax; the taxpayer must also be physically present in Washington and that presence in Washington must be integral to the transaction sought to be taxed in Washington.

In the context of evaluating the taxability of Citi in the instant matter, it is important to note that in *Tyler Pipe*, *Lamtec*, and *J.C. Penney* the fundamental business carried on was the sale of goods.

The importance of this distinction is evident in the description of the in-state activities relied upon by the Washington Supreme Court in its constitutional analysis in *J.C. Penney*:

> The due process clause requires that there be a nexus between the taxing state and the activity sought to be taxed. *Mobil Oil Corp. v, Commissioner of Taxes*, 445 U.S. 425, 63 L.Ed.2d 510, 100 S.Ct. 1223 (1980). If the local activities are dissociated from the business activity

> which is the subject of the tax, then the local tax cannot stand. *Norton Co. v. Department of Revenue*, 340 U.S. 534, 95 L.Ed. 517, 71 S.Ct. 377 (1951). As demonstrated above, the imposition of the finance charge involves a great deal of Washington activity relating to establishing credit accounts and handling local problems relating to that credit account. These in-state activities of Penney are not sufficiently dissociated from its finance charge income to violate the due process clause.

Id. at 47-48.

Moreover, the in-state activities as described in *J.C. Penney* that were conducted at the retail locations of the same taxpayer far exceeded those cited as giving rise to taxability in the instant matter, which merely included handing out credit applications and forwarding completed applications and payments to Citi from unrelated retailers' locations in Washington (which are activities that are regularly undertaken by retailers in the context of non-private label "general" credit cards). Opinion p. 5.

This analysis is even more relevant in the context of the symbiotic relationship between a retailer and a third-party

lender, such as Citi, and further demonstrates that Citi did not satisfy the physical presence standard as set forth in *Tyler Pipe*, *Lamtec*, and *J.C. Penney*, thereby meeting the standard for review under RAP 13.4(b).

B. The petition involves an issue of substantial public interest that should be determined by the Supreme Court, which is whether a legislative enactment described as a change in law and a clearly expressed legislative intent can be ignored in interpreting a prior tax imposition provision.

The three bases cited by the Opinion as establishing Citi's physical presence in Washington were the same as the activities identified by the Legislature as not subjecting an out-of-state service provider to the Tax prior to the 2010 law change and were warranting of the adoption of the new economic nexus taxability standard. Opinion pp. 12-14.

The Opinion cites Citi's Washington cardholders, the use of the courts to collect delinquent receivables (local legal counsel), and the presence of in-state representatives (the retailers and their employees) as the basis on which it found that Citi

had established a physical presence in Washington to support the imposition of the Tax. Opinion pp. 12-14.

However, in the legislative history accompanying the 2010 law change, which is block-quoted by the Opinion, the Legislature noted that "out-of-state businesses that do not have a physical presence in Washington" and the resulting taxability included those businesses that have those same three elements in Washington cited by the Opinion as the basis for finding that Citi had established a physical presence in Washington, which are that they (i) "earn significant income from Washington residents from providing services or collecting royalties on the use of intangible property in this state;" (ii) receive "significant benefits and opportunities provided by the state" including "access to courts and judicial process to enforce business rights, including debt collection and intellectual property rights;" and (iii) benefit from the provision of "police and fire protection and a transportation system" to their "in-state agents and other representatives." Opinion p. 9.

The legislative history contextualized these findings with respect to the taxability of out-of-state lenders by stating that "the legislature intends to extend the state's business and occupation tax to these companies to ensure that they pay their fair share of the cost of services that this state renders and the infrastructure it provides."

The Opinion simply cannot be reconciled with the Legislature's description of the law applicable to the Period, which was cited as the basis for the law change and adoption of economic nexus and thereby raises an issue of significant public interest – the role of legislative intent and import of legislative changes in interpreting tax statutes.

The Opinion acknowledged that there was a physical presence taxability standard, but then applied it in such a way that it is effectively irrelevant by blatantly ignoring the Legislature's finding in favor of upholding the Department's assessment of Tax against Citi for the Period, which is an issue of

substantial public interest meeting the standard for review under RAP 13.4(b).

C. The petition raises a significant question of law under the Constitution of the State of Washington and the Constitution of the United States, which is whether it is permissible to impose tax and apportion gross income on the basis of activities of a third-party and not the putative taxpayer.

The activities cited by the Opinion as supporting the conclusion that Citi had physical presence in Washington during the Period were the activities of in-state third-party retailers with which Citi contracted to issue private label cards pursuant to a program agreement and attorneys which Citi hired to engage in collection activities, including filing law suits in Washington Courts.

None of the retailers, the retailers' employees, nor the in-state attorneys were agents of Citi. The Opinion ignored this fact and instead focused on the fact that the retailers handed out account application materials are were able to collect and forward completed credit card applications to Citi for consid-

eration as well as collect and forward payments to Citi for processing.

The Opinion dismissed as irrelevant the fact that the retailers acted on the basis of their own separate business interests, facilitating sales and minimizing interchange fees that arise from the use of general credit cards (such as those on the Visa and MasterCard networks).

The Opinion also dismissed as irrelevant that the activities cited as giving rise to taxability for Citi were practically no different from those activities undertaken by all retailers who accepted general credit cards (such as those on the Visa and MasterCard networks) and would lead to all credit card issuers with customers in Washington being subject to the Tax prior to the 2010 law change.

This cannot be a correct application of the law during the Period because the taxation of formerly untaxed out-of-state credit card issuers was the clearly stated goal of the new economic nexus standards enacted in 2010 on a prospective basis.

Sec. 101 of Ch. 23 (S.B. 6143), Laws 2010, 1st Sp. Sess.; Second Engrossed Substitute Senate Bill Report (2ESSB 6143), dated March 20, 2010; Senate Bill Report (SB 6143), dated March 5, 2010; Special Notice: New 'Economic Nexus' in Washington State May Impact Financial Institutions Including Out-of-state Banks and Credit Card Issuers (May 28, 2010).

As a factual matter, none of the retailers nor their employees were agents of Citi. Neither the retailers nor their employees performed any of the actual banking activities that actually generated gross income for Citi.

While there was a secondary benefit to Citi from the retailers' activities, they were neither qualitatively nor quantitatively comparable to the activities of the sales and other representatives engaged by the sellers of tangible personal property in *Tyler Pipe* and *Lamtec*, who actually made the sales of goods to Washington customers possible.

These activities were also very different than those at issue in *J.C. Penney*, in which the private label credit card

lending business was carried on by the same legal entity that operated retail stores in Washington that made the sales that were being financed.

In the same vein, the attorneys hired by Citi to collect delinquent loans receivable months or years after the lending activities or provision by Citi of services with respect to the Washington customer was undertaken is the exercise of creditor rights and not the delegation to an agent of the conduct of Citi's business activities.

The attorneys did not carry on any elements of the regulated lending activities, provision of services to customers, or trading or investment activities through which Citi generated its revenue. Rather, the attorneys merely utilized the courts to collect previously accrued amounts owed to Citi as a result of having conducted its service business outside of Washington in the past.

The misapplication of *Tyler Pipe*, *Lamtec*, and *J.C. Penney* raises a significant question of law under the Constitu-

tion of the State of Washington and the Constitution of the United States meeting the standard for review under RAP 13.4(b).

D. The Opinion raises a significant question of law under the Constitution of the United States, which is whether formulary apportionment may be utilized to impose tax and apportion gross income on the basis of customer location where the stipulated facts are that the putative taxpayer conducted no in-state activities.

The Opinion has overlooked or misapprehended that while not precise, formulary apportionment must seek to measure a putative taxpayer's gross income from engaging in business activities in a state. In the context of the Tax, apportionment must be based on a taxpayer's actual conduct of business activities within and without the state and, in the case of Citi, cannot be used to reach a result wholly inconsistent with the stipulated facts demonstrating that Citi conducted no business activities within Washington. Opinion pp. 16-18.

The U.S. Supreme Court has held that "[t]he Due Process Clause of the Fourteenth Amendment imposes two require-

ments for such state taxation: a ‘minimal connection’ or ‘nexus’ between the interstate activities and the taxing State, and ‘a rational relationship between the income attributed to the State and the intrastate values of the enterprise.’” *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207, 220 (1980) (citing *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 436-37 (1980) (citing *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-73 (1978))).

Thus, a state such as Washington can only impose its taxing authority on that property, income, or value which lies within its borders or is deemed to lie within its borders.

In *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983), the U.S. Supreme Court applied the fair apportionment standard and held that a tax must be externally consistent to pass muster under the Commerce Clause. A tax is externally consistent only if “the factor or factors used [for apportionment] … actually reflect a reasonable sense of how income is generated.” *Container Corp.*, 463 U.S. at 169.

Under formulary apportionment, value is properly divided "between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction." *Container Corp.*, 463 U.S. at 165.

The U.S. Supreme Court has also held that the Due Process Clause requires that the amount of income attributed to a state by that state's apportionment formula must be rationally related to the values connected with the taxing state. *Norfolk & Western R. Co. v. Missouri*, 390 U.S. 317 (1968) (testing for a grossly distorted result).

Applying these standards to a business or property that lies within and also outside of a state, the only value that can be taxed is that which is properly attributed to the taxing jurisdiction. If the tax is wholly disproportionate to the in-state presence, it will be struck down as unconstitutional. *Id.* These principles prevent a state such as Washington from imposing its

taxing authority on property, income, or value that lies outside of its jurisdictional boundaries.

In *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123 (1931), the U.S. Supreme Court found that the employment of a single-factor property formula to tax eighty-three percent of the income of a taxpayer that only had seventeen percent of its income reasonably sourced to the state (based on its manufacturing activities there) was out of all appropriate proportion to the business transacted in the state and violated the Due Process Clause.

In reaching this conclusion, the U.S. Supreme Court explained that, in general, unless an apportionment formula is "intrinsically arbitrary" the method will be sustained until proof is offered of an unreasonable and arbitrary application in particular cases. *Hans Rees' Sons*, 283 U.S. at 133. In a more recent case, the Supreme Court reiterated that Due Process Clause requires a rational relationship between the portion of the tax base attributed to the state and the contribution of the

taxpayer's business activity in that state to the tax base. *See Trinova Corp. v. Michigan Department of Treasury*, 498 U.S. 358, 373 (1991) (citing *Container Corp.*, 463 U.S. at 180-181).

Based on these cases, it is clear that an apportionment formula cannot be arbitrary and must seek to measure the amount of value properly attributable to the business activities of the taxpayer conducted in the state imposing the tax.

Furthermore, if a statutory apportionment method that is valid on its face is applied in a particular case in a way that operates in a manner that attributes value to a state "out of all appropriate proportion" to the business activities of the taxpayer transacted in that state, then the application will be struck down as being "beyond the State's authority." *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123, 135-36 (1931) (citing *Shaffer v. Carter*, 252 U.S. 37 (1944)).

In upholding the three factor formulary apportionment as applied by the Department in determining Citi's purported Tax liability for the Period, the Opinion improperly allowed Citi to

be taxed on the basis of business activities carried on by third parties in Washington, violating the above described fundamental constitutional apportionment principles. Opinion pp. 16-18. In so doing, the Opinion failed to give effect to its own factual finding that Citi did not have any place of business, employees, or property within Washington.

This is because, for a service provider the Tax is an imposition on "engaging within the state" in business activities by actually performing those business activities in the state.

While formulary apportionment that is not arbitrary is assumed to be valid and correct unless proven otherwise, and it may be a reasonable assumption that the location of a service provider's customers reflects the location of the service provider's business activities, in the case of Citi as is demonstrated by the stipulated facts it does not. To find otherwise would implicate Section 5 of the Washington Constitution which requires that every tax law distinctly state the object of taxation; allowing taxation based on a third-parties activities under a catchall

services and other business classification for activities not otherwise enumerated as taxable would seem to be a perfect example of the lack the required specificity necessary for such an imposition of the Tax to be valid under the Washington Constitution. *See* Constitution of the State of Wash. Art. 7 §5.

Moreover, the Opinion has failed to fairly apportion the gross income of Citi under the external consistency test set forth in *Container Corp.* because the factors representing only one discrete business activity and one set of customers were used to apportion all of Citi's gross income despite the Opinion recognizing that Citi engaged in four different business activities that generated four different types of gross income. Opinion p. 4.

As stipulated and described in the Opinion, Citi generated four different types of income with three different sources: (i) interest from cardholders; (ii) fee income for the provision of services to cardholders; (iii) interchange fee and other fee income from retailers, issuing banks, and third-party retailers;

and (iv) income from trading and investment activities. Opinion p. 4.

Notwithstanding these four different streams of income, generated from four different business activities and involving different parties, the apportionment of gross income by the Department, which was approved by the Opinion, only looked to "where Citibank's cardholders reside."

By ignoring three of the four types of gross income generated by Citi, the apportionment undertaken by the Department and upheld by the Opinion necessarily fails the internal consistency test described in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983) because it ignores "the factor or factors used [for apportionment] … actually reflect a reasonable sense of how income is generated."

The disregard of the standards for formulary apportionment raises a significant question of law under the Constitution of the State of Washington and the Constitution of the United States meeting the standard for review under RAP 13.4(b).

VII. CONCLUSION

Based upon the foregoing , Citi respectfully requests that this Court grant its petition for review.

I certify that this document contains 4,995 words, computed without regard to those portions excluded from the word count by RAP 18.17 in compliance with the Rules of Appellate Procedure.

DATED: February 22, 2024

SIDLEY AUSTIN LLP

Robin Wechkin
(WSBA No. 24746)
Richard A. Leavy
(*pro hac vice* application pending)
SIDLEY AUSTIN LLP
8426 316th Place Southeast
Issaquah, WA 98027

Attorneys for Petitioner Citibank (South Dakota), National Association

CERTIFICATE OF SERVICE

I certify that on the 22nd day of February, 2024, I caused a true and correct copy of this Petition of Review of Petitioner Citibank (South Dakota), National Association to be served on all parties of record in the proceeding, through my legal assistant, via court e-filing website/Portal, which sends notification of such filing to the following:

State of Washington,
Department of Revenue
Treasury Management
P.O. Box 47464
Olympia, WA 98504-7464

Washington State, Office of the Attorney General
1125 Washington St SE
PO Box 40100
Olympia, WA 98504-0100

Washington Board of Tax Appeals
1110 Capitol Way S, Suite 307
Olympia, Washington 98504

REVOlyEF@atg.wa.gov;
ChuckZ@atg.wa.gov;
wendy.hail-lombardi@atg.wa.gov;
dorappealsbta@dor.wa.gov;
serviceATG@atg.wa.gov;
bta@bta.wa.gov

I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 22nd day of February, 2024, at Issaquah, Washington.

Robin Wechkin

APPENDIX

APPENDIX

EXHIBIT

Citibank (South Dakota), National Association v. State of Washington Department of Revenue, No. 57127-7-II (Wash. Ct. App. Div. II, Nov. 14, 2023) (the "Opinion") ....A

Citibank (South Dakota), National Association v. State of Washington Department of Revenue, No. 57127-7-II (Wash. Ct. App. Div. II, Nov. 14, 2023) (denial of reconsideration) ....B

Citibank (South Dakota), National Association v. State of Washington Department of Revenue, No. 57127-7-II (Wash. Ct. App. Div. II, Nov. 14, 2023) (*Answer to Motion to Publish the Opinion*) C

Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983) ....D

Department of Revenue v. J.C. Penney Company, Inc., 96 Wn. 2d 38, 633 P.2d 870 (1981)....................E

Exxon Corp. v. Department of Revenue of Wisconsin, 447 U.S. 207 (1980)....................F

Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123 (1931) ....G

Lamtec Corp. v. Department of Revenue, 151 Wash. App. 451, 215 P.3d 968 (2009) ....H

Lamtec Corp. v. Department of Revenue, 170 Wn. 2d 838, 246 P.3d 788 (2011)....................I

Norfolk & Western R. Co. v. Missouri, 390 U.S. 317 (1968) ....J

Norton Co. v. Department of Revenue, 340 U.S. 534 (1951) ....K

Tyler Pipe Industries v. Department of Revenue,
483 U.S. 232 (1987) L

Trinova Corp. v. Michigan Department of Treasury,
498 U.S. 358 (1991) .... M

Constitution of the State of Washington Art. 7 §5 .... N

RCW 82.04.040 .... O

RCW 82.04.290 .... P

RAP 13.4 .... Q

Second Engrossed Substitute Senate Bill Report (2ESSB 6143), dated March 20, 2010 .... R

Senate Bill Report (SB 6143), dated March 5, 2010 .... S

Special Notice: New 'Economic Nexus' in Washington State May Impact Financial Institutions Including Out-of-state Banks and Credit Card Issuers (May 28, 2010) .... T

Sec. 101 of Ch. 23 (S.B. 6143), Laws 2010, 1st Sp. Sess. .... U

Appendix A

Filed
Washington State
Court of Appeals
Division Two

November 14, 2023

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

CITIBANK (SOUTH DAKOTA), NATIONAL ASSOCIATION, Appellant, v. STATE OF WASHINGTON DEPARTMENT OF REVENUE, Respondent.	No. 57127-7-II UNPUBLISHED OPINION

MAXA, P.J. – Citibank (South Dakota), National Association (Citibank) appeals the Board of Tax Appeals' grant of summary judgment in favor of the Department of Revenue (DOR) regarding the assessment of over $6 million in business and occupation (B&O) taxes from January 1, 2007 through May 31, 2010. Citibank had challenged DOR's determination that Citibank was subject to B&O taxes because it had engaged in business in Washington during the relevant period.

Citibank is a commercial bank with its headquarters in South Dakota. Citibank does not have a place of business or any employees or property within Washington. However, during the assessment period Citibank generated over $1.7 billion in interest and fee income from issuing credit cards to Washington residents. Some of these credit cards were private label, store branded cards that could only be used at certain retailers. Pursuant to agreements with Citibank, these retailers were obligated to market the credit cards and distribute marketing materials to

customers in their Washington stores in order to solicit new accounts for Citibank. In addition, Citibank used Washington attorneys to file over 3,000 lawsuits in Washington courts to collect unpaid debts owed by Washington residents during the relevant period.

Before June 2010, former RCW 82.04.220 (1961) provided that a B&O tax would be collected from every person "for the act or privilege of engaging in business activities." Effective June 1, 2010, the legislature amended this statute to state that a B&O tax would be collected from every person "*that has a substantial nexus with this state* . . . for the act or privilege of engaging in business activities." Former RCW 82.04.220 (2010) (emphasis added).

Citibank asserts that before the 2010 amendment, the term "engaging in business activities" in RCW 82.04.220 required that a business have a physical presence in Washington to be subject to B&O taxes. Citibank argues that it could not be subject to B&O taxes before June 2010 because it did not have a physical presence in Washington.

DOR acknowledges that before June 2010, its policy and procedure was to assess B&O taxes against out-of-state businesses only when they had a physical presence in Washington. But DOR argues that even though there was a physical presence requirement under RCW 82.04.220 before June 2010, Citibank's activities satisfied that requirement in two ways: (1) having a contractual relationship with retailers to promote private label credit cards issued by Citibank to Washington consumers, and (2) continuously using Washington courts to collect unpaid debts from Washington residents.

A second issue involves DOR's apportionment of Citibank's gross income to its Washington activities based on WAC 458-20-14601. DOR apportioned Citibank's income to Washington based on the billing addresses of Citibank cardholders. Citibank argues that even if it was subject to B&O taxes, no amount of income could be apportioned to Washington activities

because Citibank did not engage in any business activities in Washington. In addition, Citibank argues that WAC 458-20-14601 was an invalid regulation and was unconstitutional as applied.

We hold that (1) although before June 2010 a physical presence requirement existed for the imposition of B&O taxes on out-of-state businesses, Citibank's activities in Washington satisfied that physical presence requirement; and (2) the formula provided under WAC 458-20-14601(2)(b) was the correct formula to use to apportion Citibank's gross income to Washington activities and the regulation was not invalid or unconstitutional. Accordingly, we affirm the Board of Tax Appeals' final decision granting summary judgment in favor of DOR.

FACTS

Background

Citibank is a commercial bank with its headquarters in South Dakota. During the assessment period at issue in this appeal, Citibank did not have a place of business in Washington and did not have any employees or property within Washington. All Citibank employees worked at business locations outside of Washington.

Citibank was engaged in the business of originating, managing, and servicing unsecured revolving consumer loans as a credit card issuer. Citibank issued credit cards to customers throughout the United States, including in Washington. A majority of the credit cards that Citibank issued were general credit cards, including Visa and MasterCard, which could be used at any location that accepted the cards. Citibank also issued private label, store-branded credit cards that could be used only at the designated retailers. These cards generally bore the name and logo of the retailer. Finally, Citibank issued co-branded credit cards that could be used at the designated retailers as well as at other locations as a general credit card.

Citibank generated income through four general categories: (1) interest income received from cardholders that did not pay their outstanding amounts due within the applicable grace period; (2) interchange income from retailers, issuing banks, and third-party retailers with whom Citibank entered into private label agreements; (3) fee income for the provision of services for cardholders, such as annual fees, cash advance fees, balance transfer fees, and late payment fees; and (4) income from trading and investment activities outside of Washington.

Citibank earned gross income attributable to Washington in the following amounts: (1) $360,355,363 in 2007, (2) $421,068,521 in 2008, (3) $492,478,463 in 2009, and (4) $452,621,110 in 2010. Total income during this period exceeded $1.7 billion.

During the assessment period, Citibank used Washington counsel to file more than 3,000 collection actions in Washington courts to collect debts owed by defaulting Washington residents.

Private Label Agreements

Citibank entered into private label credit card agreements (PL agreements) with various retailers, including three retailers that operated in Washington – Home Depot U.S.A., Inc. (Home Depot), Sears, Roebuck and Co. (Sears), and Federated Department Stores, Inc. (Federated). The PL agreements generally provided that Citibank and the retailers would cooperate in the development of marketing plans for the private label cards. Citibank and the retailers agreed to review all marketing plans to support the growth of Citibank's private label card program. Pursuant to the agreements, Citibank and the retailers established joint management committees to review policy and marketing operations.

The PL agreements also required the retailers' employees to market the credit cards and distribute marketing materials to in-store customers in order to solicit new accounts. For

example, the agreement with Home Depot required Home Depot to "prominently display" credit card applications at all retailer locations and to use "reasonable efforts" to promote the program. Admin. R. (AR) at 226. Marketing plans included in-store programs such as sales associate incentives and customer events. The Sears agreement required Sears to have its store employees market and support the private label credit card program. The Federated agreement required Federated to solicit new accounts through "in-store credit procedures" and display credit card applications, and to pay sales associates compensation for soliciting new accounts. AR at 1318. Except as carried on by the retailers as provided for in the agreements, Citibank did not carry out any solicitation activities in Washington related to the private label cards.

In addition, the PL agreements provided that the retailers could accept in-store payments for the private label cards. Under the agreement with Sears, when Sears received an in-store payment, it was deemed to hold the payment in trust for Citibank until the payment was either delivered to Citibank or applied to reduce the amounts payable to Sears by Citibank.

Tax Audit and Subsequent Proceedings

Citibank did not file any Washington B&O tax returns between January 1, 2007 and May 31, 2010. DOR audited Citibank with respect to this period and assessed an outstanding liability of $6,010,265 in B&O tax under the service and other activities classification, a delinquency penalty of $1,104,440, a five percent assessment penalty of $300,513, and $775,368 in interest.

To determine gross taxable income attributable to Washington, DOR divided Citibank's total credit card receivables from Washington residents by Citibank's total gross income, and divided that number by three. This apportionment method was dictated by WAC 458-20-14601. DOR's apportionment computation from gross income attributable to Washington was based on Citibank's receipts, which were measured solely on the billing address of the credit card holders.

Citibank filed an appeal petition with respect to DOR's assessment. The DOR Appeals Division affirmed the assessment.

Citibank appealed to the Board of Tax Appeals. Citibank and DOR filed cross-motions for summary judgment. The Board granted summary judgment in favor of DOR, affirming DOR's determinations. The Board found that, as Citibank conceded, Citibank's activities met the constitutional standards for imposition of Washington's B&O tax. The Board concluded that the agreements with retailers requiring the retailers to promote and support Citibank's credit cards and Citibank's lawsuits in Washington courts "were sufficient to constitute nexus during the audit period, whether characterized as a 'physical presence' or not." AR at 67. The Board further found that "the activities of third parties, performed on behalf of a taxpayer, can constitute sufficient nexus to support the assessment of tax." AR at 67.

Citibank then paid the disputed tax assessment in the total amount of $9,725,485.10 and appealed to the superior court. The superior court transferred the case to this court for direct review pursuant to RCW 34.05.518.

Citibank appeals the Board of Tax Appeals' final decision granting summary judgment in favor of DOR.

ANALYSIS

A. Standard of Review

We review decisions of the Board of Tax Appeals under the Administrative Procedures Act (APA), chapter 34.05 RCW. *Echo Glob. Logistics, Inc. v. Dep't of Revenue*, 22 Wn. App. 2d 942, 945, 514 P.3d 704, *review denied*, 200 Wn.2d 1020 (2022). Under the APA, we may grant relief from an agency's order based on one of nine reasons listed in RCW 34.05.570(3), including that the order is based on an erroneous interpretation or application of the law. RCW

34.05.570(3)(d). We review alleged errors of law de novo. *Greenfield v. Dep't of Lab. and Indus.*, 27 Wn. App. 2d 28, 44, 531 P.3d 290 (2023). The party challenging the agency's decision has the burden of demonstrating the invalidity of that decision. RCW 34.05.570(1)(a).

When an administrative decision is decided on summary judgment, we overlay the APA and summary judgment standards of review. *Waste Mgmt. of Wash., Inc. v. Wash. Utils. and Transp. Comm'n*, 24 Wn. App. 2d 338, 344, 519 P.3d 963 (2022), *review denied*, 1 Wn.3d 1003 (2023). We review the ruling de novo and construe the facts and all reasonable inferences in the light most favorable to the nonmoving party. *Id.* Here, the parties do not dispute the material facts. Summary judgment can be determined as a matter of law if the material facts are not in dispute. *Antio, LLC v. Dep't of Revenue*, 26 Wn. App. 2d 129, 134, 527 P.3d 164 (2023).

B. IMPOSITION OF B&O TAXES

Citibank argues that it is not subject to B&O taxes for the 2007-2010 period because during that period DOR imposed B&O taxes only on businesses that had a physical presence in Washington, and Citibank did not have such a physical presence. We hold that even though before June 2010 there was a physical presence requirement for the imposition of B&O taxes, Citibank's activities in Washington satisfied that requirement.

1. Scope of B&O Tax

Before June 2010, former RCW 82.04.220 provided, "There is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities." As reflected in the statutory language, this B&O tax is an excise tax imposed for the privilege of doing business in Washington. *Ford Motor Co. v. City of Seattle*, 160 Wn.2d 32, 39, 156 P.3d 185 (2007). The term "business" is defined 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.

"In adopting our State's B & O tax system 'the legislature intended to impose the business and occupation tax upon virtually all business activities carried on within the state.' " *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn.2d 139, 149, 3 P.3d 741 (2000) (quoting *Time Oil Co. v. State*, 79 Wn.2d 143, 146, 483 P.2d 628 (1971)). "The B&O tax is to be imposed as broadly as constitutionally allowed." *Avnet, Inc. v. Dep't of Revenue*, 187 Wn.2d 44, 51, 384 P.3d 571 (2016).

A state may tax on an out-of-state business only if the requirements of the due process clause of the Fourteenth Amendment and the commerce clause[1] of the United States Constitution are satisfied. *Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 843, 246 P.3d 788 (2011). Due process requires that the business being taxed has sufficient contacts with the taxing state. *Id.* The commerce clause imposes several requirements, including that the tax be " 'applied to an activity with a substantial nexus with the taxing State.' " *Id.* at 844 (quoting *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977)).

In *Quill Corp. v. North Dakota*, the United States Supreme Court noted that due process is satisfied when an out-of-state corporation "purposefully avails itself of the benefits of an economic market in the forum State . . . even if it has no physical presence in the State." 504 U.S. 298, 307, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992), *overruled by S. Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 201 L. Ed. 2d 403 (2018). But the Court confirmed that the commerce clause mandated a physical presence requirement for sales and use taxes imposed on mail-order businesses. *Id.* at 311, 317. The Court stated, "Whether or not a State may compel a vendor to

[1] U.S. Const., article I, § 8, cl. 3.

collect a sales or use tax may turn on the presence in the taxing State of a small sales force, plant, or office." *Id.* at 315.

However, in 2011 our Supreme Court in *Lamtec* noted that the great weight of authority in other jurisdictions had limited the holding in *Quill* to sales and use taxes and had refused to apply the physical presence requirement to other kinds of taxes. *Lamtec*, 170 Wn.2d at 848-49.

2. 2010 Amendment to RCW 82.04.220

Effective June 1, 2010, the legislature amended RCW 82.04.220 to read as follows: "There is levied and collected from every person *that has a substantial nexus with this state* a tax for the act or privilege of engaging in business activities." Former RCW 82.04.220 (emphasis added).

Regarding the 2010 amendment to RCW 82.04.220 and other related amendments, the legislature provided the following findings:

> *The legislature finds that out-of-state businesses that do not have a physical presence in Washington earn significant income from Washington residents* from providing services or collecting royalties on the use of intangible property in this state. The legislature further finds that these businesses receive significant benefits and opportunities provided by the state, such as: Laws providing protection of business interests or regulating consumer credit; access to courts and judicial process to enforce business rights, including debt collection and intellectual property rights; an orderly and regulated marketplace; and police and fire protection and a transportation system benefiting in-state agents and other representatives of out-of-state businesses. Therefore, *the legislature intends to extend the state's business and occupation tax to these companies to ensure that they pay their fair share of the cost of services that this state renders and the infrastructure it provides*.

LAWS OF 2010, ch. 23, § 102 (emphasis added).

3. Physical Presence Requirement

Former RCW 82.04.220 had no express physical presence requirement. The only express requirement was "engaging in business activities." Former RCW 82.04.220. But DOR

acknowledges that its policy and procedure before June 2010 was to assess B&O taxes against out-of-state businesses only when they had a physical presence in Washington.

Therefore, during the assessment period DOR would not have imposed B&O taxes on Citibank unless Citibank had a physical presence in Washington.

4. Citibank's Physical Presence in Washington

DOR argues that Citibank's activities satisfied the physical presence requirement in two ways: (1) having a contractual relationship with retailers to promote private label credit cards issued by Citibank to Washington consumers, and (2) continuously using Washington courts to collect unpaid debts from Washington residents. We agree.

a. Legal Principles

In analyzing whether Citibank had a sufficient physical presence in Washington, the parties seem to equate physical presence under former RCW 82.04.220 with physical presence under the commerce clause's nexus standard.

The Supreme Court in *Lamtec* addressed whether there was a physical presence requirement to establish a substantial nexus with the taxing state under the commerce clause. 170 Wn.2d at 844-46. The court stated,

> *[T]o the extent there is a physical presence requirement, it can be satisfied by the presence of activities within the state.* It does not require a "presence" in the sense of having a brick and mortar address within the state. We do not see a material difference whether the activities are performed by staff permanently employed within the state, by independent agents contracted to perform the activity within the state, or persons who travel into the state from without. The activities must be substantial and must be associated with the company's ability to establish and maintain the company's market within the state.

Id. at 850-51 (emphasis added). The court held that Lamtec's practice of sending sales representatives to Washington to meet with customers satisfied the constitutional nexus requirement even though Lamtec did not have a permanent presence within the state. *Id.* at 851.

In *Lamtec*, the Supreme Court discussed *Tyler Pipe Industries v. Department of Revenue*, 105 Wn.2d 318, 715 P.2d 123 (1986), *vacated in part*, 483 U.S. 232, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987).[2] *Lamtec*, 170 Wn.2d at 849-50. Tyler Pipe distributed pipe and fittings nationwide with its principal place of business in Texas. *Tyler Pipe*, 105 Wn.2d at 320. While it did not have a place of business or employees within Washington, Tyler Pipe hired independent contractors to act as sales representatives within Washington. *Id.* at 320-21, 324. The court stated that "the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." *Id.* at 323. The court concluded that the difference between employees and independent contractors lacked constitutional significance in applying the nexus standard. *Id.* at 324. And there was a substantial nexus between Tyler Pipe and Washington because the sales representatives acted daily on behalf of Tyler Pipe, provided Tyler Pipe with almost all of their information about the Washington market, and maintained and improved Tyler Pipe's market share. *Id.* at 325.

Commenting on *Tyler Pipe* and noting that the United States Supreme Court in Tyler Pipe quoted the above passage from the Washington Supreme Court opinion, the court in *Lamtec* stated, "We agree with [DOR] that the 'crucial factor' in this language is that the activities were 'significantly associated with the taxpayer's ability to establish and maintain' its market." 170 Wn.2d at 850 (quoting *Tyler Pipe*, 483 U.S. at 250-51).

In *Department of Revenue v. J. C. Penney Co.*, J.C. Penney operated over 50 retail stores in Washington and supplied credit cards to its customers there. 96 Wn.2d 38, 39-40, 633 P.2d

[2] The United States Supreme Court reversed this case on other grounds, but affirmed the Washington Supreme Court's holding that an adequate nexus existed to support a state tax. *Lamtec*, 170 Wn.2d at 850.

870 (1981). Credit card applications could be obtained at a local store. *Id.* at 40. Local store employees solicited the credit card applications and helped customers fill them out. *Id.* The completed applications were sent to J.C. Penney's regional credit office in Portland, Oregon, which then determined whether the applicant would receive a charge card and would establish the applicant's credit limit. *Id.* J.C. Penney's credit office also handled the billing on the credit card accounts and generated income from the finance charges on the credit sales. *Id.* at 40-42.

DOR sought to tax the service charge income. *Id.* at 41. J.C. Penney argued that its finance charge income was not subject to B&O taxes because all activities relating to the imposition of the service charges occurred in Oregon. *Id.* at 42. The Supreme Court disagreed, stating, "It is the credit sale which places Penney in the position of potentially receiving a finance charge. The local activities which promote the sale on credit are sufficient to bring the finance charge income within the taxing statute." *Id.* at 44. The court concluded, "We cannot construe the facts before us to support a finding that Penney does not engage in any business activity in Washington which gives rise to a finance charge." *Id.* at 47. Therefore, the court upheld imposition of the tax. *Id.* at 48.

b. Analysis

Here, Citibank did not have a place of business or any employees or property within Washington. But under *Lamtec*, the question is whether Citibank engaged in *activities* within Washington sufficient to satisfy the physical presence requirement that existed before June 2010. *See* 170 Wn.2d at 850-51. We conclude that Citibank did engage in such activities.

First, Citibank entered into contractual relationships with three retailers – Home Depot, Sears, and Federated – to promote private label credit cards that were issued by Citibank to Washington consumers. These agreements expressly required the retailers to market Citibank's

private label credit cards *in their stores*, some of which were located in Washington. Marketing included displaying credit card applications in the stores and having store employees market the credit cards. These activities were " 'significantly associated with the taxpayer's ability to establish and maintain' its market." *Lamtec*, 170 Wn.2d at 850 (quoting *Tyler Pipe*, 483 U.S. at 250-51).

These arrangements may not have risen to the level of the activities of the sales representatives in *Lamtec* or the local agents in *Tyler Pipe*, but there is no question that Citibank was working with Washington stores and Washington store employees to sign up Washington residents for its credit cards. In this way, the facts here are similar to the involvement of the store employees in *J.C. Penney*. And issuing more credit cards to Washington residents allowed Citibank to generate more income from fees and interest. We conclude that the operation of Citibank's PL agreements was sufficient to establish a physical presence in Washington.

Second, the PL agreements authorized the retailers to accept payments from its customers on behalf of Citibank on amounts the customers owed to Citibank. As a result, the retailers facilitated Citibank's collection of income in Washington.

Third, Citibank used Washington attorneys to file more than 3,000 lawsuits against Washington residents in Washington courts to recover unpaid debts. These attorneys clearly were acting on behalf of Citibank, akin to the local agents in *Tyler Pipe*. As a result, Citibank was physically present in Washington, through its attorneys, almost on a daily basis.

Citibank argues that Citibank's Washington lawsuits cannot satisfy the physical presence requirements because they constituted the exercise of creditor rights, not the generation of gross income. But the issue here is physical presence, not whether that presence generated income. Citibank also argues that the Washington lawsuits are immaterial because they did not involve

establishing or maintaining a market, as referenced in *Lamtec*, 170 Wn.2d at 850-51. To the extent that activities must help establish or maintain a market in order to constitute a physical presence, collecting unpaid debts could be considered maintaining an existing market.[3]

Each one of these factors standing alone may not have been sufficient to establish a physical presence in Washington. But together, these factors show that Citibank was physically present in Washington. Therefore, we hold that Citibank met the pre-June 2010 physical presence requirement of RCW 82.04.220 through its activities within Washington.

C. APPORTIONMENT OF GROSS INCOME

Citibank argues that even if it was subject to B&O taxes, no amount of income could be apportioned to Washington activities because (1) Citibank did not engage in any business activities in Washington, (2) WAC 458-20-14601 is an invalid regulation because it was inconsistent with former RCW 82.04.220, and (3) WAC 458-20-14601 is unconstitutional as applied to Citibank. We disagree.

1. Legal Principles

Former RCW 82.04.460(2) (2004) required any person doing business within and without of Washington who was receiving gross income from engaging in business as a financial institution to apportion their taxable gross income to Washington pursuant to rules adopted by DOR. Those rules are stated in WAC 458-20-14601,[4] which provide the apportionment

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[3] Citibank argues that it did not meet the physical presence requirement because under former RCW 82.04.460(1) (2004), it was required to maintain a place of business within Washington. Subsection (1) referenced maintaining a place of business in Washington. But subsection (2), not subsection (1), applied to financial institutions. Subsection (2) merely required an entity to *do business* within and without of Washington, not to *maintain a place of business*.

[4] WAC 458-20-14601 was amended after the assessment period, but the amendments are not material here. Therefore, we cite to the current version of the regulation.

requirements for financial institutions that did business inside and outside of Washington and incurred tax liability through May 2010.

WAC 458-20-14601(2)(b) states,

> The apportionment percentage is determined by adding the taxpayer's receipts factor (as described in subsection (4) of this section), property factor (as described in subsection (5) of this section), and payroll factor (as described in subsection (6) of this section) together and dividing the sum by three. If one of the factors is missing, the two remaining factors are added together and the sum is divided by two. If two of the factors are missing, the remaining factor is the apportionment percentage. A factor is missing if both its numerator and denominator are zero, but it is not missing merely because its numerator is zero.

The receipts factor is a fraction where the numerator is the gross income of the taxpayer in Washington and the denominator is the gross income of the taxpayer inside and outside of Washington. WAC 458-20-14601(4)(a). When a credit card holder has a billing address in Washington, then the numerator of the receipts factor includes interest and fees from credit card receivables and income from card holder fees. WAC 458-20-14601(4)(g).

WAC 458-20-14601(2)(d) provides for the use of an alternative apportionment method under certain circumstances:

> If the allocation and apportionment provisions of this section do not fairly represent the extent of its business activity in this state, the taxpayer may petition for, or the department may require, in respect to all or any part of the taxpayer's business activity:
>
> (i) Separate accounting;
>
> (ii) A calculation of tax liability utilizing the cost of doing business method outlined in RCW 82.04.460(1);
>
> (iii) The exclusion of any one or more of the factors;
>
> (iv) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or
>
> (v) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's receipts.

2. Business Activities in Washington

Citibank argues that even if it was subject to B&O taxes, no amount of income could be apportioned to Washington activities because it did not engage in any business activities in Washington. Citibank emphasizes that under former RCW 82.04.220, B&O taxes applied only to business activities occurring in Washington. Citibank repeatedly claims that the stipulated facts establish that it had no business activities in Washington. And Citibank asserts that it is undisputed that all of its activities – transaction processing, loan accounting, funding, management of receivables, marketing and negotiation with retailers – occurred outside of Washington.

Based on its position that it had no business activities in Washington, Citibank argues that the standard apportionment formula in WAC 458-20-14601(2)(b) cannot be applied. Instead, the alternative methods in WAC 458-20-14601(2)(d) must be used because subsection (2)(b) did not "fairly represent the extent of its business activity in this state."

First, the stipulated facts do not establish that Citibank had no business activities in Washington. The stipulation stated only that Citibank had no employees or property in Washington. And the stipulation stated that Citibank issued credit cards to consumers in Washington and generated interest and fee income from those cardholders.

Second, Citibank's argument requires us to determine the usual and ordinary meaning of the term "business activities" in the context of a credit card issuer. *See Ekelmann v. City of Poulsbo*, 22 Wn. App. 2d 798, 807, 513 P.3d 840 (2022). Citibank focuses on where the employees managing the credit card business are located. But it is undisputed that Citibank issued credit cards to thousands of Washington residents and earned $1.7 billion from those Washington credit cards during the assessment period. We conclude that the usual and ordinary

meaning of the term "business activities" includes issuing credit cards in Washington and earning substantial income from those credit cards, regardless of where those credit cards are managed.

In addition, requiring retailers to market Citibank's credit cards in the PL agreements and filing lawsuits in Washington to collect unpaid debts as discussed above also fall within the usual and ordinary meaning of the term "business activities."

Third, because issuing credit cards to Washington residents constitutes business activities, apportioning gross income to Washington based on the billing address of cardholders under WAC 458-20-14601(4)(g) does "fairly represent the extent of [Citibank's] business activity in this state," which means that the alternative methods listed in WAC 458-20-14601(2)(d) are inapplicable.[5]

We hold that DOR's use of the apportionment formula in WAC 458-20-14601(2)(b) to determine Citibank's gross income attributable to Washington was appropriate.

3. Validity of Regulation

Citibank argues that WAC 458-20-14601 is an invalid regulation because it is inconsistent with the "business activities" requirement in former RCW 82.04.220. However, this argument is based on Citibank's position that it did not engage in any business activities in Washington. As discussed above, this position is incorrect. Therefore, we reject this argument.

4. Constitutional Claim

Citibank argues that WAC 458-20-14601 as applied is unconstitutional because the tax assessed under that regulation is out of proportion to the business Citibank performed in

[5] Further, there is no indication that Citibank petitioned DOR for use of an alternative apportionment method as referenced in WAC 458-20-14601(2)(d).

Washington and because Citibank did not perform or manage the services and transactions that led to the taxed credit card receivables within Washington.

Both the due process and commerce clauses require a state's apportionment formula to be fair. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 169, 103 S. Ct. 2933, 77 L. Ed. 2d 545 (1983).

> The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency – that is the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business's income being taxed. The second and more difficult requirement is what might be called external consistency – the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated.

Id. The United States Supreme Court in *Container Corp.* stated that it would strike down an apportionment formula if the taxpayer could show by clear and cogent evidence that the income allocated to a state was out of proportion to the business conducted in that state. *Id.* at 170.

Once again, the premise of Citibank's constitutional argument – that it did not engage in any business activities in Washington – is incorrect.

Regarding the *Container Corp.* analysis, the internal consistency requirement is satisfied by focusing only on where Citibank's cardholders reside. WAC 458-20-14601(4)(g) guarantees that there will not be double taxation by some other state where those cardholders do not reside. The external consistency requirement is satisfied because Citibank's income is generated by issuing credit cards and collecting gross income from Washington residents, and the apportionment formula allocates income only from those residents.

We hold that the formula applied to Citibank under WAC 458-20-14601 was not unconstitutional.

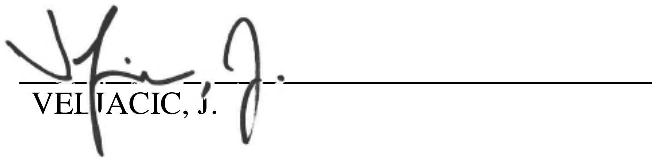
CONCLUSION

We affirm the Board of Tax Appeals' final decision granting summary judgment in favor of DOR.

A majority of the panel having determined that this opinion will not be printed in the Washington Appellate Reports, but will be filed for public record in accordance with RCW 2.06.040, it is so ordered.

MAXA, P.J.

We concur:



VELJACIC, J.

CHE, J.

Appendix B

FILED
1/23/2024
Court of Appeals
Division II
State of Washington

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

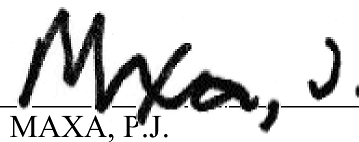
CITIBANK (SOUTH DAKOTA), NATIONAL ASSOCIATION, Appellant, v. STATE OF WASHINGTON DEPARTMENT OF REVENUE, Respondent.	No. 57127-7-II ORDER DENYING MOTIONS FOR RECONSIDERATION AND PUBLICATION

Appellant Citibank moves for reconsideration and for publication of the opinion filed November 14, 2023 in this case. Upon consideration, the court denies the motion. Accordingly, it is

SO ORDERED.

PANEL: Jj. Maxa, Veljacic, Che

FOR THE COURT:



MAXA, P.J.

Appendix C

FILED
Court of Appeals
Division II
State of Washington
1/5/2024 2:25 PM

NO. 57127-7-II

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

CITIBANK (SOUTH DAKOTA), NATIONAL ASSOCIATION, Appellant, v. STATE OF WASHINGTON, DEPARTMENT OF REVENUE, Respondent.	DEPARTMENT OF REVENUE'S ANSWER TO APPELLANT'S MOTION TO PUBLISH

The Appellant, Citibank (South Dakota), National Association (Citibank) has filed a motion asking the Court to publish its November 14, 2023 opinion. The Court has asked Respondent Department of Revenue to file an answer.

The Department does not oppose the motion to publish. The Court's opinion meets the criteria in RAP 12.3(e)(5) as the Court's analysis of the various issues raised by Citibank are matters of general public interest.

Although the Department agrees that the opinion should be published, there are a few minor scrivener's errors that should be corrected.

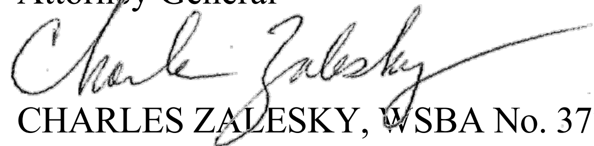
- In part B.1 of the Analysis, in the third paragraph, first sentence, there appears to be a missing word. The Court likely intended the sentence to read: "A state may <u>impose</u> tax on an out-of-state business only if the requirements of the due process clause of the Fourteenth Amendment and the commerce clause of the United States Constitution are satisfied." (Slip Op. at 8) (footnote omitted).
- In part B.2, after quoting the legislative findings pertaining to the 2010 amendment to RCW 82.04.220, the opinion cites an incorrect session law. (Slip Op. at 9). The correct citation is Laws of 2010, 1st Spec. Sess., ch. 23, § 101(1).
- In part C.1, in the first sentence after the heading "Legal Principles," the opinion uses the phrase "within and

without of Washington ….” (Slip Op. at 14). The word "of" can be deleted, so the phrase would read "within and without Washington ….”

This document contains 240 words, excluding the parts of the document exempted from the word count by RAP 18.17.

RESPECTFULLY SUBMITTED this 5th day of January, 2024.

ROBERT W. FERGUSON
Attorney General



CHARLES ZALESKY, WSBA No. 37777
Assistant Attorney General
Attorneys for Respondent, OID No. 91027

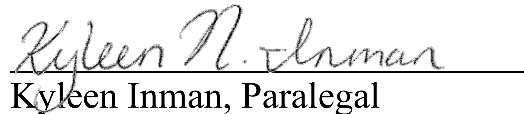
PROOF OF SERVICE

I certify that on January 5, 2024, I electronically filed and served this document with the Clerk of the Court using the Washington State Appellate Courts' e-file portal and served a copy of this document via electronic mail, pursuant to agreement, on:

Richard A. Leavy
Robin Weckkin
SIDLEY AUSTIN LLP
rleavy@sidley.com
rwechkin@sidley.com
drenne@sidley.com

I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 5th day of January, 2024, at Olympia, WA.



Kyleen Inman, Paralegal

ATTORNEY GENERAL'S OFFICE - REVENUE & FINANCE DIVISION

January 05, 2024 - 2:25 PM

Transmittal Information

Filed with Court:	Court of Appeals Division II
Appellate Court Case Number:	57127-7
Appellate Court Case Title:	Citibank South Dakota, Appellant v. State of Washington Department of Revenue, Respondent
Superior Court Case Number:	21-2-02141-1

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Department of Revenue's Answer to Appellant's Motion to Publish

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Appendix D

CONTAINER CORPORATION OF AMERICA *v.* FRANCHISE TAX BOARD

APPEAL FROM THE COURT OF APPEAL OF CALIFORNIA, FIRST APPELLATE DISTRICT

No. 81–523. Argued January 10, 1983—Decided June 27, 1983

California imposes a corporate franchise tax geared to income. It employs the "unitary business" principle and formula apportionment in applying that tax to corporations doing business both inside and outside the State. The formula used—commonly called the "three-factor" formula—is based, in equal parts, on the proportion of a unitary business' total payroll, property, and sales that are located in the State. Appellant paperboard packaging manufacturer is a Delaware corporation headquartered in Illinois and doing business in California and elsewhere. It also has a number of overseas subsidiaries incorporated in the countries in which they operate. In calculating for the tax years in question in this case the share of its net income that was apportionable to California under the three-factor formula, appellant omitted all of its subsidiaries' payroll, property, and sales. Appellee Franchise Tax Board issued notices of additional assessments, the gravamen of which was that appellant should have treated its overseas subsidiaries as part of its unitary business rather than as a passive investment. After paying the additional assessments under protest, appellant brought an action for a refund in California Superior Court, which upheld the additional assessments. The California Court of Appeal affirmed.

Held:

1. California's application of the unitary business principle to appellant and its foreign subsidiaries was proper. Pp. 175–180.

(a) The taxpayer has the burden of showing by "clear and convincing evidence" that the state tax results in extraterritorial values being taxed. This Court will, if reasonably possible, defer to the judgment of state courts in deciding whether a particular set of activities constitutes a "unitary business." The Court's task is to determine whether the state court applied the correct standards to the case, and, if it did, whether its judgment was within the realm of a permissible judgment. Pp. 175–176.

(b) Here, there is no merit to appellant's argument that the Court of Appeal in important part analyzed the case under the incorrect legal standard. Rather, the factors relied upon by the court in holding that appellant and its foreign subsidiaries constituted a unitary business—

which factors included appellant's assistance to its subsidiaries in obtaining equipment and in filling personnel needs that could not be met locally, the substantial role played by appellant in loaning funds to the subsidiaries and guaranteeing loans provided by others, the considerable interplay between appellant and its subsidiaries in the area of corporate expansion, the substantial technical assistance provided by appellant to the subsidiaries, and the supervisory role played by appellant's officers in providing general guidance to the subsidiaries—taken in combination clearly demonstrate that the court reached a conclusion "within the realm of permissible judgment." Pp. 177–180.

2. California's use of the three-factor formula to apportion the income of the unitary business consisting of appellant and its foreign subsidiaries was fair. Appellant had the burden of proving that the income apportioned to California was out of all appropriate proportions to the business transacted in the State. This burden was not met by offering various statistics that appeared to demonstrate not only that wage rates are generally lower in the foreign countries in which appellant's subsidiaries operate but also that those lower wage rates are not offset by lower levels of productivity. It may well be that in addition to the foreign payroll going into the production of any given corrugated container by a foreign subsidiary, there is a California payroll, as well as other California factors, contributing to the same production. The mere fact that this possibility is not reflected in appellant's accounting does not disturb the underlying premises of the formula apportionment method. Pp. 180–184.

3. California had no obligation under the Foreign Commerce Clause to employ the "arm's-length" analysis used by the Federal Government and most foreign nations in evaluating the tax consequences of intercorporate relationships. *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U. S. 434, distinguished. Pp. 184–197.

(a) The double taxation occasioned by the California scheme is not impermissible. Due in part to the difference between a tax on income and a tax on tangible property, California would have trouble avoiding double taxation of corporations subject to its franchise tax even if it adopted the "arm's-length" approach. Moreover, the California tax does not result in "inevitable" double taxation. It would be perverse, simply for the sake of avoiding double taxation, to require California to give up one allocation method that sometimes results in double taxation in favor of another allocation method that sometimes has the same result. Pp. 189–193.

(b) The California tax does not violate the "one voice" standard established in *Japan Line*, *supra*, under which a state tax at variance with federal policy will be struck down if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear

federal directive. Three factors weigh strongly against the conclusion that the tax might lead to significant foreign retaliation. The tax does not create an *automatic* "asymmetry" in international taxation, it is imposed on a domestic corporation and not on a foreign entity, and even if foreign nations had a legitimate interest in reducing the tax burden of domestic corporations, appellant is amenable to be taxed in California one way or another and the tax it pays is more the function of California's tax rate than of its allocation method. Moreover, the California tax is not pre-empted by federal law or fatally inconsistent with federal policy. There is no claim that the federal tax statutes themselves provide the necessary pre-emptive force. The requirement of some tax treaties that the Federal Government adopt some form of arm's-length analysis in taxing the domestic income of multinational enterprises is generally waived as to taxes imposed by each of the contracting nations on its own domestic corporations. Tax treaties do not cover the taxing activities of States. And Congress has never enacted legislation designed to regulate state taxation of income. Pp. 193–197.

117 Cal. App. 3d 988, 173 Cal. Rptr. 121, affirmed.

BRENNAN, J., delivered the opinion of the Court, in which WHITE, MARSHALL, BLACKMUN, and REHNQUIST, JJ., joined. POWELL J., filed a dissenting opinion, in which BURGER, C. J., and O'CONNOR, J., joined, *post*, p. 197. STEVENS, J., took no part in the consideration or decision of the case.

Franklin C. Latcham argued the cause for appellant. With him on the briefs was *Prentiss Willson, Jr.*

Neal J. Gobar, Deputy Attorney General of California, argued the cause for appellee. With him on the brief was *George Deukmejian*, Attorney General.*

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*Briefs of *amici curiae* urging reversal were filed by *Marlow W. Cook*, *Lee H. Spence*, and *Robert L. Ash* for Allied Lyons p. l. c. et al.; by *J. Elaine Bialczak* for Coca-Cola Co.; by *George W. Beatty* and *William L. Goldman* for Colgate-Palmolive Co.; by *James H. Peters*, *Paul H. Frankel*, and *Jean A. Walker* for the Committee on State Taxation of the Council of State Chambers of Commerce; by *Valentine Brookes* and *Lawrence V. Brookes* for EMI Limited et al.; by *William H. Allen*, *John B. Jones, Jr.*, and *Mark I. Levy*, for the Financial Executives Institute; by *Neil Papiano* and *Dennis A. Page* for Firestone Tire & Rubber Co.; and by *Jeffrey G. Balkin*, *pro se*, for Jeffrey G. Balkin et al.

Briefs of *amici curiae* urging affirmance were filed by *David H. Leroy*, Attorney General of Idaho, *Theodore V. Spangler, Jr.*, Deputy Attorney

JUSTICE BRENNAN delivered the opinion of the Court.

This is another appeal claiming that the application of a state taxing scheme violates the Due Process and Commerce Clauses of the Federal Constitution. California imposes a corporate franchise tax geared to income. In common with a large number of other States, it employs the "unitary busi-

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General, and *David L. Wilkinson*, Attorney General of Utah, for the State of Idaho et al.; by *Tyrone C. Fahner*, Attorney General, *Fred H. Montgomery*, Special Assistant Attorney General, and *Lloyd B. Foster* for the State of Illinois; by *Michael J. Rieley*, Special Assistant Attorney General, for the State of Montana; by *Jeff Bingaman*, Attorney General, and *Lisa Gillard Gmuca*, Assistant Attorney General, for the State of New Mexico; by *Robert Abrams*, Attorney General, *Francis V. Dow*, Assistant Attorney General, and *Peter H. Schiff* for the State of New York; by *Robert O. Wefald*, Attorney General, and *Kenneth M. Jakes*, Assistant Attorney General, for the State of North Dakota; by *Dave Frohnmayer*, Attorney General, *Stanton F. Long*, Deputy Attorney General, *William F. Gary*, Solicitor General, and *Theodore W. de Looze*, Assistant Attorney General, for the State of Oregon; by *William D. Dexter*, *Wilson Condon*, Attorney General of Alaska, *James R. Eads, Jr.*, *J. D. MacFarlane*, Attorney General of Colorado, *Carl R. Ajello*, Attorney General of Connecticut, *Richard S. Gebelein*, Attorney General of Delaware, *David H. Leroy*, Attorney General of Idaho, and *Theodore V. Spangler, Jr.*, Deputy Attorney General, *Linley E. Pearson*, Attorney General of Indiana, *Robert T. Stephan*, Attorney General of Kansas, *Francis X. Bellotti*, Attorney General of Massachusetts, *Frank K. Kelley*, Attorney General of Michigan, *Warren R. Spannaus*, Attorney General of Minnesota, *John Ashcroft*, Attorney General of Missouri, *Paul L. Douglas*, Attorney General of Nebraska, *Gregory H. Smith*, Attorney General of New Hampshire, *Jeff Bingaman*, Attorney General of New Mexico, *Rufus L. Edmisten*, Attorney General of North Carolina, *M. C. Banks*, Deputy Attorney General, *Robert O. Wefald*, Attorney General of North Dakota, and *Albert R. Hausauer*, Assistant Attorney General, *Dave Frohnmayer*, Attorney General of Oregon, and *David L. Wilkinson*, Attorney General of Utah, for the Multistate Tax Commission et al.; by *Richard B. Geltman* and *Tany S. Hong*, Attorney General of Hawaii, for the National Governors' Association et al.; by *Charles F. Brannan* for the National Farmers Union; for Citizens for Tax Justice et al.; and by *Frank M. Keesling*, *pro se*.

Briefs of *amici curiae* were filed by *Lloyd N. Cutler* and *William T. Lake* for the Government of the Kingdom of the Netherlands; by *John J. Easton, Jr.*, Attorney General, and *Paul P. Hanlon* for the State of

ness" principle and formula apportionment in applying that tax to corporations doing business both inside and outside the State. Appellant is a Delaware corporation headquartered in Illinois and doing business in California and elsewhere. It also has a number of overseas subsidiaries incorporated in the countries in which they operate. Appellee is the California authority charged with administering the State's franchise tax. This appeal presents three questions for review: (1) Was it improper for appellee and the state courts to find that appellant and its overseas subsidiaries constituted a "unitary business" for purposes of the state tax? (2) Even if the unitary business finding was proper, do certain salient differences among national economies render the standard three-factor apportionment formula used by California so inaccurate as applied to the multinational enterprise consisting of appellant and its subsidiaries as to violate the constitutional requirement of "fair apportionment"? (3) In any event, did California have an obligation under the Foreign Commerce Clause, U. S. Const., Art. I, §8, cl. 3, to employ the "arm's-length" analysis used by the Federal Government and most foreign nations in evaluating the tax consequences of intercorporate relationships?

I

A

Various aspects of state tax systems based on the "unitary business" principle and formula apportionment have pro-

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Vermont; by *Francis D. Morrissey* and *Peter B. Powles* for the Canadian Imperial Bank of Commerce et al.; by *Don S. Harnack* and *Richard A. Hanson* for Caterpillar Tractor Co.; by *Joanne M. Garvey* and *Roy E. Crawford* for the Committee on Unitary Tax; by *John S. Nolan* for the Confederation of British Industry; by *Norman B. Barker* for Gulf Oil Corp.; by *Anthon S. Cannon, Jr.*, for the International Bankers Association in California et al.; by *Kenneth Heady* for Phillips Petroleum Co.; by *John R. Hupper* and *Paul M. Dodyk* for Shell Petroleum N. V.; by *Norman B. Barker* and *Dean C. Dunlavey* for Sony Corp. et al.; and by *Joseph H. Guttentag*, *Carolyn E. Agger*, and *Daniel M. Lewis* for the Union of Industries of the European Community.

voked repeated constitutional litigation in this Court. See, *e. g., ASARCO Inc.* v. *Idaho State Tax Comm'n*, 458 U. S. 307 (1982); *F. W. Woolworth Co.* v. *Taxation & Revenue Dept.*, 458 U. S. 354 (1982); *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, 447 U. S. 207 (1980); *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U. S. 425 (1980); *Moorman Mfg. Co.* v. *Bair*, 437 U. S. 267 (1978); *General Motors Corp.* v. *Washington*, 377 U. S. 436 (1964); *Butler Bros.* v. *McColgan*, 315 U. S. 501 (1942); *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Comm'n*, 266 U. S. 271 (1924); *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113 (1920).

Under both the Due Process and the Commerce Clauses of the Constitution, a State may not, when imposing an income-based tax, "tax value earned outside its borders." *ASARCO, supra*, at 315. In the case of a more-or-less integrated business enterprise operating in more than one State, however, arriving at precise territorial allocations of "value" is often an elusive goal, both in theory and in practice. See *Mobil Oil Corp.* v. *Commissioner of Taxes, supra*, at 438; *Butler Bros.* v. *McColgan, supra*, at 507–509; *Underwood Typewriter Co.* v. *Chamberlain, supra*, at 121. For this reason and others, we have long held that the Constitution imposes no single formula on the States, *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435, 445 (1940), and that the taxpayer has the "'distinct burden of showing by "clear and cogent evidence" that [the state tax] results in extraterritorial values being taxed . . . .'" *Exxon Corp., supra*, at 221, quoting *Butler Bros.* v. *McColgan, supra*, at 507, in turn quoting *Norfolk & Western R. Co.* v. *North Carolina ex rel. Maxwell*, 297 U. S. 682, 688 (1936).

One way of deriving locally taxable income is on the basis of formal geographical or transactional accounting. The problem with this method is that formal accounting is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifi-

able transfers of value that take place among the components of a single enterprise. See generally *Mobil Oil Corp.*, *supra,* at 438–439, and sources cited. The unitary business/formula apportionment method is a very different approach to the problem of taxing businesses operating in more than one jurisdiction. It rejects geographical or transactional accounting, and instead calculates the local tax base by first defining the scope of the "unitary business" of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that "unitary business" between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction. This Court long ago upheld the constitutionality of the unitary business/formula apportionment method, although subject to certain constraints. See, *e. g.*, *Hans Rees' Sons, Inc.* v. *North Carolina ex rel. Maxwell*, 283 U. S. 123 (1931); *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Comm'n, supra; Underwood Typewriter Co.* v. *Chamberlain, supra.* The method has now gained wide acceptance, and is in one of its forms the basis for the the Uniform Division of Income for Tax Purposes Act (Uniform Act), which has at last count been substantially adopted by 23 States, including California.

B

Two aspects of the unitary business/formula apportionment method have traditionally attracted judicial attention. These are, as one might easily guess, the notions of "unitary business" and "formula apportionment," respectively.

(1)

The Due Process and Commerce Clauses of the Constitution do not allow a State to tax income arising out of interstate activities—even on a proportional basis—unless there is a "'minimal connection' or 'nexus' between the interstate ac-

tivities and the taxing State, and 'a rational relationship between the income attributed to the State and the intrastate values of the enterprise.'" *Exxon Corp.* v. *Wisconsin Dept. of Revenue, supra,* at 219–220, quoting *Mobil Oil Corp.* v. *Commissioner of Taxes, supra,* at 436, 437. At the very least, this set of principles imposes the obvious and largely self-executing limitation that a State not tax a purported "unitary business" unless at least some part of it is conducted in the State. See *Exxon Corp., supra,* at 220; *Wisconsin* v. *J. C. Penney Co., supra,* at 444. It also requires that there be some bond of ownership or control uniting the purported "unitary business." See *ASARCO, supra,* at 316–317.

In addition, the principles we have quoted require that the out-of-state activities of the purported "unitary business" be related in some concrete way to the in-state activities. The functional meaning of this requirement is that there be some sharing or exchange of value not capable of precise identification or measurement—beyond the mere flow of funds arising out of a passive investment or a distinct business operation—which renders formula apportionment a reasonable method of taxation. See generally *ASARCO, supra,* at 317; *Mobil Oil Corp., supra,* at 438–442. In *Underwood Typewriter Co.* v. *Chamberlain, supra,* we held that a State could tax on an apportioned basis the combined income of a vertically integrated business whose various components (manufacturing, sales, etc.) operated in different States. In *Bass, Ratcliff & Gretton, supra,* we applied the same principle to a vertically integrated business operating across national boundaries. In *Butler Bros.* v. *McColgan, supra,* we recognized that the unitary business principle could apply, not only to vertically integrated enterprises, but also to a series of similar enterprises operating separately in various jurisdictions but linked by common managerial or operational resources that produced economies of scale and transfers of value. More recently, we have further refined the "unitary business" concept in *Exxon Corp.* v. *Wisconsin Dept. of Rev-*

enue, 447 U. S. 207 (1980), and *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U. S. 425 (1980), where we upheld the States' unitary business findings, and in *ASARCO Inc.* v. *Idaho State Tax Comm'n*, 458 U. S. 307 (1982), and *F. W. Woolworth Co.* v. *Taxation & Revenue Dept.*, 458 U. S. 354 (1982), in which we found such findings to have been improper.

The California statute at issue in this case, and the Uniform Act from which most of its relevant provisions are derived, track in large part the principles we have just discussed. In particular, the statute distinguishes between the "business income" of a multijurisdictional enterprise, which is apportioned by formula, Cal. Rev. & Tax. Code Ann. §§ 25128–25136 (West 1979), and its "nonbusiness" income, which is not.[1] Although the statute does not explicitly require that income from distinct business enterprises be apportioned separately, this requirement antedated adoption of the Uniform Act,[2] and has not been abandoned.[3]

A final point that needs to be made about the unitary business concept is that it is not, so to speak, unitary: there are variations on the theme, and any number of them are logically consistent with the underlying principles motivating the approach. For example, a State might decide to respect for-

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[1] Certain forms of nonbusiness income, such as dividends, are allocated on the basis of the taxpayer's commercial domicile. Other forms of nonbusiness income, such as capital gains on sales of real property, are allocated on the basis of situs. See Cal. Rev. & Tax. Code Ann. §§ 25123–25127 (West 1979).

[2] See generally *Honolulu Oil Corp.* v. *Franchise Tax Board*, 60 Cal. 2d 417, 386 P. 2d 40 (1963); *Superior Oil Corp.* v. *Franchise Tax Board*, 60 Cal. 2d 406, 386 P. 2d 33 (1963).

[3] See the opinion of the California Court of Appeal in this case, 117 Cal. App. 3d 988, 990–991, 993–995, 173 Cal. Rptr. 121, 123, 124–126 (1981). See also Cal. Rev. & Tax. Code Ann. § 25137 (West 1979) (allowing for separate accounting or other alternative methods of apportionment when total formula apportionment would "not fairly represent the extent of the taxpayer's business activity in this state").

mal corporate lines and treat the ownership of a corporate subsidiary as *per se* a passive investment.[4] In *Mobil Oil Corp.*, 445 U. S., at 440–441, however, we made clear that, as a general matter, such a *per se* rule is not constitutionally required:

> "Superficially, intercorporate division might appear to be a[n] . . . attractive basis for limiting apportionability. But the form of business organization may have nothing to do with the underlying unity or diversity of business enterprise." *Id.*, at 440.

Thus, for example, California law provides:

> "In the case of a corporation . . . owning or controlling, either directly or indirectly, another corporation, or other corporations, and in the case of a corporation . . . owned or controlled, either directly or indirectly, by another corporation, the Franchise Tax Board may require a consolidated report showing the combined net income or such other facts as it deems necessary." Cal. Rev. & Tax. Code Ann. § 25104 (West 1979).[5]

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[4] We note that the Uniform Act does not speak to this question one way or the other.

[5] See also Cal. Rev. & Tax. Code Ann. § 25105 (West 1979) (defining "ownership or control"). A necessary corollary of the California approach, of course, is that intercorporate dividends in a unitary business *not* be included in gross income, since such inclusion would result in double-counting of a portion of the subsidiary's income (first as income attributed to the unitary business, and second as dividend income to the parent). See § 25106.

Some States, it should be noted, have adopted a hybrid approach. In *Mobil* itself, for example, a nondomiciliary State invoked a unitary business justification to include an apportioned share of certain corporate dividends in the gross income of the taxpayer, but did not require a combined return and combined apportionment. The Court in *Mobil* held that the taxpayer's objection to this approach had not been properly raised in the state proceedings. 445 U. S., at 441, n. 15. JUSTICE STEVENS, however, reached the merits, stating in part: "Either Mobil's worldwide 'petroleum enterprise' is all part of one unitary business, or it is not; if it is, Vermont must evaluate the entire enterprise in a consistent manner." *Id.*, at 461 (citation omitted). See *id.*, at 462 (STEVENS, J., dissenting) (outlining al-

Even among States that take this approach, however, only some apply it in taxing American corporations with subsidiaries located in foreign countries.[6] The difficult question we address in Part V of this opinion is whether, for reasons not implicated in *Mobil*,[7] that particular variation on the theme is constitutionally barred.

(2)

Having determined that a certain set of activities constitute a "unitary business," a State must then apply a formula apportioning the income of that business within and without the State. Such an apportionment formula must, under both the Due Process and Commerce Clauses, be fair. See *Exxon Corp.*, *supra*, at 219, 227–228; *Moorman Mfg. Co.*, 437 U. S., at 272–273; *Hans Rees' Sons, Inc.*, 283 U. S., at 134. The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed. The second and more difficult requirement is what might be called external consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated. The Constitution does not "invalidat[e] an apportionment formula whenever it *may* result in taxation

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ternative approaches available to State); cf. The Supreme Court, 1981 Term, 96 Harv. L. Rev. 62, 93–96 (1982).

[6] See generally General Accounting Office Report to the Chairman, House Committee on Ways and Means: Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving 31 (1982).

[7] *Mobil* did, in fact, involve income from foreign subsidiaries, but that fact was of little importance to the case for two reasons. First, as discussed in n. 5, *supra*, the State in that case included *dividends* from the subsidiaries to the parent in its calculation of the parent's apportionable taxable income, but did not include the underlying income of the subsidiaries themselves. Second, the taxpayer in that case conceded that the dividends could be taxed *somewhere* in the United States, so the actual issue before the Court was merely whether a particular State could be barred from imposing some portion of that tax. See 445 U. S., at 447.

of some income that did not have its source in the taxing State . . . ." *Moorman Mfg. Co.*, *supra*, at 272 (emphasis added). See *Underwood Typewriter Co.*, 254 U. S., at 120–121. Nevertheless, we will strike down the application of an apportionment formula if the taxpayer can prove "by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted . . . in that State,' *[Hans Rees' Sons, Inc.,]* 283 U. S., at 135, or has 'led to a grossly distorted result,' [*Norfolk & Western R. Co.* v. *State Tax Comm'n*, 390 U. S. 317, 326 (1968)]." *Moorman Mfg. Co.*, *supra*, at 274.

California and the other States that have adopted the Uniform Act use a formula—commonly called the "three-factor" formula—which is based, in equal parts, on the proportion of a unitary business' total payroll, property, and sales which are located in the taxing State. See Cal. Tax & Rev. Code Ann. §§25128–25136 (West 1979). We approved the three-factor formula in *Butler Bros.* v. *McColgan*, 315 U. S. 501 (1942). Indeed, not only has the three-factor formula met our approval, but it has become, for reasons we discuss in more detail *infra*, at 183, something of a benchmark against which other apportionment formulas are judged. See *Moorman Mfg. Co.*, *supra*, at 282 (BLACKMUN, J., dissenting); cf. *General Motors Corp.* v. *District of Columbia*, 380 U. S. 553, 561 (1965).

Besides being fair, an apportionment formula must, under the Commerce Clause, also not result in discrimination against interstate or foreign commerce. See *Mobil Oil Corp.*, *supra*, at 444; cf. *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U. S. 434, 444–448 (1979) (property tax). Aside from forbidding the obvious types of discrimination against interstate or foreign commerce, this principle might have been construed to require that a state apportionment formula not differ so substantially from methods of allocation used by other jurisdictions in which the taxpayer is subject to taxation as to produce double taxation of the same income

and a resultant tax burden higher than the taxpayer would incur if its business were limited to any one jurisdiction. At least in the interstate commerce context, however, the antidiscrimination principle has not in practice required much in addition to the requirement of fair apportionment. In *Moorman Mfg. Co.* v. *Bair*, *supra*, in particular, we explained that eliminating all overlapping taxation would require this Court to establish not only a single constitutionally mandated method of taxation, but also rules regarding the application of that method in particular cases. 437 U. S., at 278–280. Because that task was thought to be essentially legislative, we declined to undertake it, and held that a fairly apportioned tax would not be found invalid simply because it differed from the prevailing approach adopted by the States. As we discuss *infra*, at 185–187, however, a more searching inquiry is necessary when we are confronted with the possibility of international double taxation.

II

A

Appellant is in the business of manufacturing custom-ordered paperboard packaging. Its operation is vertically integrated, and includes the production of paperboard from raw timber and wastepaper as well as its composition into the finished products ordered by customers. The operation is also largely domestic. During the years at issue in this case—1963, 1964, and 1965—appellant controlled 20 foreign subsidiaries located in four Latin American and four European countries. Its percentage ownership of the subsidiaries (either directly or through other subsidiaries) ranged between 66.7% and 100%. In those instances (about half) in which appellant did not own a 100% interest in the subsidiary, the remainder was owned by local nationals. One of the subsidiaries was a holding company that had no payroll, sales, or property, but did have book income. Another was

inactive. The rest were all engaged—in their respective local markets—in essentially the same business as appellant.

Most of appellant's subsidiaries were, like appellant itself, fully integrated, although a few bought paperboard and other intermediate products elsewhere. Sales of materials from appellant to its subsidiaries accounted for only about 1% of the subsidiaries' total purchases. The subsidiaries were also relatively autonomous with respect to matters of personnel and day-to-day management. For example, transfers of personnel from appellant to its subsidiaries were rare, and occurred only when a subsidiary could not fill a position locally. There was no formal United States training program for the subsidiaries' employees, although groups of foreign employees occasionally visited the United States for 2–6 week periods to familiarize themselves with appellant's methods of operation. Appellant charged one senior vice president and four other officers with the task of overseeing the operations of the subsidiaries. These officers established general standards of professionalism, profitability, and ethical practices and dealt with major problems and long-term decisions; day-to-day management of the subsidiaries, however, was left in the hands of local executives who were always citizens of the host country. Although local decisions regarding capital expenditures were subject to review by appellant, problems were generally worked out by consensus rather than outright domination. Appellant also had a number of its directors and officers on the boards of directors of the subsidiaries, but they did not generally play an active role in management decisions.[8]

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[8] There were a number of reasons for appellant's relatively hands-off attitude toward the management of its subsidiaries. First, it comported with the company's general management philosophy emphasizing local responsibility and accountability; in this respect, the treatment of the foreign subsidiaries was similar to the organization of appellant's domestic geographical divisions. Second, it reflected the fact that the packaging industry, like the advertising industry to which it is closely related, is highly

Nevertheless, in certain respects, the relationship between appellant and its subsidiaries was decidedly close. For example, approximately half of the subsidiaries' long-term debt was either held directly, or guaranteed, by appellant. Appellant also provided advice and consultation regarding manufacturing techniques, engineering, design, architecture, insurance, and cost accounting to a number of its subsidiaries, either by entering into technical service agreements with them or by informal arrangement. Finally, appellant occasionally assisted its subsidiaries in their procurement of equipment, either by selling them used equipment of its own or by employing its own purchasing department to act as an agent for the subsidiaries.[9]

B

During the tax years at issue in this case, appellant filed California franchise tax returns. In 1969, after conducting an audit of appellant's returns for the years in question, appellee issued notices of additional assessments for each of those years. The respective approaches and results reflected in appellant's initial returns and in appellee's notices of additional assessments capture the legal differences at issue in this case.[10]

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sensitive to differences in consumer habits and economic development among different nations, and therefore requires a good dose of local expertise to be successful. Third, appellant's policy was designed to appeal to the sensibilities of local customers and governments.

[9] There was also a certain spillover of goodwill between appellant and its subsidiaries; that is, appellant's customers who had overseas needs would on occasion ask appellant's sales representatives to recommend foreign firms, and, where possible, the representatives would refer the customers to appellant's subsidiaries. In at least one instance, appellant became involved in the actual negotiation of a contract between a customer and a foreign subsidiary.

[10] After the notices of additional tax, there followed a series of further adjustments, payments, claims for refunds, and assessments, whose combined effect was to render the figures outlined in text more illustrative

In calculating the total unapportioned taxable income of its unitary business, appellant included its own corporate net earnings as derived from its federal tax form (subject to certain adjustments not relevant here), but did not include any income of its subsidiaries. It also deducted—as it was authorized to do under state law, see *supra*, at 167, and n. 1—all dividend income, nonbusiness interest income, and gains on sales of assets not related to the unitary business. In calculating the share of its net income which was apportionable to California under the three-factor formula, appellant omitted all of its subsidiaries' payroll, property, and sales. The results of these calculations are summarized in the margin.[11]

The gravamen of the notices issued by appellee in 1969 was that appellant should have treated its overseas subsidiaries as part of its unitary business rather than as passive investments. Including the overseas subsidiaries in appellant's unitary business had two primary effects: it increased the income subject to apportionment by an amount equal to the total income of those subsidiaries (less intersubsidiary dividends, see n. 5, *supra*), and it decreased the percentage of that income which was apportionable to California. The net

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than real as descriptions of the present claims of the parties with regard to appellant's total tax liability. These subsequent events, however, did not concern the legal issues raised in this case, nor did they remove either party's financial stake in the resolution of those issues. We therefore disregard them for the sake of simplicity.

11	*Total income of unitary business*	*Percentage attributed to California*	*Amount attributed to California*	*Tax (5.5%)*
1963....	$26,870,427.00	11.041	$2,966,763.85	$163,172.01
1964....	28,774,320.48	10.6422	3,062,220.73	168,422.14
1965....	32,280,842.90	9.8336	3,174,368.97	174,590.29

See Exhibit A–7 to Stipulation; Record 36, 76, 77, 79, 104, 126.

effect, however, was to increase appellant's tax liability in each of the three years.[12]

Appellant paid the additional amounts under protest, and then sued in California Superior Court for a refund, raising the issues now before this Court. The case was tried on stipulated facts, and the Superior Court upheld appellee's assessments. On appeal, the California Court of Appeal affirmed, 117 Cal. App. 3d 988, 173 Cal. Rptr. 121 (1981), and the California Supreme Court refused to exercise discretionary review. We noted probable jurisdiction. 456 U. S. 960 (1982).

III

A

We address the unitary business issue first. As previously noted, the taxpayer always has the "distinct burden of showing by 'clear and cogent evidence' that [the state tax] results in extraterritorial values being taxed." *Supra*, at 164. One necessary corollary of that principle is that this Court will, if reasonably possible, defer to the judgment of state courts in deciding whether a particular set of activities constitutes a "unitary business." As we said in a closely related context in *Norton Co.* v. *Department of Revenue*, 340 U. S. 534 (1951):

> "The general rule, applicable here, is that a taxpayer claiming immunity from a tax has the burden of establishing his exemption.

[12] According to the notices, appellant's actual tax obligations were as follows:

	Total income of unitary business	*Percentage attributed to California*	*Amount attributed to California*	*Tax (5.5%)*
1963....	$37,348,183.00	8.6886	$3,245,034.23	$178,476.88
1964....	44,245,879.00	8.3135	3,673,381.15	202,310.95
1965....	46,884,966.00	7.6528	3,588,012.68	197,340.70

See Exhibit A–7 to Stipulation; Record 76, 77, 79.

> "*This burden is never met merely by showing a fair difference of opinion which as an original matter might be decided differently.* . . . Of course, in constitutional cases, we have power to examine the whole record to arrive at an independent judgment as to whether constitutional rights have been invaded, but that does not mean that we will re-examine, as a court of first instance, findings of fact supported by substantial evidence." *Id.*, at 537–538 (footnotes omitted; emphasis added).[13]

See *id.*, at 538 (concluding that, "in light of all the evidence, the [state] judgment [on a question of whether income should be attributed to the State] was within the realm of permissible judgment"). The legal principles defining the constitutional limits on the unitary business principle are now well established. The factual records in such cases, even when the parties enter into a stipulation, tend to be long and complex, and the line between "historical fact" and "constitutional fact" is often fuzzy at best. Cf. *ASARCO*, 458 U. S., at 326–328, nn. 22, 23. It will do the cause of legal certainty little good if this Court turns every colorable claim that a state court erred in a particular application of those principles into a *de novo* adjudication, whose unintended nuances would then spawn further litigation and an avalanche of critical comment.[14] Rather, our task must be to determine whether the state court applied the correct standards to the case; and if it did, whether its judgment "was within the realm of permissible judgment."[15]

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[13] This approach is, of course, quite different from the one we follow in certain other constitutional contexts. See, *e. g.*, *Brooks* v. *Florida*, 389 U. S. 413 (1967); *New York Times Co.* v. *Sullivan*, 376 U. S. 254, 285 (1964).

[14] It should also go without saying that not every claim that a state court erred in making a unitary business finding will pose a substantial federal question in the first place.

[15] *ASARCO* and *F. W. Woolworth* are consistent with this standard of review. *ASARCO* involved a claim that a parent and certain of its partial subsidiaries, in which it held either minority interests or bare majority interests, were part of the same unitary business. The State Supreme

B

In this case, we are singularly unconvinced by appellant's argument that the State Court of Appeal "in important part analyzed this case under a different legal standard," *F. W. Woolworth*, 458 U. S., at 363, from the one articulated by this Court. Appellant argues that the state court here, like the state court in *F. W. Woolworth*, improperly relied on appellant's mere *potential* to control the operations of its subsidiaries as a dispositive factor in reaching its unitary business finding. In fact, although the state court mentioned that "major policy decisions of the subsidiaries were subject to review by appellant," 117 Cal. App. 3d, at 998, 173 Cal. Rptr., at 127, it relied principally, in discussing the management relationship between appellant and its subsidiaries, on the more concrete observation that "[h]igh officials of appellant gave directions to subsidiaries for compliance with the parent's standard of professionalism, profitability, and ethical practices." *Id.*, at 998, 173 Cal. Rptr., at 127–128.[16]

Court upheld the claim. We concluded, *relying on factual findings made by the state courts*, that a unitary business finding was impermissible because the partial subsidiaries were not realistically subject to even minimal control by ASARCO, and were therefore passive investments in the most basic sense of the term. 458 U. S., at 320–324. We held specifically that to accept the State's theory of the case would not only constitute a misapplication of the unitary business concept, but would "destroy" the concept entirely. *Id.*, at 326.

F. W. Woolworth was a much closer case, involving one partially owned subsidiary and three wholly owned subsidiaries. We examined the evidence in some detail, and reversed the state court's unitary business finding, but only after concluding that the state court had made specific and crucial legal errors, not merely in the conclusions it drew, but in the legal standard it applied in analyzing the case. 458 U. S., at 363–364.

[16] In any event, although potential control is, as we said in *F. W. Woolworth*, not *"dispositive"* of the unitary business issue, *id.*, at 362 (emphasis added), it is *relevant*, both to whether or not the components of the purported unitary business share that degree of common ownership which is a prerequisite to a finding of unitariness, and also to whether there might exist a degree of implicit control sufficient to render the parent and the subsidiary an integrated enterprise.

Appellant also argues that the state court erred in endorsing an administrative presumption that corporations engaged in the same line of business are unitary. This presumption affected the state court's reasoning, but only as one element among many. Moreover, considering the limited use to which it was put, we find the "presumption" criticized by appellant to be reasonable. Investment in a business enterprise truly "distinct" from a corporation's main line of business often serves the primary function of diversifying the corporate portfolio and reducing the risks inherent in being tied to one industry's business cycle. When a corporation invests in a subsidiary that engages in the same line of work as itself, it becomes much more likely that one function of the investment is to make better use—either through economies of scale or through operational integration or sharing of expertise—of the parent's existing business-related resources.

Finally, appellant urges us to adopt a bright-line rule requiring as a prerequisite to a finding that a mercantile or manufacturing enterprise is unitary that it be characterized by "a substantial flow of goods." Brief for Appellant 47. We decline this invitation. The prerequisite to a constitutionally acceptable finding of unitary business is a flow of *value*, not a flow of goods.[17] As we reiterated in *F. W. Wool-*

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[17] As we state *supra*, at 167–169, there is a wide range of constitutionally acceptable variations on the unitary business theme. Thus, a leading scholar has suggested that a "flow of goods" requirement would provide a reasonable and workable bright-line test for unitary business, see Hellerstein, Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business, 21 Nat. Tax J. 487, 501–502 (1968); Hellerstein, Allocation and Apportionment of Dividends and the Delineation of the Unitary Business, 14 Tax Notes 155 (Jan. 25, 1982), and some state courts have adopted such a test, see, *e. g.*, *Commonwealth* v. *ACF Industries, Inc.*, 441 Pa. 129, 271 A. 2d 273 (1970). But see, *e. g.*, McLure, Operational Interdependence Is Not the Appropriate "Bright Line Test" of a Unitary Business—At Least Not Now, 18 Tax Notes 107 (Jan. 10, 1983). However sensible such a test may be as a policy matter, however, we see no reason to impose it on all the States as a requirement of constitutional law. Cf. *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435, 445 (1940).

worth, a relevant question in the unitary business inquiry is whether "'contributions to income [of the subsidiaries] result[ed] from functional integration, centralization of management, and economies of scale.'" 458 U. S., at 364, quoting *Mobil*, 445 U. S., at 438. "[S]ubstantial mutual interdependence," *F. W. Woolworth*, *supra*, at 371, can arise in any number of ways; a substantial flow of goods is clearly one but just as clearly not the only one.

C

The State Court of Appeal relied on a large number of factors in reaching its judgment that appellant and its foreign subsidiaries constituted a unitary business. These included appellant's assistance to its subsidiaries in obtaining used and new equipment and in filling personnel needs that could not be met locally, the substantial role played by appellant in loaning funds to the subsidiaries and guaranteeing loans provided by others, the "considerable interplay between appellant and its foreign subsidiaries in the area of corporate expansion," 117 Cal. App. 3d, at 997, 173 Cal. Rptr., at 127, the "substantial" technical assistance provided by appellant to the subsidiaries, *id.*, at 998–999, 173 Cal. Rptr., at 128, and the supervisory role played by appellant's officers in providing general guidance to the subsidiaries. In each of these respects, this case differs from *ASARCO* and *F. W. Woolworth*,[18] and clearly comes closer than those cases did to presenting a "functionally integrated enterprise," *Mobil*, *supra*, at 440, which the State is entitled to tax as a single entity. We need not decide whether any one of these factors

[18] See n. 15, *supra*. See also, *e. g.*, *F. W. Woolworth*, 458 U. S., at 365 ("*no* phase of any subsidiary's business was integrated with the parent's"); *ibid.* (undisputed testimony stated that each subsidiary made business decisions independently of parent); *id.*, at 366 ("each subsidiary was responsible for obtaining its own financing from sources other than the parent"); *ibid.* ("With one possible exception, none of the subsidiaries' officers during the year in question was a current or former employee of the parent") (footnote omitted).

would be sufficient as a constitutional matter to prove the existence of a unitary business. Taken in combination, at least, they clearly demonstrate that the state court reached a conclusion "within the realm of permissible judgment." [19]

IV

We turn now to the question of fair apportionment. Once again, appellant has the burden of proof; it must demonstrate that there is "'no rational relationship between the income attributed to the State and the intrastate values of the enterprise,'" *Exxon Corp.*, 447 U. S., at 220, quoting *Mobil*, *supra*, at 437, by proving that the income apportioned to

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[19] Two of the factors relied on by the state court deserve particular mention. The first of these is the flow of capital resources from appellant to its subsidiaries through loans and loan guarantees. There is no indication that any of these capital transactions were conducted at arm's length, and the resulting flow of value is obvious. As we made clear in another context in *Corn Products Refining Co.* v. *Commissioner*, 350 U. S. 46, 50–53 (1955), capital transactions can serve either an investment function or an operational function. In this case, appellant's loans and loan guarantees were clearly part of an effort to ensure that "[t]he overseas operations of [appellant] continue to grow and to become a more substantial part of the company's strength and profitability." Container Corporation of America, 1964 Annual Report 6, reproduced in Exhibit I to Stipulation of Facts. See generally *id.*, at 6–9, 11.

The second noteworthy factor is the managerial role played by appellant in its subsidiaries' affairs. We made clear in *F. W. Woolworth Co.* that a unitary business finding could not be based merely on "the type of occasional oversight—with respect to capital structure, major debt, and dividends—that any parent gives to an investment in a subsidiary . . . ." 458 U. S., at 369. As *Exxon* illustrates, however, mere decentralization of day-to-day management responsibility and accountability cannot defeat a unitary business finding. 447 U. S., at 224. The difference lies in whether the management role that the parent does play is grounded in its own operational expertise and its overall operational strategy. In this case, the business "guidelines" established by appellant for its subsidiaries, the "consensus" process by which appellant's management was involved in the subsidiaries' business decisions, and the sometimes uncompensated technical assistance provided by appellant, all point to precisely the sort of operational role we found lacking in *F. W. Woolworth.*

California under the statute is "out of all appropriate proportion to the business transacted by the appellant in that State," *Hans Rees' Sons, Inc.*, 283 U. S., at 135.

Appellant challenges the application of California's three-factor formula to its business on two related grounds, both arising as a practical (although not a theoretical) matter out of the international character of the enterprise. First, appellant argues that its foreign subsidiaries are significantly more profitable than it is, and that the three-factor formula, by ignoring that fact and relying instead on indirect measures of income such as payroll, property, and sales, systematically distorts the true allocation of income between appellant and the subsidiaries. The problem with this argument is obvious: the profit figures relied on by appellant are based on precisely the sort of formal geographical accounting whose basic theoretical weaknesses justify resort to formula apportionment in the first place. Indeed, we considered and rejected a very similar argument in *Mobil*, pointing out that whenever a unitary business exists,

> "separate [geographical] accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable 'source.' Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required." 445 U. S., at 438 (citation omitted).

Appellant's second argument is related, and can be answered in the same way. Appellant contends:

> "The costs of production in foreign countries are generally significantly lower than in the United States, pri-

> marily as a result of the lower wage rates of workers in countries other than the United States. Because wages are one of the three factors used in formulary apportionment, the use of the formula unfairly inflates the amount of income apportioned to United States operations, where wages are higher." Brief for Appellant 12.

Appellant supports this argument with various statistics that appear to demonstrate, not only that wage rates are generally lower in the foreign countries in which its subsidiaries operate, but also that those lower wages are not offset by lower levels of productivity. Indeed, it is able to show that at least one foreign plant had labor costs per thousand square feet of corrugated container that were approximately 40% of the same costs in appellant's California plants.

The problem with all this evidence, however, is that it does not by itself come close to impeaching the basic rationale behind the three-factor formula. Appellant and its foreign subsidiaries have been determined to be a unitary business. It therefore may well be that in addition to the foreign payroll going into the production of any given corrugated container by a foreign subsidiary, there is also California payroll, as well as other California factors, contributing—albeit more indirectly—to the same production. The mere fact that this possibility is not reflected in appellant's accounting does not disturb the underlying premises of the formula apportionment method.

Both geographical accounting and formula apportionment are imperfect proxies for an ideal which is not only difficult to achieve in practice, but also difficult to describe in theory. Some methods of formula apportionment are particularly problematic because they focus on only a small part of the spectrum of activities by which value is generated. Although we have generally upheld the use of such formulas, see, *e. g.*, *Moorman Mfg. Co.* v. *Bair*, 437 U. S. 267 (1978); *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113 (1920), we have on occasion found the distortive effect of fo-

cusing on only one factor so outrageous in a particular case as to require reversal. In *Hans Rees' Sons, Inc.* v. *North Carolina ex rel. Maxwell, supra*, for example, an apportionment method based entirely on ownership of tangible property resulted in an attribution to North Carolina of between 66% and 85% of the taxpayer's income over the course of a number of years, while a separate accounting analysis purposely skewed to resolve all doubts in favor of the State resulted in an attribution of no more than 21.7%. We struck down the application of the one-factor formula to that particular business, holding that the method, "albeit fair on its face, operates so as to reach profits which are in no just sense attributable to transactions within its jurisdiction." *Id.*,at 134.

The three-factor formula used by California has gained wide approval precisely because payroll, property, and sales appear in combination to reflect a very large share of the activities by which value is generated. It is therefore able to avoid the sorts of distortions that were present in *Hans Rees' Sons, Inc.*

Of course, even the three-factor formula is necessarily imperfect.[20] But we have seen no evidence demonstrating that

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[20] First, the one-third-each weight given to the three factors is essentially arbitrary. Second, payroll, property, and sales still do not exhaust the entire set of factors arguably relevant to the production of income. Finally, the relationship between each of the factors and income is by no means exact. The three-factor formula, as applied to horizontally linked enterprises, is based in part on the very rough economic assumption that rates of return on property and payroll—as such rates of return would be measured by an ideal accounting method that took all transfers of value into account—are roughly the same in different taxing jurisdictions. This assumption has a powerful basis in economic theory: if true rates of return were radically different in different jurisdictions, one might expect a significant shift in investment resources to take advantage of that difference. On the other hand, the assumption has admitted weaknesses: an enterprise's willingness to invest simultaneously in two jurisdictions with very different true rates of return might be adequately explained by, for example, the difficulty of shifting resources, the decreasing marginal value of additional investment, and portfolio-balancing considerations.

the margin of error (systematic or not) inherent in the three-factor formula is greater than the margin of error (systematic or not) inherent in the sort of separate accounting urged upon us by appellant. Indeed, it would be difficult to come to such a conclusion on the basis of the figures in this case: for all of appellant's statistics showing allegedly enormous distortions caused by the three-factor formula, the tables we set out at nn. 11, 12, *supra*, reveal that the percentage increase in taxable income attributable to California between the methodology employed by appellant and the methodology employed by appellee comes to approximately 14%, a far cry from the more than 250% difference which led us to strike down the state tax in *Hans Rees' Sons, Inc.*, and a figure certainly within the substantial margin of error inherent in any method of attributing income among the components of a unitary business. See also *Moorman Mfg. Co.*, *supra*, at 272–273; *Ford Motor Co.* v. *Beauchamp*, 308 U. S. 331 (1939); *Underwood Typewriter Co.*, *supra*, at 120–121.

V

For the reasons we have just outlined, we conclude that California's application of the unitary business principle to appellant and its foreign subsidiaries was proper, and that its use of the standard three-factor formula to apportion the income of that unitary business was fair. This proper and fair method of taxation happens, however, to be quite different from the method employed both by the Federal Government in taxing appellant's business, and by each of the relevant foreign jurisdictions in taxing the business of appellant's subsidiaries. Each of these other taxing jurisdictions has adopted a qualified separate accounting approach—often referred to as the "arm's-length" approach—to the taxation of related corporations.[21] Under the "arm's-length" approach,

[21] The "arm's-length" approach is also often applied to geographically distinct divisions of a single corporation.

every corporation, even if closely tied to other corporations, is treated for most—but decidedly not all—purposes as if it were an independent entity dealing at arm's length with its affiliated corporations, and subject to taxation only by the jurisdictions in which it operates and only for the income it realizes on its own books.

If the unitary business consisting of appellant and its subsidiaries were entirely domestic, the fact that different jurisdictions applied different methods of taxation to it would probably make little constitutional difference, for the reasons we discuss *supra*, at 170–171. Given that it is international, however, we must subject this case to the additional scrutiny required by the Foreign Commerce Clause. See *Mobil Oil Corp.*, 445 U. S., at 446; *Japan Line, Ltd.*, 441 U. S., at 446; *Bowman* v. *Chicago & N. W. R. Co.*, 125 U. S. 465, 482 (1888). The case most relevant to our inquiry is *Japan Line*.

A

Japan Line involved an attempt by California to impose an apparently fairly apportioned, nondiscriminatory, ad valorem property tax on cargo containers which were instrumentalities of foreign commerce and which were temporarily located in various California ports. The same cargo containers, however, were subject to an unapportioned property tax in their home port of Japan. Moreover, a convention signed by the United States and Japan made clear, at least, that neither National Government could impose a tax on temporarily imported cargo containers whose home port was in the other nation. We held that "[w]hen a State seeks to tax the instrumentalities of foreign commerce, two additional considerations, beyond those articulated in [the doctrine governing the Interstate Commerce Clause], come into play." 441 U. S., at 446. The first is the enhanced risk of multiple taxation. Although consistent application of the fair apportionment standard can generally mitigate, if not eliminate, double taxation in the domestic context,

"neither this Court nor this Nation can ensure full apportionment when one of the taxing entities is a foreign sovereign. If an instrumentality of commerce is domiciled abroad, the country of domicile may have the right, consistently with the custom of nations, to impose a tax on its full value. If a State should seek to tax the same instrumentality on an apportioned basis, multiple taxation inevitably results. . . . Due to the absence of an authoritative tribunal capable of ensuring that the aggregation of taxes is computed on no more than one full value, a state tax, even though 'fairly apportioned' to reflect an instrumentality's presence within the State, may subject foreign commerce '"to the risk of a double tax burden to which [domestic] commerce is not exposed, and which the commerce clause forbids."'" *Id.*, at 447–448, quoting *Evco* v. *Jones*, 409 U. S. 91, 94 (1972), in turn quoting *J. D. Adams Mfg. Co.* v. *Storen*, 304 U. S. 307, 311 (1938) (footnote omitted).

The second additional consideration that arises in the foreign commerce context is the possibility that a state tax will "impair federal uniformity in an area where federal uniformity is essential." 441 U. S., at 448.

"A state tax on instrumentalities of foreign commerce may frustrate the achievement of federal uniformity in several ways. If the State imposes an apportioned tax, international disputes over reconciling apportionment formulae may arise. If a novel state tax creates an asymmetry in the international tax structure, foreign nations disadvantaged by the levy may retaliate against American-owned instrumentalities present in their jurisdictions. . . . If other States followed the taxing State's example, various instrumentalities of commerce could be subjected to varying degrees of multiple taxation, a result that would plainly prevent this Nation from 'speaking with one voice' in regulating foreign commerce." *Id.*, at 450–451 (footnote omitted).

On the basis of the facts in *Japan Line*, we concluded that the California tax at issue was constitutionally improper because it failed to meet either of the additional tests mandated by the Foreign Commerce Clause. *Id.*, at 451–454.

This case is similar to *Japan Line* in a number of important respects. First, the tax imposed here, like the tax imposed in *Japan Line*, has resulted in actual double taxation, in the sense that some of the income taxed without apportionment by foreign nations as attributable to appellant's foreign subsidiaries was also taxed by California as attributable to the State's share of the total income of the unitary business of which those subsidiaries are a part.[22] Second, that double taxation stems from a serious divergence in the taxing schemes adopted by California and the foreign taxing authorities. Third, the taxing method adopted by those foreign taxing authorities is consistent with accepted international practice. Finally, our own Federal Government, to the degree it has spoken, seems to prefer the taxing method adopted by the international community to the taxing method adopted by California.[23]

Nevertheless, there are also a number of ways in which this case is clearly distinguishable from *Japan Line*.[24] First,

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[22] The stipulation of facts indicates that the tax returns filed by appellant's subsidiaries in their foreign domiciles took into account "only the applicable income and deductions incurred by the subsidiary or subsidiaries in that country and not . . . the income and deductions of [appellant] or the subsidiaries operating in other countries." App. 72. This does not conclusively demonstrate the existence of double taxation because appellant has not produced its foreign tax returns, and it is entirely possible that deductions, exemptions, or adjustments in those returns eliminated whatever overlap in taxable income resulted from the application of the California apportionment method. Nevertheless, appellee does not seriously dispute the existence of actual double taxation as we have defined it, Brief for Appellee 114–121, but cf. Tr. of Oral Arg. 28–29, and we assume its existence for the purposes of our analysis. Cf. *Japan Line*, 441 U. S., at 452, n. 17.

[23] But see *infra*, at 196–197 (discussing whether state scheme is preempted by federal law).

[24] Note that we deliberately emphasized in *Japan Line* the narrowness of the question presented: "whether instrumentalities of commerce that are

it involves a tax on income rather than a tax on property. We distinguished property from income taxation in *Mobil Oil Corp.*, 445 U. S., at 444–446, and *Exxon Corp.*, 447 U. S., at 228–229, suggesting that "[t]he reasons for allocation to a single situs that often apply in the case of property taxation carry little force" in the case of income taxation. 445 U. S., at 445. Second, the double taxation in this case, although real, is not the "inevitabl[e]" result of the California taxing scheme. Cf. *Japan Line*, 441 U. S., at 447. In *Japan Line*, we relied strongly on the fact that one taxing jurisdiction claimed the right to tax a given value in full, and another taxing jurisdiction claimed the right to tax the same entity in part—a combination resulting necessarily in double taxation. *Id.*, at 447, 452, 455. Here, by contrast, we are faced with two distinct methods of allocating the income of a multinational enterprise. The "arm's-length" approach divides the pie on the basis of formal accounting principles. The formula apportionment method divides the same pie on the basis of a mathematical generalization. Whether the combination of the two methods results in the same income being taxed twice or in some portion of income not being taxed at all is dependent solely on the facts of the individual case.[25] The third difference between this case and *Japan Line* is that the tax here falls, not on the foreign owners of an instrumentality of foreign commerce, but on a corporation domiciled and headquartered in the United States. We specifically left open in *Japan Line* the application of that case to "domesti-

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owned, based, and registered abroad and that are used exclusively in international commerce, may be subjected to apportioned ad valorem property taxation by a State." 441 U. S., at 444.

[25] Indeed, in *Chicago Bridge & Iron Co.* v. *Caterpillar Tractor Co.*, No. 81–349, which was argued last Term and carried over to this Term, application of worldwide combined apportionment resulted in a refund to the taxpayer from the amount he had paid under a tax return that included neither foreign income nor foreign apportionment factors.

cally owned instrumentalities engaged in foreign commerce," *id.*, at 444, n. 7, and—to the extent that corporations can be analogized to cargo containers in the first place—this case falls clearly within that reservation.[26]

In light of these considerations, our task in this case must be to determine whether the distinctions between the present tax and the tax at issue in *Japan Line* add up to a constitutionally significant difference. For the reasons we are about to explain, we conclude that they do.

B

In *Japan Line*, we said that "[e]ven a slight overlapping of tax—a problem that might be deemed *de minimis* in a domestic context—assumes importance when sensitive matters of foreign relations and national sovereignty are concerned." *Id.*, at 456 (footnote omitted). If we were to take that statement as an absolute prohibition on state-induced double taxation in the international context, then our analysis here would be at an end. But, in fact, such an absolute rule is no more appropriate here than it was in *Japan Line* itself, where we relied on much more than the mere fact of double taxation to strike down the state tax at issue. Although double taxation in the foreign commerce context deserves to receive close scrutiny, that scrutiny must take into account the context in which the double taxation takes place and the alternatives reasonably available to the taxing State.

In *Japan Line*, the taxing State could entirely eliminate one important source of double taxation simply by adhering to one bright-line rule: do not tax, to any extent whatsoever, cargo containers "that are owned, based, and registered abroad and that are used exclusively in international com-

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[26] We have no need to address in this opinion the constitutionality of combined apportionment with respect to state taxation of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries. See also n. 32, *infra*.

merce . . . ." *Id.*, at 444. To require that the State adhere to this rule was by no means unfair, because the rule did no more than reflect consistent international practice and express federal policy. In this case, California could try to avoid double taxation simply by not taxing appellant's income at all, even though a good deal of it is plainly domestic. But no party has suggested such a rule, and its obvious unfairness requires no elaboration. Or California could try to avoid double taxation by adopting some version of the "arm's-length" approach. That course, however, would not by any means guarantee an end to double taxation.

As we have already noted, the "arm's-length" approach is generally based, in the first instance, on a multicorporate enterprise's own formal accounting. But, despite that initial reliance, the "arm's-length" approach recognizes, as much as the formula apportionment approach, that closely related corporations can engage in a transfer of values that is not fully reflected in their formal ledgers. Thus, for example, 26 U. S. C. § 482 provides:

> "In any case of two or more . . . businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary [of the Treasury] may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such . . . businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such . . . businesses."[27]

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[27] Cf. Treasury Department's Model Income Tax Treaty of June 16, 1981, Art. 9, reprinted in CCH Tax Treaties ¶ 158 (1981) (hereinafter Model Treaty) ("Where . . . an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State . . . and . . . conditions are made or imposed between the two enterprises in their commercial or financial relations

And, as one might expect, the United States Internal Revenue Service has developed elaborate regulations in order to give content to this general provision. Many other countries have similar provisions.[28] A serious problem, however, is that even though most nations have adopted the "arm's-length" approach in its general outlines, the precise rules under which they reallocate income among affiliated corporations often differ substantially, and whenever that difference exists, the possibility of double taxation also exists.[29] Thus, even if California were to adopt some version of the "arm's-length" approach, it could not eliminate the risk of double taxation of corporations subject to its franchise tax, and might in some cases end up subjecting those corporations to more serious double taxation than would occur under formula apportionment.[30]

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which differ from those which would be made between independent enterprises, then any profits which, but for those conditions would have accrued to one of the enterprises, but by reason of those conditions have not so accrued, may be included in the profits of that enterprise and taxed accordingly"); J. Bischel, Income Tax Treaties 219 (1978) (hereinafter Bischel).

[28] See generally G. Harley, International Division of the Income Tax Base of Multinational Enterprise 143–160 (1981) (hereinafter Harley); Madere, International Pricing: Allocation Guidelines and Relief from Double Taxation, 10 Tex. Int'l L. J. 108, 111–120 (1975).

[29] See Surrey, Reflections on the Allocation of Income and Expenses Among National Tax Jurisdictions, 10 L. & Policy Int'l Bus. 409 (1978); Bischel 459–461, 464–466; B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders ¶ 15.06 (4th ed. 1979); Harley 143–160.

[30] Another problem arises out of the treatment of intercorporate dividends. Under formula apportionment as practiced by California, intercorporate dividends attributable to the unitary business are, like many other intercorporate transactions, considered essentially irrelevant and are not included in taxable income. See n. 5, *supra*. If the "arm's-length" method were entirely consistent, it would tax intercorporate dividends when they occur, just as all other investment income is taxed. (In which State that dividend could be taxed is not particularly important, since the issue here is international rather than interstate double taxation. See *Mobil*, 445 U. S., at 447–448.) It could also be argued that this would not,

That California would have trouble avoiding double taxation even if it adopted the "arm's-length" approach is, we think, a product of the difference between a tax on income and a tax on tangible property. See *supra*, at 187–188. Allocating income among various taxing jurisdictions bears some resemblance, as we have emphasized throughout this opinion, to slicing a shadow. In the absence of a central coordinating authority, absolute consistency, even among taxing authorities whose basic approach to the task is quite similar, may just be too much to ask.[31] If California's

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strictly speaking, result in double taxation, since the income taxed would be income "of" the parent rather than income "of" the subsidiary. The effect, however, would often be to penalize an enterprise simply because it has adopted a particular corporate structure. In practice, therefore, most jurisdictions allow for tax credits or outright exemptions for intercorporate dividends among closely tied corporations, and provision for such credits or exemptions is often included in tax treaties. See generally Model Treaty, Art. 23; Bischel 2. No suggestion has been made here that appellant's dividends from its subsidiaries would have to be exempt entirely from domestic state taxation. And the grant of a credit, which is the approach taken by federal law, see 26 U. S. C. § 901 *et seq.*, does not in fact entirely eliminate effective double taxation: the same income is still taxed twice, although the credit insures that the total tax is no greater than that which would be paid under the higher of the two tax rates involved. Moreover, once the Federal Government has allowed a credit for foreign taxes on a particular intercorporate dividend, we are not persuaded why, as a logical matter, a State would have to grant another credit of its own, since the federal credit would have already vindicated the goal of not subjecting the taxpayer to a higher tax burden that it would have to bear if its subsidiary's income were not taxed abroad.

[31] At the federal level, double taxation is sometimes mitigated by provisions in tax treaties providing for intergovernmental negotiations to resolve differences in the approaches of the respective taxing authorities. See generally Model Treaty, Art. 25; 2 New York University, Proceedings of the Fortieth Annual Institute on Federal Taxation § 31.03[2] (1982) (hereinafter N. Y. U. Institute). But cf. Owens, United States Income Tax Treaties: Their Role in Relieving Double Taxation, 17 Rutgers L. Rev. 428, 443–444 (1963) (role of such provisions procedural rather than substantive). California, however, is in no position to negotiate with foreign gov-

method of formula apportionment "inevitably" led to double taxation, see *supra*, at 188, that might be reason enough to render it suspect. But since it does not, it would be perverse, simply for the sake of avoiding double taxation, to require California to give up one allocation method that sometimes results in double taxation in favor of another allocation method that also sometimes results in double taxation. Cf. *Moorman Mfg. Co.*, 437 U. S., at 278–280.

It could be argued that even if the Foreign Commerce Clause does not require California to adopt the "arm's-length" approach to foreign subsidiaries of domestic corporations, it does require that whatever system of taxation California adopts must not result in double taxation in any particular case. The implication of such a rule, however, would be that even if California adopted the "arm's-length" method, it would be required to defer, not merely to a single internationally accepted bright-line standard, as was the case in *Japan Line*, but to a variety of § 482-type reallocation decisions made by individual foreign countries in individual cases. Although double taxation is a constitutionally disfavored state of affairs, particularly in the international context, *Japan Line* does not require forbearance so extreme or so one-sided.

C

We come finally to the second inquiry suggested by *Japan Line*—whether California's decision to adopt formula apportionment in the international context was impermissible because it "may impair federal uniformity in an area where federal uniformity is essential," 441 U. S., at 448, and "prevents the Federal Government from 'speaking with one voice' in international trade," *id.*, at 453, quoting *Michelin Tire Corp.*

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ernments, and neither the tax treaties nor federal law provides a mechanism by which the Federal Government could negotiate double taxation arising out of state tax systems. In any event, such negotiations do not always occur, and when they do occur they do not always succeed.

v. *Wages*, 423 U. S. 276, 285 (1976). In conducting this inquiry, however, we must keep in mind that if a state tax merely has foreign resonances, but does not implicate foreign affairs, we cannot infer, "[a]bsent some explicit directive from Congress, . . . that treatment of foreign income at the federal level mandates identical treatment by the States." *Mobil*, 445 U. S., at 448. See also *Japan Line*, 441 U. S., at 456, n. 20; *Michelin Tire Corp.*, *supra*, at 286. Thus, a state tax at variance with federal policy will violate the "one voice" standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive. The second of these considerations is, of course, essentially a species of pre-emption analysis.

(1)

The most obvious foreign policy implication of a state tax is the threat it might pose of offending our foreign trading partners and leading them to retaliate against the Nation as a whole. 441 U. S., at 450. In considering this issue, however, we are faced with a distinct problem. This Court has little competence in determining precisely when foreign nations will be offended by particular acts, and even less competence in deciding how to balance a particular risk of retaliation against the sovereign right of the United States as a whole to let the States tax as they please. The best that we can do, in the absence of explicit action by Congress, is to attempt to develop objective standards that reflect very general observations about the imperatives of international trade and international relations.

This case is not like *Mobil*, in which the real issue came down to a question of interstate rather than foreign commerce. 445 U. S., at 446–449. Nevertheless, three distinct factors, which we have already discussed in one way or another, seem to us to weigh strongly against the conclusion that the tax imposed by California might justifiably lead to significant foreign retaliation. First, the tax here does not

create an *automatic* "asymmetry," *Japan Line*, *supra*, at 453, in international taxation. See *supra*, at 188, 192–193. Second, the tax here was imposed, not on a foreign entity as was the case in *Japan Line*, but on a domestic corporation. Although, California "counts" income arguably attributable to foreign corporations in calculating the taxable income of that domestic corporation, the legal incidence of the tax falls on the domestic corporation.[32] Third, even if foreign nations have a legitimate interest in reducing the tax burden of domestic corporations, the fact remains that appellant is without a doubt amenable to be taxed in California in one way or another, and that the amount of tax it pays is much more the function of California's tax rate than of its allocation method. Although a foreign nation might be more offended by what it considers unorthodox treatment of appellant than it would be if California simply raised its general tax rate to achieve the same economic result, we can only assume that the offense involved in either event would be attenuated at best.

A state tax may, of course, have foreign policy implications other than the threat of retaliation. We note, however, that in this case, unlike *Japan Line*, the Executive Branch has decided not to file an *amicus curiae* brief in opposition to the state tax.[33] The lack of such a submission is by no means

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[32] We recognize that the fact that the legal incidence of a tax falls on a corporation whose formal corporate domicile is domestic might be less significant in the case of a domestic corporation that was owned by foreign interests. We need not decide here whether such a case would require us to alter our analysis.

[33] The Solicitor General did submit a memorandum opposing worldwide formula apportionment by a State in *Chicago Bridge & Iron Co.* v. *Caterpillar Tractor Co.*, No. 81–349, a case that was argued last Term, and carried over to this Term. Although there is no need for us to speculate as to the reasons for the Solicitor General's decision not to submit a similar memorandum or brief in this case, cf. Brief for National Governors' Association et al. as *Amici Curiae* 6–7, there has been no indication that the position taken by the Government in *Chicago Bridge & Iron Co.* still represents its views, or that we should regard the brief in that case as applying to this case.

dispositive. Nevertheless, when combined with all the other considerations we have discussed, it does suggest that the foreign policy of the United States—whose nuances, we must emphasize again, are much more the province of the Executive Branch and Congress than of this Court—is not seriously threatened by California's decision to apply the unitary business concept and formula apportionment in calculating appellant's taxable income.

(2)

When we turn to specific indications of congressional intent, appellant's position fares no better. First, there is no claim here that the federal tax statutes themselves provide the necessary pre-emptive force. Second, although the United States is a party to a great number of tax treaties that require the Federal Government to adopt some form of "arm's-length" analysis in taxing the domestic income of multinational enterprises,[34] that requirement is generally waived with respect to the taxes imposed by each of the contracting nations on its own domestic corporations.[35] This fact, if nothing else, confirms our view that such taxation is in reality of local rather than international concern. Third, the tax treaties into which the United States has entered do not generally cover the taxing activities of subnational governmental units such as States,[36] and in none of the treaties does the restriction on "non-arm's-length" methods of taxation apply to the States. Moreover, the Senate has on at least one occasion, in considering a proposed treaty, attached a reservation declining to give its consent to a provision in the treaty that would have extended that restriction to the States.[37] Finally, it remains true, as we said in *Mobil*, that "Congress

[34] See generally Model Treaty, Art. 7(2); Bischel 33–38, 459–461.

[35] See Model Treaty, Art. 1(3); Bischel 718; N. Y. U. Institute § 31.04[3].

[36] See Bischel 7.

[37] See 124 Cong. Rec. 18400, 19076 (1978).

has long debated, but has not enacted, legislation designed to regulate state taxation of income." 445 U. S., at 448.[38] Thus, whether we apply the "explicit directive" standard articulated in *Mobil*, or some more relaxed standard which takes into account our residual concern about the foreign policy implications of California's tax, we cannot conclude that the California tax at issue here is pre-empted by federal law or fatally inconsistent with federal policy.

VI

The judgment of the California Court of Appeal is

Affirmed.

JUSTICE STEVENS took no part in the consideration or decision of this case.

JUSTICE POWELL, with whom THE CHIEF JUSTICE and JUSTICE O'CONNOR join, dissenting.

The Court's opinion addresses the several questions presented in this case with commendable thoroughness. In my view, however, the California tax clearly violates the Foreign Commerce Clause—just as did the tax in *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U. S. 434 (1979). I therefore do not consider whether appellant and its foreign subsidiaries constitute a "unitary business" or whether the State's apportionment formula is fair.

With respect to the Foreign Commerce Clause issue, the Court candidly concedes: (i) "double taxation is a constitutionally disfavored state of affairs, particularly in the international context," *ante*, at 193; (ii) "like the tax imposed in *Japan Line*, [California's tax] has resulted in actual double taxation," *ante*, at 187; and therefore (iii) this tax "deserves

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[38] There is now pending one such bill of which we are aware. See H. R. 2918, 98th Cong., 1st Sess. (1983).

to receive close scrutiny," *ante*, at 189. The Court also concedes that "[t]his case is similar to *Japan Line* in a number of important respects," *ante*, at 187, and that the Federal Government "seems to prefer the ['arm's-length'] taxing method adopted by the international community," *ibid.* The Court identifies several distinctions between this case and *Japan Line*, however, and sustains the validity of the California tax despite the inevitable double taxation and the incompatibility with the method of taxation accepted by the international community.

In reaching its result, the Court fails to apply "close scrutiny" in a manner that meets the requirements of that exacting standard of review. Although the facts of *Japan Line* differ in some respects, they are identical on the critical questions of double taxation and federal uniformity. The principles enunciated in that case should be controlling here: a state tax is unconstitutional if it either "creates a substantial risk of international multiple taxation" or "prevents the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" 441 U. S., at 451.

I

It is undisputed that the California tax not only "creates a substantial risk of international multiple taxation," but also "has resulted in actual double taxation" in this case. See *ante*, at 187. As the Court explains, this double taxation occurs because California has adopted a taxing system that "serious[ly] diverge[s]" from the internationally accepted taxing methods adopted by foreign taxing authorities. *Ibid.* The Court nevertheless upholds the tax on the ground that California would not necessarily reduce double taxation by conforming to the accepted international practice.[1] *Ante*, at

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[1] The Court also appears to attach some weight to its view that California is unable "simply [to] adher[e] to one bright-line rule" to eliminate double taxation. See *ante*, at 189. From California's perspective, however, a

190–193. This argument fails to recognize the fundamental difference between the current double taxation and the risk that would remain under an "arm's-length" system. I conclude that the California tax violates the first principle enunciated in *Japan Line*.

At present, double taxation exists because California uses an allocation method that is different in its basic assumptions from the method used by all of the countries in which appellant's subsidiaries operate. The State's formula has no necessary relationship to the amount of income earned in a given jurisdiction as calculated under the "arm's-length" method. On the contrary, the formula allocates a higher proportion of income to jurisdictions where wage rates, property values, and sales prices are higher. See J. Hellerstein & W. Hellerstein, State and Local Taxation 538–539 (4th ed. 1978). To the extent that California is such a jurisdiction, the formula inherently leads to double taxation.

Appellant's case is a good illustration of the problem. The overwhelming majority of its overseas income is earned by its Latin American subsidiaries. See App. 112. Since wage rates, property values, and sales prices are much lower in Latin America than they are in California, the State's apportionment formula systematically allocates a much lower proportion of this income to Latin America than does the internationally accepted "arm's-length" method.[2] Correspond-

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bright-line rule that avoids Foreign Commerce Clause problems clearly exists. The State simply could base its apportionment calculations on appellant's United States income as reported on its federal return. This sum is calculated by the "arm's-length" method, and is thus consistent with international practice and federal policy. Double taxation is avoided to the extent possible by international negotiation conducted by the Federal Government. California need not concern itself with the details of the international allocation, but could apportion the American income using its three-factor formula.

[2] Although there are a few foreign countries where wage rates, property values, and sales prices are higher than they are in California, appellant's principal subsidiaries did not operate in such countries.

ingly, the formula allocates a higher proportion of the income to California, where it is subject to state tax. As long as the three factors remain higher in California, it is inevitable that the State will tax income under its formula that already has been taxed by another country under accepted international practice.

In the tax years in question, for example, over 27% of appellant's worldwide income was earned in Latin America and taxed by Latin American countries under the "arm's-length" method. See *ibid.* Latin American wages, however, represented under 6% of the worldwide total; Latin American property was about 20% of the worldwide total; and Latin American sales were less than 14% of the worldwide total. See *id.*, at 109–111. As a result, roughly 13% of appellant's worldwide income—less than half of the "arm's-length" total—was allocated to Latin America under California's formula. In other words, over half of the income of appellant's largest group of subsidiaries was allocated elsewhere under the State's formula. In accordance with international practice, all of this income had been taxed in Latin America, but the California system would allow the income to be taxed a second time in California and other jurisdictions. This problem of double taxation cannot be eliminated without either California or the international community changing its basic tax practices.

If California adopted the "arm's-length" method, double taxation could still exist through differences in application.[3] California and Colombia, for example, might apply different accounting principles to a given intracorporate transfer. But these types of differences, although presently tolerated under international practice, are not inherent in the "arm's-

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[3] Similarly, there could be double taxation if the entire international community adopted California's method of formula apportionment. Different jurisdictions might apply different accounting principles to determine wages, property values, and sales. Indeed, any system that calls for the exercise of any judgment leaves the possibility for some double taxation.

length" system. Moreover, there is no reason to suppose that they will consistently favor one jurisdiction over another. And as international practice becomes more refined, such differences are more likely to be resolved and double taxation eliminated.

In sum, the risk of double taxation can arise in two ways. Under the present system, it arises because California has rejected accepted international practice in favor of a tax structure that is fundamentally different in its basic assumptions. Under a uniform system, double taxation also could arise because different jurisdictions—despite their agreement on basic principles—may differ in their application of the system. But these two risks are fundamentally different. Under the former, double taxation is inevitable. It cannot be avoided without changing the system itself. Under the latter, any double taxation that exists is the result of disagreements in application. Such disagreements may be unavoidable in view of the need to make individual judgments, but problems of this kind are more likely to be resolved by international negotiation.

On its face, the present double taxation violates the Foreign Commerce Clause. I would not reject, as the Court does, the solution to this constitutional violation simply because an international system based on the principle of uniformity would not necessarily be uniform in all of the details of its operation.

II

The Court acknowledges that its decision is contrary to the Federal Government's "prefer[ence for] the taxing method adopted by the international community." *Ante*, at 187. It also states the appropriate standard for assessing the State's rejection of this preference: "a state tax at variance with federal policy will violate the 'one voice' standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive." *Ante*, at 194 (emphasis in original). The Court concludes, however, that the California tax does not prevent the Federal

Government from speaking with one voice because it perceives relevant factual distinctions between this case and *Japan Line*. I conclude that the California taxing plan violates the second principle enunciated in *Japan Line*, despite these factual distinctions, because it seriously "implicates foreign policy issues which must be left to the Federal Government."

The Court first contends that "the tax here does not create an *automatic* 'asymmetry.'" *Ante*, at 194–195 (emphasis in original) (quoting *Japan Line*, 441 U. S., at 453). This seems to mean only that the California tax does not result in double taxation in every case. But the fundamental inconsistency between the two methods of apportionment means that double taxation is inevitable. Since California is a jurisdiction where wage rates, property values, and sales prices are relatively high, double taxation is the logical expectation in a large proportion of the cases. Moreover, we recognized in *Japan Line* that "[e]ven a slight overlapping of tax—a problem that might be deemed *de minimis* in a domestic context—assumes importance when sensitive matters of foreign relations and national sovereignty are concerned." *Id.*, at 456.

The Court also relies on the fact that the taxpayer here technically is a domestic corporation. See *ante*, at 195. I have several problems with this argument. Although appellant may be the taxpayer in a technical sense, it is unquestioned that California is taxing the income of the foreign subsidiaries. Even if foreign governments are indifferent about the overall tax burden of an American corporation, they have legitimate grounds to complain when a heavier tax is calculated on the basis of the income of corporations domiciled in their countries. If nothing else, such a tax has the effect of discouraging American investment in their countries.

The Court's argument is even more difficult to accept when one considers the dilemma it creates for cases involving foreign corporations. If California attempts to tax the Ameri-

can subsidiary of an overseas company on the basis of the parent's worldwide income, with the result that double taxation occurs, I see no acceptable solution to the problem created. Most of the Court's analysis is inapplicable to such a case. There can be little doubt that the parent's government would be offended by the State's action and that international disputes, or even retaliation against American corporations, might be expected.[4] It thus seems inevitable that the tax would have to be found unconstitutional—at least to the extent it is applied to foreign companies. But in my view, invalidating the tax only to this limited extent also would be unacceptable. It would leave California free to discriminate against a Delaware corporation in favor of an overseas corporation. I would not permit such discrimination[5] without explicit congressional authorization.

The Court further suggests that California could impose the same tax burden on appellant under the "arm's-length" system simply by raising the general tax rate. See *ante*, at 195. Although this may be true in theory, the argument ignores the political restraints that make such a course infeasible. If appellant's tax rate were increased, the State

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[4] This is well illustrated by the protests that the Federal Government already has received from our principal trading partners. Several of these are reprinted or discussed in the papers now before the Court. See, *e. g.*, App. to Brief for Committee on Unitary Tax as *Amicus Curiae* 7 (Canada); *id.*, at 9 (France); *id.*, at 13–16 (United Kingdom); *id.*, at 17–19 (European Economic Community); App. to Brief for International Bankers Association in California et al. as *Amici Curiae* in *Chicago Bridge & Iron Co.* v. *Caterpillar Tractor Co.*, O. T. 1982, No. 81–349, pp. 4–5 (Japan); Memorandum for United States as *Amicus Curiae* in *Chicago Bridge & Iron Co.* v. *Caterpillar Tractor Co.*, O. T. 1982, No. 81–349, p. 3 ("[A] number of foreign governments have complained—both officially and unofficially—that the apportioned combined method . . . creates an irritant in their commercial relations with the United States. Retaliatory taxation may ensue . . ."); App. to *id.*, at 2a–3a (United Kingdom); *id.*, at 8a–9a (Canada).

[5] California is, of course, free to tax its own corporations more heavily than it taxes out-of-state corporations.

would be forced to raise the rate for all corporations.[6] If California wishes to follow this course, I see no constitutional objection. But it must be accomplished through the political process in which corporations doing business in California are free to voice their objections.

Finally, the Court attaches some weight to the fact that "the Executive Branch has decided not to file an *amicus curiae* brief in opposition to the state tax." *Ibid.* The Court, in a footnote, dismisses the Solicitor General's memorandum in *Chicago Bridge & Iron Co.* v. *Caterpillar Tractor Co.*, No. 81–349, despite the fact that it is directly on point and the case is currently pending before the Court. See *ante*, at 195, n. 33. In this memorandum, the Solicitor General makes it clear beyond question what the Executive Branch believes: "imposition of [a state tax] on the apportioned combined worldwide business income of a unitary group of related corporations, including foreign corporations, impairs federal uniformity in an area where such uniformity is essential."[7] Memorandum for United States as *Amicus Curiae* in *Chicago Bridge & Iron Co.* v. *Caterpillar Tractor Co.*, O. T. 1982, No. 81–349, p. 2. I recognize that the Government may change its position from time to time, but I see no reason to ignore its view in one case currently pending before the Court when considering another case that raises exactly the same issue. The Solicitor General has not withdrawn his memorandum, nor has he supplemented it with anything taking a contrary position. As long as *Chicago Bridge & Iron* remains before us, we must conclude that the Government's views are accurately reflected in the Solicitor General's memorandum in that pending case.

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[6] The State could not raise the tax rate for appellant alone, or even for corporations engaged in foreign commerce, without facing constitutional challenges under the Equal Protection or the Commerce Clause.

[7] *Chicago Bridge & Iron*, it might be noted, is a case in which the state tax is imposed on an American parent corporation.

In sum, none of the distinctions on which the Court relies is convincing. California imposes a tax that is flatly inconsistent with federal policy. It prevents the Federal Government from speaking with one voice in a field that should be left to the Federal Government.[8] This is an intrusion on national policy in foreign affairs that is not permitted by the Constitution.

III

In *Japan Line* we identified two constraints that a state tax on an international business must satisfy to comply with the Foreign Commerce Clause. We explicitly declared that "[i]f a state tax contravenes either of these precepts, it is unconstitutional." 441 U. S., at 451. In my view, the California tax before us today violates *both* requirements. I would declare it unconstitutional.

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[8] The Court relies on the absence of a "clear federal directive." See *ante*, at 194, 196–197. In light of the Government's position, as stated in the Solicitor General's memorandum, see *supra*, at 204, the absence of a more formal statement of its view is entitled to little weight.

Appendix E

Nos. 46930-3, 47305-6
The Supreme Court of Washington. En Banc

Dep't of Revenue v. J.C. Penney Co.

96 Wn. 2d 38 (Wash. 1981) · 96 Wash. 2d 38 · 633 P.2d 870
Decided Sep 17, 1981

Nos. 46930-3, 47305-6.

September 17, 1981.

[1] Taxation — Business and Occupation Tax — Other Business Activity — Scope. The business and occupation tax imposed by RCW 82.04.290 applies to all in-state business activity not otherwise subject to taxation.

[2] Taxation — Business and Occupation Tax — Other Business Activity — Service Charge on Credit Sale. That portion of the income derived from service charges on credit sales which is attributable to business activities within the state other than the retail sale itself is subject to the business and occupation tax under RCW 82.04.290.

[3] Taxation — Business and Occupation Tax — Income From Finance Charges — Apportionment — Factors. In determining how to apportion a business and occupation tax on income derived from finance charges involving more than one state, a court must determine the situs of all the business activities giving rise to the finance charges. Factors to be considered include where assistance in applying for credit is provided, credit is approved, intercession to have a credit sale approved occurs, retail credit sale takes place, books are kept, bills are generated and mailed, payments on credit accounts are sent, third parties are hired to collect delinquent accounts, and a customer or retailer can bring an action to settle disputes and invoke the protection of laws regulating credit transactions.

[4] Taxation — Due Process — Business Activity — Association With Taxing State. The imposition of a tax upon the portion of income which is associated with business activity conducted within the taxing state does not violate due process.

[5] Taxation — Commerce — Interstate Business — Validity of Tax. A tax upon interstate business does not violate the interstate commerce clause (U.S. Const. art. 1, § 8) if it is apportioned so that the business bears its fair share of the cost of state or local government.

Taxation — Commerce — Multiple Taxation — Burden of Proof.

39 *39

DOLLIVER, J., and BRACHTENBACH, C.J., dissent by separate opinion.

Nature of Action: The Department of Revenue sought judicial review of a Board of Tax Appeals decision that the state business and occupation tax could not be imposed upon service charge income generated by retail credit sales within Washington. In a separate action, the retailer sought a refund of taxes assessed on its service charge income under a municipal business and occupation tax. An out-of-state office serviced the credit accounts.

Superior Court: The Superior Court for Thurston County, No. 79-2-00190-0, Carol A. Fuller, J., on March 17, 1980, upheld the decision of the Board of Tax Appeals. The Superior Court for Pierce County, No. 271861, Thomas A. Swayze, Jr., J.,

on August 23, 1979, granted a summary judgment requiring the municipal business and occupation tax to be refunded to the retailer.

Supreme Court: Holding that the portion of the service charge income arising from the retailer's in-state activity was subject to the taxes, the court *reverses* the judgments and *remands* for apportionment of the taxes.

Kenneth O. Eikenberry, Attorney General, and *William B. Collins, Assistant*, for appellant State.

Robert R. Hamilton, F.H. Chapin, Jr., and *Thomas L. Dempsey*, for appellant City of Tacoma.

Davis, Wright, Todd, Riese Jones, by *C. James Judson* and *Neil H. Schickner*, for respondent.

John T. Piper and *James H. Lowe*, amici curiae for respondents.

DORE, J.

The critical facts are not in dispute in these consolidated cases. J.C. Penney Company, Inc. (Penney) operates over 50 retail stores in Washington, including one in Tacoma. A Penney customer who wishes to obtain a *40 charge card may fill out a "Credit Agreement" application, obtained at a local store or in a Penney catalog. The completed application may be mailed directly to Penney's regional credit office in Portland, Oregon (Portland office), or returned to the local store (which forwards one copy to the Portland office and another copy to a Washington credit bureau designated by the Portland office), or, in the case of a catalog application, sent directly to the catalog center in Wisconsin. Local stores are staffed with credit-layaway associates who answer questions about the application and otherwise aid in the filling out of the application. Local store employees are encouraged to solicit credit card applications which, the record discloses, boosts retail sales. The Portland office determines, after receiving the credit history of the applicant from the Washington credit bureau, whether the applicant will receive a charge card. If the application is approved, the Portland office establishes the customer's credit limit. The Credit Agreement is governed by Washington law.

When a Penney's charge card is offered for payment at a local store, the cashier will check for authorization through a computer terminal which is linked to the Portland office computer. If the computer refuses the purchase, the customer is directed to the credit-layaway associate who calls the Portland office and provides updated credit information, if any, supplied by the customer. The Portland office determines whether to authorize the purchase and relays this decision to the credit-layaway associate who informs the waiting customer.

A charge card holder receives a monthly statement indicating the purchases made during the prior billing period. The customer may pay the amount owed in full or may pay in monthly installments. If the latter is elected, a service charge will be assessed on the deferred balance. The billing on credit card accounts is handled through the Portland office, including assessment of the service charge. The monthly statements are mailed directly to the customer; a return envelope to the Portland office is supplied. Customers *41 may, alternatively, deliver their payments to the local store.

If a customer fails to pay the bill, the Portland office directly contacts the customer by mail or telephone. Delinquent accounts are referred to a Washington collection agency selected by the Portland office. If necessary, the collection agency may hire attorneys who litigate in the Washington courts.

The Washington State Department of Revenue (Department) imposed a business and occupation tax (B O tax), set out at RCW 82.04.290 [1] on Penney for the period 1966 through 1974 seeking to tax service charge income received by Penney on credit sales to Washington residents. Penney protested. The Board of Tax Appeals (Board) reversed the Department, holding Penney's

activities outside the reach of that tax. The Board also held that the assessment violated the due process and commerce clauses of the United States Constitution. The Superior Court for Thurston County affirmed the Board. This appeal followed.

1 RCW 82.04.290 reads:

"Upon every person engaging within this state in any business activity other than or in addition to those enumerated in RCW 82.04.230, 82.04.240, 82.04.250, 82.04.255, 82.04.260, 82.04.270, 82.04.275 and 82.04.280; as to such persons the amount of tax on account of such activities shall be equal to the gross income of the business multiplied by the rate of one percent. This section includes, among others, and without limiting the scope hereof (whether or not title to materials used in the performance of such business passes to another by accession, confusion or other than by outright sale), persons engaged in the business of rendering any type of service which does not constitute a `sale at retail' or a `sale at wholesale.'"

The City of Tacoma (Tacoma) assessed its B O tax, Tacoma Municipal Code 6.68.220(i)[2] on Penney's service *42 charge income generated from January 1972 through September 1977 on activity at Penney's Tacoma store. Penney brought suit to recover the tax paid. The Superior Court for Pierce County granted Penney's motion for summary judgment directing Tacoma to refund the tax and enjoining further assessment. This appeal followed.

2 Section 6.68.220(i) reads:

"Upon every person engaging within this city in any business activity other than or in addition to those enumerated in subsections (a), (b), (c), (d), (e), (f), (g), and (h) above, the amount of tax on account of such activities shall be equal to the gross income of the business multiplied by the rate of one-half of one percent (.005). This subsection includes, among others, and without limiting the scope thereof (whether or not title to material used in the performance of such business passes to another by accession, confusion or other than outright sale), persons engaged in the business of rendering any type of service."

We reverse the courts below, reinstate the imposition of the taxes, and remand to the lower courts for a determination of the proper apportionment formula.

[1] The B O tax in question[3] was designed to tax all business activities within the state which have not otherwise been taxed. The State imposed its B O tax upon Penney's income derived from finance charges. Penney argues that its finance charge income is beyond the ken of the tax because all activities relating to Penney's imposition of the finance charge take place in Oregon. The State concedes it has no authority to tax income earned outside of Washington; however, it contends that Penney's activities in this state give rise to the finance charge. The parties agree as to the specific services which are provided by the local Penney stores as well as those provided through the Oregon office. Thus, a single question is posed: Which activities of Penney's give rise to the finance charge? Our answer is that all of Penney's activities relating to the sale on credit give rise to the finance charge. Some of these activities are subject to the Washington tax at issue, others are not. We elaborate below.

3 RCW 82.04.290 and the Tacoma Municipal Code 6.68.220(i) are substantially identical in their language and intent. *See* footnotes 1 and 2. For convenience sake, we will refer to the State tax imposed through RCW 82.04.290 in this opinion. The analysis and discussion of that tax, however, should be applied to the Tacoma tax as well.

[2] In order to be subject to the tax in question, Penney must, within Washington, engage in some business activity, including rendering a service, other than a sale at retail. The servicing of installment (credit) accounts was held to *43 be such a business activity in *Rena-Ware Distribs., Inc. v. State*, 77 Wn.2d 514, 463 P.2d 622 (1970), and the resulting service charge income was taxable under RCW 82.04.290. Penney views the subject cases as the "flip side" of *Rena-Ware.* We do not agree.

In *Rena-Ware*, door-to-door salesmen offered goods for sale to out-of-state persons. At the time of purchase, the buyer had the choice of paying in cash or establishing a credit account, thereby accruing a service charge. All activities relating to the credit sale — credit approval, bookkeeping and billing — were performed in Rena-Ware's home office in Washington. In discussing whether or not these local activities were taxable, the court noted that it was legislative intent, as expressed in RCW 82.04.220, to tax all business activity not yet subjected to a B O tax. The servicing of credit accounts was a business activity which the taxpayer engaged in locally; it gave rise to a finance charge which was income; this income was not otherwise taxed.

> The business activity of servicing installment accounts falls naturally within this definition, and it is our conclusion that the legislature intended that this activity should be taxed under this section. . .

Rena-Ware, at 517. Thus, *Rena-Ware* distinguished the cash sale from the credit sale.

> When cash is not paid for a purchase, a service charge, designated as such, is added to the purchase price. The service charge is the same, regardless of the amount of the unpaid balance.

Rena-Ware, at 515. If a sale is made on credit, the *income derived from the service charge* is taxable. The business activities which give rise to that service charge are those activities relating to the privilege of making the purchase on credit. Although, in *Rena-Ware*, some of these activities took place out of state, there were sufficient ties with Washington to subject the service charge income to the B O tax.

In accordance with the holding in *Rena-Ware*, we must, first, acknowledge that the servicing of Penney's credit *44 accounts is taxable activity; second, identify the activities relating to sales for credit, rather than sales made for cash; and, third, identify the situs of those activities as within or without Washington.

[3] As described above, the activities relating to the credit sales which occur outside of Washington are generally those involving credit approval, billing and bookkeeping. The parties agree that the following credit sales activities occur in Washington:

> 1. 100 percent of the retail credit sales underlying the finance charges were made at Washington stores.
>
> 2. Employees of Penney's at the Washington stores assisted customers in applying for credit privileges.
>
> 3. The Portland credit office's provisional decision to *not* authorize a credit sale may be reversed (by Portland personnel) after an employee in the Washington store telephones Portland with additional credit information.
>
> 4. Washington Penney stores receive payments from customers on credit accounts (although the great majority of customers send such payments directly to Portland).
>
> 5. Washington companies are hired to collect delinquent accounts.

6. Washington laws concerning consumer protection and usury apply to the underlying credit sale and imposition of the finance charge.

7. Washington courts are being used to settle disputes.

It is the credit sale which places Penney in the position of potentially receiving a finance charge. The local activities which promote the sale on credit are sufficient to bring the finance charge income within the taxing statute. If all purchasers who buy on credit pay their accounts within 30 days and thereby avoid incurring a finance charge, then the *measure* of tax will be zero. The credit sale is the triggering business activity; the imposition of Penney's finance charge is the measuring device by which the State can assess its B O tax. All activities which establish credit status for customers, as well as the credit sale itself and those services provided to customers in the Portland office, are business activities which give rise to the finance charge. *Rena-Ware* *45 did not discuss the type of credit arrangement that is before the court in the subject case. It is the local activities which must be assessed in light of the taxpayer's entire operation and business presence in the state. A traveling salesman selling cookware is hardly in the same retailers' league as is Penney. What served in *Rena-Ware* as local activities which subjected the finance charge income to the B O tax does not preclude different local activities from serving the same purpose. Penney's presence in Washington cannot be compared to a single door-to-door salesman traveling from one town to another. Those accounting methods used by the seller in *Rena-Ware* are not necessarily the *only* activities which give rise to a finance charge in every case.

The West Virginia Supreme Court has held, on substantially identical facts,[4] that Penney's finance charge income was the result of credit activity which took place in West Virginia, notwithstanding the fact that the credit approval, billing and bookkeeping relating to the finance charge occurred outside of that state. *J.C. Penney Co. v. Hardesty*, 264 S.E.2d 604 (W.Va. 1979). It held that the finance charge income was taxable under a West Virginia statute described as a

> business and occupation tax imposed on income from finance charges . . . levied upon a service business not *46 otherwise specifically taxed.

Hardesty, at 618 (Miller, J., concurring). Penney attempts to distinguish *Hardesty* because that case was decided upon constitutional grounds, whereas the subject case involves statutory construction. This so-called distinction begs the very question before both courts. It is true that the analysis in

[4] "Here, the factual focus is on the activities surrounding Penney's extension of credit and collection of credit finance charges from State customers who do not elect to pay their account in full within thirty days from the date of the sale. It does not appear to be disputed that applications for a Penney's credit card, which forms the basis for a credit sale, can be obtained at the local stores.

"Although Penney's main West Virginia credit office is located in Greentree, Pennsylvania, it relies on credit investigations by West Virginia agencies. Credit sales are made at local stores, which can also receive credit payments, although most payments are made directly to the Greentree office, which sends the bills. The local store does make adjustment for the return of merchandise received on credit. West Virginia collection agencies and its court system are employed by Penney in its collection of delinquent accounts. Finally, the credit sales are subject to West Virginia usury and consumer protection laws. These factors constitute substantial contacts sufficient to justify the imposition of the tax." *J.C. Penney Co. v. Hardesty*, 264 S.E.2d 604, 618 (W.Va. 1979) (Miller, J., concurring).

Hardesty turns on whether the tax imposed is constitutionally permissible; however, one does not reach the constitutional question without the initial determination that the imposition of the West Virginia tax on Penney's finance charge income was proper. The credit activities which occurred in West Virginia were sufficient to give rise to that finance charge. The fact that the mechanical imposition of the service charge occurred outside of West Virginia did not sway that Supreme Court. It similarly has not influenced us.

Department of State Revenue v. J.C. Penney Co., ___ Ind. App. ___, 412 N.E.2d 1246 (1980), also relied on by Penney, is distinguishable. Penney is a nonresident of Indiana; the service charge income is considered an intangible in Indiana. The presumption (as reflected in the Department of Revenue's regulations, *see Department of State Revenue v. J.C. Penney Co., supra* at 1251-52) that income of a nonresident received from intangibles is *not* taxable under the gross income tax. In order to rebut this, it must be shown that such intangible obtained legal situs within Indiana by being an integral part of the in-state business. The Indiana court concluded that the generation of service charges did not meet this test. In other words, the legal situs of the intangible remained out of state and not subject to tax.

The Indiana Court of Appeals held that

> the facts in this case support the trial court's conclusion that *Penney's local credit service activities* were remote and minimal in comparison to the overall interstate character of the transaction.

(Italics ours.) *Department of State Revenue v. J.C. Penney Co., supra* at 1252. In describing the state law on activity *47 considered integral to a business, the court quoted from *Department of State Revenue v. Convenient Indus. of America, Inc.*, 157 Ind. App. 179, 299 N.E.2d 641, 647 (1973) as follows, in part:

> "Here, the *minimal activities* taking place within the State of Indiana with respect to the `service fee' . . . and with respect to the `advertising fee'. . . attributable to only a fractional portion of the fee, fall far short of the *degree of activity contemplated by the Indiana Gross Income Tax."*

(Italics ours.) *Department of State Revenue v. J.C. Penney Co., supra* at 1251. As explained earlier, the Washington legislature, through RCW 82.04.290, intended to catch *all* business activity not yet taxed. The *degree of activity* is what the Indiana court balanced. The question in Washington is whether there is *any business activity at all;* if interstate in nature, the proper apportionment will be made. We cannot construe the facts before us to support a finding that Penney does not engage in any business activity in Washington which gives rise to a finance charge. Reliance on the Indiana court's conclusion, that insufficient activity was shown to subject the income to that tax, is, therefore, misplaced.

There is no doubt but that Penney engages in interstate commerce. Because we are upholding the imposition of this tax, the question of the alleged violation of the due process and commerce clauses of the United States Constitution must be reached.

[4] The due process clause requires that there be a nexus between the taxing state and the activity sought to be taxed. *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 63 L.Ed.2d 510, 100 S.Ct. 1223 (1980). If the local activities are dissociated from the business activity which is the subject of the tax, then the local tax cannot stand. *Norton Co. v. Department of Revenue*, 340 U.S. 534, 95 L.Ed. 517, 71 S.Ct. 377 (1951). As demonstrated above, the imposition of the finance charge involves a great deal of Washington activity relating to establishing credit accounts *48 and handling local problems relating to that credit

account. These in-state activities of Penney are not sufficiently dissociated from its finance charge income to violate the due process clause.

The due process clause also requires that there be a relationship between the income attributable to the State and the intrastate values of the enterprise. The question here is one of apportionment. The State concedes that apportionment is proper. When properly apportioned, the tax will not offend the due process clause.

[5] The commerce clause will not be violated if a state tax which falls on interstate commerce is "designed to make the commerce bear a fair share of the cost of the local government whose protection it enjoys". *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 18 L.Ed.2d 505, 87 S.Ct. 1389 (1967). Once again, the question is one of apportionment. As stated above, appellants concede that apportionment is required because some of the activity relating to the finance charge takes place outside of Washington.

[6] There is an allegation that impermissible multiple taxation will result if the Washington tax is upheld, because Penney's service charge income may be taxed by Oregon. The burden is on the taxpayer to show that it is the victim of multiple taxation. The taxpayer has not met this burden; absent the mere assertion that Oregon "may" impose such a tax, there is nothing in the record to support such a claim. In any event, if a multiple tax is shown, the local tax need not fail; rather, apportionment can cure the defect. *Department of Revenue v. Association of Wash. Stevedoring Cos.*, 435 U.S. 734, 55 L.Ed.2d 682, 98 S.Ct. 1388 (1978).

The lower courts are reversed and the causes remanded for a determination of the proper apportionment formula, the assessment of taxes, and entry of judgment in accordance with the provisions of this opinion.

ROSELLINI, STAFFORD, UTTER, HICKS, WILLIAMS, and DIMMICK, JJ., concur.

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DOLLIVER, J. (dissenting)

All parties to this case, as well as the majority, rely to some extent on *Rena-Ware Distribs., Inc. v. State*, 77 Wn.2d 514, 463 P.2d 622 (1970), which also involved the application of RCW 82.04.290. In contrast to the majority, I believe the principles enunciated in that case require the court to find for Penney. An extensive analysis of the facts and holding in *Rena-Ware* is necessary in order to understand its applicability.

Rena-Ware sold cookware through the use of door-to-door salespeople. Sales were made from approximately 30 district sales offices, including 2 in Washington, but all orders were received and processed at the home office in Opportunity, Washington. Deliveries were made from warehouses in a number of states. Rena-Ware did not manufacture the products but purchased them from various manufacturers. When a customer did not pay cash, a service charge, designated as such, was added to the purchase price. The service charge was the same regardless of the amount of the unpaid balance.

The Department of Revenue assessed the business and occupation tax upon the receipts from the service charge on the theory that the servicing of accounts is a business handled entirely within the state and that a tax upon it is not a burden on interstate commerce. Rena-Ware challenged the tax. It argued that the extension of credit and the servicing of credit accounts were inseparable components of the underlying sales transactions and therefore, since the sales were out of state, they were beyond the taxing authority of the State. The State, however, argued that the servicing of credit accounts is a distinct business separate and apart from the business of making sales at retail.

The court held (1) Rena-Ware's extension of credit and servicing of credit accounts producing service charge income constituted a distinct business separate and apart from the underlying retail sales

transactions; and (2) Rena-Ware was engaged in this business within the State of *50 Washington so as to subject it to the business and occupation tax under RCW 82.04.290. The court stated:

> As the [State] points out, [Rena-Ware's] activities for which the service charge is made are not expressly covered in any section of the taxing act, nor are they expressly excluded. Since it was the intent of the legislature, set forth in RCW 82.04.220, to tax all business activities not expressly excluded, it is reasonable to conclude that the legislature intended to include this activity in the catch-all provision, RCW 82.04.290.
>
> We are of the opinion that the Department of Revenue has correctly construed RCW 82.04.290, which levies a tax on "every person engaging within this state in any business activity . . . [including] the business of rendering any type of service which does not constitute a `sale at retail' . . ." The business activity of servicing installment accounts falls naturally within this definition, and it is our conclusion that the legislature intended that this activity should be taxed under this section rather than under RCW 82.04.250, taxing retail sales. This interpretation not only gives effect to the legislative intent evidenced in the taxing statutes, but harmonizes them with RCW 63.14.040, which regulates installment sales and requires that service charges be separately stated. The legislative approach to the problems dealt with in that statute indicates an awareness on the part of the members of that body that service charges on installment sales are not in fact a part of the purchase price.

The Department of Revenue has also levied a tax upon income which the appellant derives from management services which it renders to its wholly-owned Canadian and Washington subsidiaries. The appellant contends that this tax is improper since the officers and directors and the sales manager of the three companies are the same. In brief, the appellant would have us "lift the corporate veil" and observe that in fact there is only one corporation.

If this case involved a fraud upon third persons, of course, the court would not permit the appellant to escape liability by means of the corporate structures which it employs. But we are not here concerned with such a case. The appellant has chosen to employ these structures for its own reasons, and we assume that it finds them advantageous. For purposes of the taxing *51 statutes, they are separate entities. Mere common ownership of stock, the same officers, employees, etc., does not justify disregarding the separate corporate identities unless a fraud is being worked upon a third person. *See Associated Oil Co. v. Seiberling Rubber Co.*, 172 Wn. 204, 19 P.2d 940 (1933).

In *Washington Sav-Mor Oil Co. v. Tax Comm'n*, 58 Wn.2d 518, 523, 364 P.2d 440 (1961), the plaintiff sought to avoid business and occupation taxes imposed under RCW 82.04, upon the ground that it was making sales to a wholly-owned subsidiary corporation. We said:

> The appellant asks us to disregard its separate existence, not in order to prevent fraud or injustice, but in order to gain an advantage. This we cannot do. The legislature has not seen fit to exclude transactions between affiliated corporations, and we find in the facts of this case nothing which would justify the judicial engrafting of such an exclusion upon the statute.
>
> In that case, the parent was selling goods to its subsidiary. Here the appellant is selling its services. There is no other significant distinction between the cases. What we said there is applicable here. The appellant is rendering valuable services to its subsidiary and is receiving remuneration for them. This activity is taxable under the statutes. The trial court correctly sustained the Department of Revenue's ruling on this matter.

Rena-Ware, at 517-18.

The principles to be derived from *Rena-Ware* are: (1) Service charge income received in exchange for the extension of the privilege of paying for goods over a time period represents income from the "business activity" of servicing credit accounts, which constitutes a distinct business separate and apart from the underlying retail sale transactions giving rise to the credit account; and (2) This "business activity" is engaged in where the processing, maintaining and record-keeping functions incidental to the servicing of the credit card accounts are performed.

Again, in contrast to the majority, I agree with the assertion of Penney that the situation in this case is a mirror image to that in *Rena-Ware.* In *Rena-Ware*, as here, authority and responsibility for the servicing of credit accounts was separated from that of retail sales. In *Rena-Ware*, *52 the company maintained warehouses and district sales offices in numerous states and cities in support of its retail sales operations while all essential credit account servicing functions were performed in the home office in Washington. In this case, Penney operates retail sale outlets in Tacoma and other parts of Washington while all essential credit account servicing functions are performed in Portland, Oregon. In *Rena-Ware*, the taxpayer's primary business was the generation of retail sales. The deferred balance credit accounts of Rena-Ware arising from retail credit sales were controlled by the regional credit office responsible for servicing credit accounts. The same is true here.

In terms of factual distinctions between the two cases, this case provides even greater support for application of the principles enunciated in *Rena-Ware.* In *Rena-Ware* there was a direct link between the consummation of the retail sale and the generation of service charge income. The sale was consummated only when the order and application for credit were submitted by the customer in the customer's own state and then approved by the Rena-Ware office in Washington. Upon approval, a finance charge was immediately assessed. Despite this direct link between the retail sale and the generation of service charge income, the court ruled that Rena-Ware's credit account servicing activities constituted a distinct business, separate and apart from its retail sales activities. Furthermore, despite the direct link between the salesperson's contact with the out-of-state customer which led to a retail credit sale and the automatic assessment of a service charge, the court ruled that no part of the activities encompassed within Rena-Ware's service charge "business" was carried on outside the state.

Here, in contrast, there was no such direct link between the consummation of a retail sale and the generation of finance charge income. When the Portland credit office approved a credit card sale in a Washington outlet, that act in itself did not give rise to any finance charge since the purchaser could avoid these charges by paying the purchase price in full when it was billed. Finance charge income was *53 generated only when, after the retail sale was consummated and after the

customer received the bill, the customer chose to defer payment of the purchase to a subsequent billing period.

Thus, unlike *Rena-Ware* where each retail credit sale automatically gave rise to service charge income, in this case the generation of finance charge income was completely divorced from the underlying retail credit sales. When a Penney credit card holder decided to defer payment for a credit sale to a subsequent billing period, the customer was in effect deciding to borrow the unpaid balance from Penney at a specific interest rate. Penney's finance charge income was thus derived solely from the independent decisions of its credit card holders as to the method of financing their credit purchases after their initial billing.

To justify the imposition of the tax, the majority states at page 44:

> It is the credit sale which places Penney in the position of potentially receiving a finance charge. The local activities which promote the sale on credit are sufficient to bring the finance charge income within the taxing statute. If all purchasers who buy on credit pay their accounts within 30 days and thereby avoid incurring a finance charge, then the *measure* of tax will be zero. The credit sale is the triggering business activity; the imposition of Penney's finance charge is the measuring device by which the State can assess its B O tax. All activities which establish credit status for customers, as well as the credit sale itself and those services provided to customers in the Portland office, are business activities which give rise to the finance charge.

This is, of course, exactly the same argument used by Rena-Ware: that the extension of credit ("the local activities which promote the sale on credit") and the servicing of credit accounts ("the imposition of Penney's finance charge") were components of the underlying sales transaction and could not be separated. In *Rena-Ware*, we refused to follow this argument and found the business activity of servicing credit accounts to be a business separate and *54 apart from the sales transaction which gave rise to the credit account. No doubt the majority can ignore this analysis if it chooses. It is difficult to put much faith in the consistency of judicial analysis if the chief guideline appears to be that the taxpayer will pay. At the very least, the majority ought to announce it has overruled *Rena-Ware.*

The other part of the majority position seems to be that Rena-Ware was small and Penney is big: "A traveling salesman selling cookware is hardly in the same retailers' league as is Penney." Majority opinion, at 45. I would suppose legislation could be passed which would have a different standard for door-to-door salespersons and giant retailers. The legislature did not choose to do so. Nor should we. We are bound by the terms of the statute which apply to large and small alike.

It is true that Penney engages in extensive credit sales activities within Washington. These activities consist principally in processing credit card purchases, handling credit applications, and handling merchandise returns, all of which are directly related and attributable to the generation of retail credit sales. Simply because a Penney customer maintains a continuing credit relationship or credit line with a local retail outlet does not change the essential fact that such relationship, from the perspective of the credit-related activities of the retail outlet, is related solely to the credit sale side of the transaction.

In *Rena-Ware*, the company's generation of service charge income would not have been possible but for the initial sale contact made by the out-of-state salesperson. In the case of Penney's retail activities, however, a retail credit sale does not automatically give rise to finance charge income

as in *Rena-Ware*, nor does the mere fact that such sales contacts are repeated and continuing change their essential nature as being sales related.

Finance charge income cannot, of course, be generated without there first being credit sales. There is a clear, factual boundary, however, between a retail credit sale and the *55 generation of finance charge income. The occurrence of a credit sale is not an appropriate bridge to the contention that the business activities responsible for the finance charge income include all the activities of Penney performed in Washington directed to the generation of credit sales.

The granting of credit is a part of the retailing business and is a cost of that business. If the customer pays within, say, 30 to 60 days, so that there is no service charge, the cost of providing credit becomes a cost of doing retail business. The enhancement of business which the retailer hopes will come from the extension of credit is, of course, already taxed by the State in its assessment of the business and occupation tax against the gross retail sales. RCW 82.04.250.

All of the functions essential to the generation and collection of finance charges — recording of credit card transactions, preparation of billing statements, crediting of account payments, and monitoring and enforcement of delinquent accounts — were the responsibility of and were performed at the Portland credit office. The logic of the reasoning in *Rena-Ware* supports the conclusion that Penney "engaged" in the "business activities" responsible for producing the finance charge income solely at its Portland credit office and not within the State of Washington.

The majority cites *J.C. Penney Co. v. Hardesty*, 264 S.E.2d 604 (W.Va. 1979). The case is not in point; it is barren of the analysis used by this court in *Rena-Ware.* The West Virginia court uses a "substantial contacts" analysis to justify imposition of the tax (Miller, J., concurring, at 618). It does not discuss or analyze the question of whether the servicing of credit accounts is a business separate and distinct from the retail sale giving rise to the credit account.

The case of *Department of State Revenue v. J.C. Penney Co.*, ___ Ind. App. ___, 412 N.E.2d 1246 (1980), is likewise not relevant. The Indiana court uses a "minimal activity" analysis to hold the tax inapplicable. Again, as in *Hardesty*, *56 this court fails to engage in the kind of analysis which is set forth in *Rena-Ware* to determine whether there was a "business activity".

I can well understand the desire of the State to get all the revenue it can. I do have difficulty sympathizing with the State shifting its analysis of the characteristics of the credit and service charge activities of a retailer as it suits its purpose. While it may be this is a natural and inevitable characteristic of the taxing authorities, I see no reason why the court should become a party to this duplicity.

BRACHTENBACH, C.J., concurs with DOLLIVER, J.

Reconsideration denied December 17, 1981.

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Appendix F

EXXON CORP. *v.* DEPARTMENT OF REVENUE OF WISCONSIN

APPEAL FROM THE SUPREME COURT OF WISCONSIN

No. 79-509. Argued March 18, 1980—Decided June 10, 1980

Appellant, a vertically integrated petroleum company doing business in several States, was organized, during the years in question in this case, into three levels of management, one of which was responsible for directing the operating activities of the company's functional departments. Transfers of products and supplies among the three major functional departments—Exploration and Production, Refining, and Marketing—were theoretically based on competitive wholesale prices. Appellant had no exploration and production or refining operations in Wisconsin and carried out only marketing in that State. During the years in question, appellant filed income tax returns in Wisconsin using a separate geographical system of accounting which reflected only the Wisconsin marketing operations and showed a loss for each year, thus resulting in no taxes being due, but appellee Wisconsin Department of Revenue, upon auditing the returns, assessed taxes, based on appellant's total income, pursuant to Wisconsin's tax apportionment statute. Ultimately, after appellant's application for abatement had proceeded through administrative and judicial review, the Wisconsin Supreme Court held that appellant's Wisconsin marketing operations were an integral part of one unitary business and that therefore its total corporate income was subject to the statutory apportionment formula. The court further held that situs income derived from crude oil produced by appellant outside Wisconsin and transferred to its own refineries and thus part of the unitary stream of income was apportionable under the Wisconsin statute despite appellant's separate functional accounting system, and that taxation of such situs income did not impermissibly burden interstate commerce.

Held:

1. The Due Process Clause of the Fourteenth Amendment did not prevent Wisconsin from applying its statutory apportionment formula to appellant's total income. Pp. 219-225.

(a) The Due Process Clause imposes two requirements for state taxation of the income of a corporation operating in interstate commerce: a "minimal connection" or "nexus" between the corporation's interstate activities and the taxing State, and "a rational relationship between the

income attributed to the State and the intrastate values of the enterprise." *Mobil Oil Corp.* v. *Commissioner of Taxes,* 445 U. S. 425, 436–437. Such a nexus is established if the corporation "avails itself of the 'substantial privilege of carrying on business' within the State." *Id.,* at 437. Here, appellant concededly avails itself of that privilege through its marketing operations within Wisconsin. Pp. 219–220.

(b) Appellant's use of separate functional accounting by which it shows what portion of its income is derived from exploration and production and from refining—functions occurring outside Wisconsin—does not demonstrate that application of the Wisconsin apportionment statute violated the Due Process Clause. A company's internal accounting techniques are not binding on a State for tax purposes and are not required to be accepted as a matter of constitutional law for such purposes. Pp. 220–223.

(c) The "linchpin of apportionability" for state income taxation of an interstate enterprise is the "unitary-business principle." *Mobil Oil Corp.* v. *Commissioner of Taxes, supra,* at 439. If a company is a unitary business, then a State may apply an apportionment formula to the taxpayer's total income in order to obtain a "rough approximation" of the corporate income that is "reasonably related to the activities conducted within the taxing State." *Moorman Mfg. Co.* v. *Bair,* 437 U. S. 267, 273. Here, the evidence fully supports the conclusion that appellant's marketing operations in Wisconsin were an integral part of such a unitary business. And appellant's use of separate functional accounting, and its decision for purposes of corporate accountability to assign wholesale market values to interdepartmental transfers of products and supplies, do not defeat the clear and sufficient nexus between appellant's interstate activities and the taxing State. Pp. 223–225.

2. Similarly, the Due Process Clause did not preclude Wisconsin from subjecting to taxation under its statutory apportionment formula appellant's income derived from extraction of oil and gas located outside the State which was used by the Refining Department, and the State was not required to allocate such income to the situs State. There was a unitary stream of income, of which the income derived from internal transfers of raw materials from exploration and production to refining was a part. This was a sufficient nexus to satisfy the Due Process Clause, and there was also the necessary "rational relationship" between the income attributed to the State by the apportionment formula and the intrastate value of the business. Pp. 225–227.

3. The Commerce Clause did not require Wisconsin to allocate all income derived from appellant's exploration and production function to the situs State rather than include such income in the apportionment

formula. The Wisconsin taxing statute, as applied, did not subject interstate business to an unfair burden of multiple taxation. *Mobil Oil Corp.* v. *Commissioner of Taxes, supra.* The State sought to tax income, not property ownership, and it was the *risk* of multiple taxation that was being asserted, actual multiple taxation not having been shown. The Commerce Clause did not require that any income which appellant was able to separate through accounting methods and attribute to exploration and production of crude oil and gas be allocated to the States in which those production centers were located. The geographic location of such raw materials did not alter the fact that such income was part of the unitary business of appellant's interstate enterprise and was subject to fair apportionment among all States to which there was a sufficient nexus with the interstate activities. Pp. 227-230.

90 Wis. 2d 700, 281 N. W. 2d 94, affirmed.

MARSHALL, J., delivered the opinion of the Court, in which all other Members joined except STEWART, J., who took no part in the consideration or decision of the case.

Thomas G. Ragatz argued the cause for appellant. With him on the briefs were *Leonard S. Sosnowski, Lloyd M. McBride,* and *Paul D. Frenz.*

Gerald S. Wilcox, Assistant Attorney General of Wisconsin, argued the cause for appellee. With him on the brief was *Bronson C. La Follette,* Attorney General.*

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*Briefs of *amici curiae* urging affirmance were filed by *William D. Dexter, Charles A. Groddick,* Attorney General of Alabama, *George Deukmejian,* Attorney General of California, *J. D. MacFarlane,* Attorney General of Colorado, *Richard Gebelein,* Attorney General of Delaware, *David H. Leroy,* Attorney General of Idaho, *Theodore L. Sendak,* Attorney General of Indiana, *Steven Sachs,* Attorney General of Maryland, *Frank J. Kelly,* Attorney General of Michigan, *Warren R. Spannaus,* Attorney General of Minnesota, *Mike Greely,* Attorney General of Montana, *Paul L. Douglas,* Attorney General of Nebraska, *Thomas D. Roth,* Attorney General of New Hampshire, *Jeff Bingaman,* Attorney General of New Mexico, *Rufus L. Edmisten,* Attorney General of North Carolina, *Albert R. Hausauer,* Special Assistant Attorney General of North Dakota, *James Redden,* Attorney General of Oregon, *Robert B. Hanen,* Attorney General of Utah, and *James R. Eads* for the Multistate Tax Commission et al.; and by *William J. Scott,* Attorney General of Illinois, and *Fred H. Montgomery* and *John*

MR. JUSTICE MARSHALL delivered the opinion of the Court.

This case raises three important questions regarding state taxation of the income of a vertically integrated corporation doing business in several States. The first issue is whether the Due Process Clause of the Fourteenth Amendment prevents a State from applying its statutory apportionment formula to the total corporate income of the taxpayer when the taxpayer's functional accounting separates its income into the three distinct categories of marketing, exploration and production, and refining, and when the taxpayer performs only marketing operations within the State. The second issue is whether the Due Process Clause permits a State to subject to taxation under its statutory apportionment formula income derived from the extraction of oil and gas located outside the State which is used by the refining department of the taxpayer, or whether the State is required to allocate such income to the situs State. The third issue is whether the Commerce Clause requires such an allocation to the situs State.

I

A

Appellant Exxon Corp.,[1] a vertically integrated petroleum company, is organized under the laws of Delaware with its

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D. WhiteNack, Special Assistant Attorneys General, *Carl R. Ajello,* Attorney General of Connecticut, *Francis X. Bellotti,* Attorney General of Massachusetts, and *Warren R. Spannaus,* Attorney General of Minnesota, for the State of Illinois et al.

Briefs of *amici curiae* were filed by *Theodore J. Carlson, Davison W. Grant, Joseph J. Schumm, Jr.,* and *Thomas C. Hutton* for Associated Dry Goods Corp.; and by *Frank M. Keesling, pro se.*

[1] The original taxpayer during the years in question was Humble Oil and Refining Co., a wholly owned subsidiary of Standard Oil Co. of New Jersey. In 1956, Standard Oil Co. of New Jersey organized as a wholly owned subsidiary Pate Oil Co., a Delaware corporation. Pate acquired all of the assets and liabilities of Saxon Corp., a Wisconsin company which marketed petroleum products and accessory products in that State. Pate

general offices located in Houston, Tex. During the years in question here, 1965 through 1968, appellant's corporate organization structure consisted of three parts: Corporate Management, Coordination and Services Management, and Operations Management.

Corporate Management, which was the highest order of management for the entire corporation, consisted of the board of directors, the executive committee, the chairman of the board (who was also the chief executive officer), the president, and various directors-in-charge who were members of the board of directors. Coordination and Services Management was composed of corporate staff departments which provided specialized corporate services. These services included long-range planning for the company, maximization of overall company operations, development of financial policy and procedures, financing of corporate activities, maintenance of the accounting system, legal advice, public relations, labor relations, purchase and sale of raw crude oil and raw materials, and coordination between the refining and other operating functions "so as to obtain an optimum short range operating program." App. 189; *id.*, at 187–192.[2]

The third level of management within the corporation was

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continued those marketing operations. In 1960, Pate was merged into Humble Oil and Refining Co., and the Wisconsin marketing operations were continued by that company under the brand name "Enco." In early 1973, Humble was merged into Standard Oil Co. of New Jersey, and the corporate name was changed to Exxon Corp. Exxon is the legal successor to Humble Oil and Refining Co. The taxpayer will be referred to throughout this opinion by its present name, Exxon.

[2] The corporate staff departments which were part of Coordination and Services Management, and which were not considered profit centers for accounting purposes by appellant, included: Corporate Planning Department, Secretary's Department, Supply Department, Treasury Department, Comptroller's Department, Tax Department, Law Department, Public Relations Department, Government Relations Department, Employee Relations Department, General Services Department, Medical Department, and Aviation Department. App. 189–192.

Operations Management, which was responsible for directing the operating activities of the functional departments of the company. These functional departments were Exploration and Production, Refining, Marketing, Marine, Coal and Shale Oil, Minerals, and Land Management. Each functional department was organized as a separate unit operating independently of the other operating segments, and each department had its own separate management responsible for the proper conduct of the operation. These departments were treated as separate investment centers by the company, and a profit was determined for each functional department.

At all relevant times each operating department was independently responsible for its performance. This arrangement permitted centralized management to evaluate each operation separately. Each department was therefore required to compete with the other departments for available investment funds, and with other members of the industry performing the same function for the company's raw materials and refined products. There was no requirement that appellant's crude oil go to its own refineries or that the refined products sold through marketing be produced from appellant's crude oil.

Transfers of products and raw materials among the three major functional departments—Exploration and Production, Refining, and Marketing—were theoretically based on competitive wholesale market prices. For purposes of separate functional accounting, transfers of crude oil from Exploration and Production to Refining were treated as sales at posted industry prices; transfers of products from Refining to Marketing were also based on wholesale market prices. If no readily available wholesale market value existed for a product, then representatives of the two departments involved would negotiate as to the appropriate internal transfer value.

Appellant had no exploration and production operations or refining operations in Wisconsin; the only activity carried out

in that State was marketing. The Wisconsin marketing district reported administratively to the central region office in Chicago, which in turn was responsible to the Marketing Department headquarters in Houston. App. 217. The motor oils, greases, and other packaged materials sold by appellant in Wisconsin during this period were manufactured outside the State and then shipped into that State from central warehouse facilities in Chicago. Tires, batteries, and accessories were centrally purchased through the Houston office and then shipped into Wisconsin for resale. The gasoline sold in Wisconsin was not produced by Exxon but rather was obtained from Pure Oil Co. in Illinois under an exchange agreement, permitting Exxon to reduce the cost of transporting the gasoline from its source to the retail outlets. This exchange agreement was negotiated by the Supply and Refining Departments. Additives were put into the Pure Oil gasoline in order to make the final product conform to uniform Exxon standards.

Exxon used a nationwide uniform credit card system, which was administered out of the national headquarters in Houston. Uniform packaging and brand names were used, and the overall plan for distribution of products was developed in Houston. Promotional display equipment was designed by the engineering staff at the marketing headquarters.

B

Because appellant marketed its products in Wisconsin during the calendar years 1965 through 1968, it was required to file corporate income and franchise tax returns in that State for those years. Exxon prepared the returns based on separate state accounting methods, reflecting only the Wisconsin marketing operation. The returns showed losses in the amounts of $821,320 for 1965, $1,159,830 for 1966, $1,026,224 for 1967, and $919,575 for 1968. Accordingly, no tax was shown as being due for any of those years.

Appellee Wisconsin Department of Revenue audited Exxon for the years in question, and on June 25, 1971, the Department sent the taxpayer a notice of assessment of additional income and franchise tax. The Department concluded that pursuant to Wis. Stat. § 71.07 (2) (1967) [3] the Wisconsin marketing operation was "an integral part of a unitary business," and therefore Exxon's taxable income in Wisconsin must be determined by application of the State's apportionment formula to the taxpayer's total income. The Department's calculation revealed an additional taxable income of $4,532,155 for the period 1965 through 1968. Additional

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[3] Wisconsin Stat. § 71.07 (2) (1967) during this period provided in relevant part:

"Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof, when the business of such person within the state is not an integral part of a unitary business, provided, however, that the department of taxation may permit an allocation and separate accounting in any case in which it is satisfied that the use of such method will properly reflect the income taxable by this state. In all cases in which allocation and separate accounting is not permissible, the determination shall be made in the following manner: There shall first be deducted from the total net income of the taxpayer such part thereof (less related expenses, if any) as follows the situs of the property. . . . The remaining net income shall be apportioned to Wisconsin on the basis of the ratio obtained by taking the arithmetical average of the following 3 ratios:

"(a) The ratio of the tangible property, real, personal and mixed, owned and used by the taxpayer in Wisconsin in connection with his trade or business during the income year to the total of such property of the taxpayer owned and used by him in connection with his trade or business everywhere. . . .

"(b) . . . the ratio of the total cost of manufacturing, collecting, assembling or processing within this state to the total cost of manufacturing, or assembling or processing everywhere. . . .

"(c) . . . the ratio of the total sales made through or by offices, agencies or branches located in Wisconsin during the income year to the total net sales made everywhere during said income year."

taxes in the amount of $316,470.85 were assessed against appellant.[4]

Exxon filed an application for abatement in July 1971, which the Department denied on November 30, 1971. Appellant then filed a petition for review with the Wisconsin Tax Appeals Commission. The Commission agreed with the Department that Exxon's separate geographical accounting did not accurately reflect its Wisconsin income for tax purposes. CCH Wis. Tax Rep. ¶ 201-223, p. 10,410 (1976). However, the Commission concluded that appellant's three main functional operating departments—Exploration and Production, Refining, and Marketing—were separate unitary businesses. *Id.*, at 10,409. According to the Commission, Exxon's marketing operation in Wisconsin was an integral part of its overall marketing function, but was not an integral part of its exploration and production function nor its refining function. *Id.*, at 10,411. The Commission found that the statutory apportionment formula as applied by the Department "had the effect of imposing a tax on the [appellant's] exploration and on its refining net income, all of which was derived solely from operations outside the State of Wisconsin and which had no integral relationship to the [appellant's] marketing operations within Wisconsin." *Id.*, at 10,410. The Commission also found that taxation by Wisconsin of Exxon's net income from its exploration and production function and its refining function would subject

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[4] The additional net income was determined to be:

1965	$759,371
1966	$1,043,395
1967	$1,264,946
1968	$1,464,443

The additional taxes owed were determined to be:

1965	$52,960.97
1966	$72,842.65
1967	$88,351.22
1968	$102,316.01

appellant "to multiple-state taxation as to such income." *Ibid.* The Commission therefore concluded that the Department had erred in its application of the apportionment formula since it had included "extraterritorial income," but that "apportioning income earned by the [appellant] from its marketing function within and without the State of Wisconsin, would be proper. . . ." *Id.*, at 10,411.

The Circuit Court for Dane County set aside some of the factual findings and conclusions of law of the Tax Appeals Commission. CCH Wis. Tax Rep. ¶ 201-373, pp. 10,501-10,504 (1977). In particular, the Circuit Court held that the Commission's finding that Exxon's three main functional operating departments were separate unitary businesses was an erroneous conclusion of law. *Id.*, at 10,502. Similarly, the court set aside the findings that there was no economic dependence between the Wisconsin marketing operations and Exxon's exploration and production function or its refining function. *Ibid.* Instead the court held that "[t]he Wisconsin operation contributed sales to [Exxon's] business of producing, refining and marketing petroleum products. This contribution was sufficient alone in the opinion of this Court to make [Exxon's] business a unitary one." *Ibid.* Accordingly, appellant's business during the relevant years "considered as a whole both within and without Wisconsin constituted a unitary business" within the meaning of the apportionment statute. *Ibid.*

The Circuit Court concluded, however, that another statute, Wis. Stat. § 71.07 (1) (1967),[5] excluded from income subject to the apportionment formula all situs income derived

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[5] Wisconsin Stat. § 71.07 (1) (1967) during this period provided in relevant part:

"For the purposes of taxation income or loss from business, not requiring apportionment under sub. (2), . . . shall follow the situs of the business from which derived. Income or loss derived from . . . the operation of any . . . mine . . . shall follow the situs of the property from which derived."

from appellant's oil and gas wells. CCH Wis. Tax Rep. ¶ 201-373, at 10,502-10,504. The Department had used a so-called "barrel formula" to separate two sets of income figures: income derived from the sale of crude oil to third parties, and income derived from crude oil produced by Exxon and transferred to its own refineries. The former was allocated to the situs State and excluded from Wisconsin taxable income, and the latter was included in the apportionment formula. A similar division was made of the income derived from appellant's gas production. The Circuit Court held that both sets of income were derived from the oil and gas wells and should be allocated to the situs State under the statute. The court noted that "there is no question but that the department's inclusion of [Exxon's] income derived from crude oil and gas produced and not sold to third parties by [Exxon's] production department resulted in double taxation of such income." [6] *Id.*, at 10,503.

The Wisconsin Supreme Court affirmed in part and reversed in part. 90 Wis. 2d 700, 281 N. W. 2d 94 (1979). That court concluded that the test for what constituted a unitary business was "'whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state. If there is such a relationship the business is unitary.'" *Id.,* at 711, 281 N. W. 2d, at 100, quoting G. Altman

[6] The Circuit Court also held that on remand the Tax Appeals Commission should determine whether the Department had properly weighted the apportionment formula. The apportionment formula uses three factors: sales, property, and manufacturing costs. See n. 3, *supra.* The Department adjusted the formula as to manufacturing costs because not all of the products sold through Exxon's Marketing Department were manufactured by Exxon; the Department divided by 2.6 rather than the statutory 3. The Wisconsin Supreme Court agreed that it was an issue for the Tax Appeals Commission on remand. 90 Wis. 2d 700, 731-735, 281 N. W. 2d 94, 111-113 (1979). That particular question is not before this Court.

& F. Keesling, Allocation of Income in State Taxation 101 (2d ed. 1950). Reviewing the organizational structure and business operations of Exxon, the court reasoned that Exxon's production and refining functions were dependent on its marketing operation to provide an outlet for its products, and Wisconsin was a part of that marketing system. In a high capital investment industry such as the petroleum industry, the court found, the existence of a stable marketing system was important for the full utilization of refining capacity. 90 Wis. 2d, at 718, 281 N. W. 2d, at 104. Accordingly, the court concluded that Exxon's Wisconsin marketing operations were an integral part of one unitary business and therefore its total corporate income was subject to the statutory apportionment formula. *Id.*, at 721–722, 281 N. W. 2d, at 105–106.

The Wisconsin Supreme Court disagreed with the Circuit Court on the issue of situs income. While the extraction and production of oil and gas constituted "mining" within the meaning of Wis. Stat. § 71.07 (1) (1967), 90 Wis. 2d, at 723, 281 N. W. 2d, at 106, the court agreed with the Department that situs income which is part of the unitary stream of income is nonetheless apportionable under the statute, while situs income which does not enter the unitary stream of income is nonapportionable and must be excluded from the formula. *Id.*, at 723–724, 281 N. W. 2d, at 106–107. The Wisconsin Supreme Court rejected appellant's contention that its separate functional accounting proved that its exploration and production income was earned totally outside Wisconsin, noting that "the idea of separate functional accounting seems to be incompatible with the 'very essence of formulary apportionment, namely, that where there are integrated, interdependent steps in the economic process carried on by a business enterprise, there is no logical or viable method for accurately separating out the profit attributable to one step in the economic process from other steps.'" *Id.*, at 726, 281 N. W. 2d, at 109, quoting J. Hellerstein, State and Local Taxation 400 (3d ed. 1969). The court concluded that the

State was acting within constitutional limitations despite appellant's evidence based on separate functional accounting.

The court also rejected Exxon's argument that the sources of income derived from exploration and production were all outside of Wisconsin and therefore could not be taxed in that State without impermissibly burdening interstate commerce. According to the court, Wisconsin was taxing only its "fair share" of appellant's income, there was a substantial nexus between appellant and the State, the tax was not claimed to discriminate between interstate and intrastate commerce, and the tax was fairly related to services provided by Wisconsin. 90 Wis. 2d, at 729–731, 281 N. W. 2d, at 110–111.

Because of the importance of the issues raised, we noted probable jurisdiction, 444 U. S. 961 (1979). We now affirm.

II

We recently set forth at some length the basic principles for state taxation of the income of a business operating in interstate commerce, see *Mobil Oil Corp.* v. *Commissioner of Taxes,* 445 U. S. 425, 436–442 (1980), and need not repeat them here in great detail. It has long been settled that "the entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs." *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U. S. 450, 460 (1959); *Mobil Oil Corp.* v. *Commissioner of Taxes, supra,* at 436. See generally *Underwood Typewriter Co.* v. *Chamberlain,* 254 U. S. 113 (1920); *Hans Rees' Sons* v. *North Carolina ex rel. Maxwell,* 283 U. S. 123 (1931); *Butler Bros.* v. *McColgan,* 315 U. S. 501 (1942); *Moorman Mfg. Co.* v. *Bair,* 437 U. S. 267 (1978). See also *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Comm'n,* 266 U. S. 271 (1924). The Due Process Clause of the Fourteenth Amendment imposes two requirements for such state taxation: a "minimal connection" or "nexus" between the interstate activities and the taxing State, and "a

rational relationship between the income attributed to the State and the intrastate values of the enterprise." *Mobil Oil Corp.* v. *Commissioner of Taxes, supra,* at 436, 437. See *Moorman Mfg. Co.* v. *Bair, supra,* at 272–273; *National Bellas Hess, Inc.* v. *Department of Revenue,* 386 U. S. 753, 756 (1967); *Norfolk & Western R. Co.* v. *State Tax Comm'n,* 390 U. S. 317, 325 (1968). The tax cannot be "out of all appropriate proportion to the business transacted by the appellant in that State." *Hans Rees' Sons* v. *North Carolina ex rel. Maxwell, supra,* at 135.

The nexus is established if the corporation "avails itself of the 'substantial privilege of carrying on business' within the State." *Mobil Oil Corp.* v. *Commissioner of Taxes, supra,* at 437, quoting *Wisconsin* v. *J. C. Penney Co.,* 311 U. S. 435, 444–445 (1940). In the present case, Exxon does not dispute that it avails itself of that privilege through its marketing operations within Wisconsin. Appellant contends, however, that this nexus is insufficient to permit inclusion of all of Exxon's corporate income within the apportionment formula. While appellant appears to concede that Wisconsin may properly apply its apportionment statute to Exxon's Marketing Department income as established by its separate functional accounting, see Brief for Appellant 18, 29, 33; Reply Brief for Appellant 2–3, it argues that it has demonstrated through its accounting method what portion of its income is derived from exploration and production and from refining—functions which do not occur in Wisconsin and of which the marketing operation in that State is not an integral part.

Appellant relies heavily on *Moorman Mfg. Co.* v. *Bair, supra.* The principal issue in that case was whether the single-factor sales formula used by Iowa to apportion for income tax purposes the income of an interstate business was prohibited by either the Due Process Clause or the Commerce Clause. In the course of that decision we noted that "[a]ppellant does not suggest that it has shown that a significant portion of the income attributed to Iowa in fact was gen-

erated by its Illinois operations; the record does not contain any separate accounting analysis showing what portion of appellant's profits was attributable to sales, to manufacturing, or to any other phase of the company's operations." 437 U. S., at 272. See also *id.,* at 275, n. 9. Exxon contends that *Moorman* sanctions the use of separate functional accounting in order to prove the extraterritorial reach of a state tax statute, and that its accounting in this case demonstrates that the Wisconsin Supreme Court's application of the state apportionment statute violates the Due Process Clause.

We cannot agree. As this Court has on several occasions recognized, a company's internal accounting techniques are not binding on a State for tax purposes. For example, in *Butler Bros.* v. *McColgan, supra,* an interstate business challenged the application of the California apportionment statute. The company was engaged in the wholesale dry goods and general merchandise business as a middleman, and it had distributing houses in seven States, including one in California. Each house maintained stocks of goods, had a cognizable territory, had its own sales force, did its own solicitation of sales, made its own credit and collection arrangements, and kept its own books. There was, however, a central buying division that was able to purchase goods for resale at a lower price. The company used "recognized accounting principles," 315 U. S., at 505, to allocate all costs and charges to each house, with certain centralized expenses allocated among the houses. Based on that "separate accounting system," *id.,* at 507, the business asserted there was no net income in California.

We concluded that California could constitutionally apply its apportionment formula to the company's total net income to establish taxable income, rather than being limited to the income shown by the taxpayer's accounting methods to be attributable to the one house in that State. The company had the "distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed,"

ibid., quoting *Norfolk & Western R. Co.* v. *North Carolina ex rel. Maxwell,* 297 U. S. 682, 688 (1936), and the taxpayer's accounting evidence was insufficient to meet that burden.

> "[W]e need not impeach the integrity of that accounting system to say that it does not prove appellant's assertion that extraterritorial values are being taxed. Accounting practices for income statements may vary considerably according to the problem at hand. . . . A particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a State seeks to tax values created by business within its borders. . . . That may be due to the fact, as stated by Mr. Justice Brandeis in *Underwood Typewriter Co.* v. *Chamberlain,* 254 U. S. 113, 121, that a State in attempting to place upon a business extending into several States 'its fair share of the burden of taxation' is 'faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders.' Furthermore, the particular system used may not reveal the facts basic to the State's determination. *Bass, Ratcliff & Gretton, Ltd.* v. *Tax Commission, supra,* p. 283. In either aspect of the matter, the results of the accounting system employed by appellant do not impeach the validity or propriety of the formula which California has applied here." 315 U. S., at 507–508.

Similarly, in *Mobil Oil Corp.* v. *Commissioner of Taxes,* we noted that "separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale." 445 U. S., at 438. Since such factors arise "from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable 'source.' Although separate geographical

accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required." *Ibid.*[7]

The dicta in *Moorman* upon which appellant relies are not incompatible with these principles. In *Moorman* we simply noted that the taxpayer had made no showing that its Illinois operations were responsible for profits from sales in Iowa. This hardly leads to the conclusion, urged by Exxon here, that a taxpayer's separate functional accounting, if it purports to separate out income from various aspects of the business, must be accepted as a matter of constitutional law for state tax purposes. Such evidence may be helpful, but *Moorman* in no sense renders such accounting conclusive.[8]

The "linchpin of apportionability" for state income taxation of an interstate enterprise is the "unitary-business principle." *Mobil Oil Corp.* v. *Commissioner of Taxes, supra,* at 439. If a company is a unitary business, then a State may apply an apportionment formula to the taxpayer's total income in order to obtain a "rough approximation" of the corporate income that is "reasonably related to the activities conducted within the taxing State." *Moorman Mfg. Co.* v. *Bair,* 437 U. S., at 273. See also *Underwood Typewriter Co.* v. *Chamberlain,* 254 U. S., at 120. In order to exclude certain income from the apportionment formula, the company must prove that "the income was earned in the course of activities unrelated to the sale of petroleum products in that State." *Mobil Oil Corp.* v. *Commissioner of Taxes, supra,* at 439. The court looks to the "underlying economic realities of a

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[7] The fact that Exxon in the present case relies on its own separate *functional* accounting rather than separate *geographic* accounting, which it had used initially in preparing its Wisconsin income tax returns, does not make the principles expressed in *Mobil Oil Corp.* v. *Commissioner of Taxes* any less applicable.

[8] In reaching this conclusion we need not challenge the integrity of Exxon's separate functional accounting for its own internal purposes. See *Butler Bros* v. *McColgan,* 315 U. S. 501, 507 (1942).

unitary business," and the income must derive from "unrelated business activity" which constitutes a "discrete business enterprise," 445 U. S., at 441, 442, 439.

We agree with the Wisconsin Supreme Court that Exxon is such a unitary business and that Exxon has not carried its burden of showing that its functional departments are "discrete business enterprises" whose income is beyond the apportionment statute of the State. While Exxon may treat its operational departments as independent profit centers, it is nonetheless true that this case involves a highly integrated business which benefits from an umbrella of centralized management and controlled interaction.

As has already been noted, Exxon's Coordination and Services Management provided many essential corporate services for the entire company, including the coordination of the refining and other operational functions "to obtain an optimum short range operating program." App. 189. Many of the items sold by appellant in Wisconsin were obtained through a centralized purchasing office in Houston whose obvious purpose was to increase overall corporate profits through bulk purchases and efficient allocation of supplies among retailers. Cf. *Butler Bros.* v. *McColgan,* 315 U. S., at 508 ("the operation of the central buying division alone demonstrates that functionally the various branches are closely integrated"). Even the gasoline sold in Wisconsin was available only because of an exchange agreement with another company arranged by the Supply Department, part of Coordination and Services Management, and the Refining Department. Similarly, sales were facilitated through the use of a uniform credit card system, uniform packaging, brand names, and promotional displays, all run from the national headquarters.

The important link among the three main operating departments of appellant was stated most clearly in the

testimony of an Exxon senior vice president. This official testified:

> "[I]n any industry which is highly capital intensive, such as the petroleum industry, the fixed operating costs are highly relative to total operating costs, and for this reason the profitability of such an industry is very sensitive and directly related to the full utilization of the capacity of the facilities.
>
> "So, in the case of the petroleum industry it is—where you have high capital investments in refineries, the existence of an assured supply of raw materials and crude is important and the assured and stable outlet for products is important, and therefore when there are—when these segments are under a single corporate entity, it provides for some assurance that the risk of disruptions in refining operations are minimized due to supply and demand imbalances that may occur from time to time.
>
> . . . . .
>
> "[T]he placing individual segments under one corporate entity does provide greater profits stability for the reason that . . . nonparallel and nonmutual economic factors which may affect one department may be offset by the factors existing in another department." App. 224–225.

The evidence fully supports the conclusion of the court below that appellant's marketing operation in Wisconsin is an integral part of a unitary business. Exxon's use of separate functional accounting, and its decision for purposes of corporate accountability to assign wholesale market values to interdepartmental transfers of products and supplies, does not defeat the clear and sufficient nexus between appellant's interstate activities and the taxing State.

The same analysis disposes of the other prong of Exxon's Due Process Clause attack on the Wisconsin statute. Appellant contends that at least the income derived from explora-

tion and production must be treated as situs income and allocated to the situs State rather than included in the apportionment statute.[9] Appellee did in fact exclude that income derived from the sale of crude oil and gas at the wellhead to third parties. However, the Department of Revenue concluded that the income characterized through appellant's separate functional accounting as income derived from intracorporate transfer of crude oil and gas for refining was part of the "unitary stream" of Exxon's income and apportionable.

We agree with appellee. As previously noted, appellant's internal accounting system is not binding on the State for tax purposes. The decision to assign wholesale market values to internal transfers of raw materials for corporate accountability does not change the unitary nature of appellant's business. An effective marketing operation is important to assure full or nearly full use of the refining capacities. Obviously the quality of the refined product affects the marketing operation. And the success of the Exploration and Production Department helps to keep the refineries operating at a capacity which is cost-efficient. There is indeed a unitary stream of income, of which the income derived from internal transfers of raw materials from exploration and production to refining is a part.[10] There is a sufficient nexus to satisfy the Due Process Clause.

There is also the necessary "rational relationship" between the income attributed to the State by the apportionment for-

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[9] Exxon also appears to suggest that the state statute requires allocation to the situs State of such income rather than apportionment. See Brief for Appellant 31–32, 40–41. That, of course, is a matter of state statutory construction which the Wisconsin Supreme Court, as the final arbiter of that State's law, has decided against appellant.

[10] Since appellee determined that income derived from the sale of crude oil and gas at the wellhead to third parties must, under the state statute, be allocated to the situs State and excluded from the reach of the apportionment statute, we need not address the issue of whether the Due Process Clause would require such allocation rather than apportionment.

mula and the intrastate value of the business. Exxon had a total of $60,073,293 in sales income from its Wisconsin operation in the years 1965 through 1968. App. 799. The Wisconsin assessed taxable income for the four years in question represented 0.22 percent of total company net income adjusted to the Wisconsin basis, and Exxon's Wisconsin sales for those years represented 0.41 percent of total company sales. 90 Wis. 2d, at 729, 281 N. W. 2d, at 110. This is hardly a case where the State has used its formula to attribute income "out of all appropriate proportion to the business transacted . . . in that State," *Hans Rees' Sons* v. *North Carolina ex rel. Maxwell,* 283 U. S., at 135, and application of the formula has not "led to a grossly distorted result," *Norfolk & Western R. Co.* v. *State Tax Comm'n,* 390 U. S., at 326. See also *Moorman Mfg. Co.* v. *Bair,* 437 U. S., at 274. That Exxon's Wisconsin marketing operation, through the use of separate geographic accounting, failed to show a net profit for the years in question does not change this rational relationship. *Butler Bros.* v. *McColgan,* 315 U. S., at 507–508; *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Comm'n,* 266 U. S., at 284. Cf. *Underwood Typewriter Co.* v. *Chamberlain,* 254 U. S., at 120. The Wisconsin Supreme Court's application of Wis. Stat. §§ 71.07 (1) and (2) (1967) in this case does not violate the Due Process Clause of the Fourteenth Amendment.

III

Appellant also contends that the Commerce Clause requires allocation of all income derived from its exploration and production function to the situs State rather than inclusion of such income in the apportionment formula.[11] The Court must therefore examine the "practical effect" of the tax to

[11] Because of appellee's construction of the state statute involved, we do not here address the issue of whether the Commerce Clause requires allocation of income derived from the sale of crude oil and gas at the wellhead to third parties to the situs State rather than apportionment.

determine whether it " 'is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.' " *Mobil Oil Corp.* v. *Commissioner of Taxes,* 445 U. S., at 443, quoting *Complete Auto Transit, Inc.* v. *Brady,* 430 U. S. 274, 279 (1977). See also *Japan Line, Ltd.* v. *County of Los Angeles,* 441 U. S. 434, 444–445 (1979); *Washington Revenue Dept.* v. *Association of Wash. Stevedoring Cos.,* 435 U. S. 734, 750 (1978).

It has already been demonstrated that the necessary nexus is present and that the tax is fairly apportioned. Similarly, appellant does not contest the conclusion that the tax is fairly related to the services rendered by Wisconsin, which include police and fire protection, the benefit of a trained work force, and "the advantages of a civilized society." *Japan Line, Ltd.* v. *County of Los Angeles, supra,* at 445. Exxon asserts, however, that Wisconsin's taxing statute, as applied, subjects interstate business to an unfair burden of multiple taxation.

We were faced with a very similar argument in *Mobil Oil Corp.* v. *Commissioner of Taxes, supra,* and we reject it now for the same reasons we rejected it in that case. Here, as in that prior case, the State seeks to tax income, not property ownership. Similarly, it is the *risk* of multiple taxation that is being asserted; actual multiple taxation has not been shown.[12] While of course "the constitutionality of a [Wiscon-

[12] Appellant presses the argument here that the *risk* of multiple taxation of income violates the Commerce Clause. Brief for Appellant 46–48; Reply Brief for Appellant 15–18; Supplemental Brief for Appellant 8. There was testimony by one witness before the Tax Appeals Commission that some States imposed "severance taxes" on oil and gas production. App. 432. Based on this brief testimony, the Tax Appeals Commission concluded that application of the state apportionment formula to Exxon's net income from its exploration, production, and refining functions subjected that income to multiple taxation, CCH Wis. Tax Rep. ¶ 201–223, p. 10,410 (1976), and the Circuit Court for Dane County reached a similar result solely as to the exploration and production income, CCH Wis. Tax Rep. ¶ 201–373, p. 10,503 (1977). Severance taxes, however, are directed

sin] tax should not depend on the vagaries of [another State's] tax policy," nonetheless "the absence of any existing duplicative tax does alter the nature of appellant's claim." *Id.*, at 444. Exxon asserts, in essence, that the Commerce Clause requires allocation of exploration and production income to the situs State rather than apportionment among the States, regardless of the situs State's actual tax policy. Cf. *ibid.* (dividend income).

We do not agree. As was the case with income from intangibles, there is nothing "talismanic" about the concept of situs for income from exploration and production of crude oil and gas. *Id.*, at 445. Presumably, the States in which appellant's crude oil and gas production is located are permitted to tax in some manner the income derived from that production, there being an obvious nexus between the taxpayer and those States. However, "there is no reason in theory why that power should be exclusive when the [exploration and production income as distinguished through separate functional accounting] reflect[s] income from a unitary business, part of which is conducted in other States. In that situation, the income bears relation to benefits and privileges conferred by several States. These are the circumstances in which apportionment is ordinarily the accepted method." *Id.*, at 445-446.

In short, the Commerce Clause does not require that any income which a taxpayer is able to separate through account-

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at the gross value of the mineral extracted or the quantity of production rather than the net income derived from the production activities. See R. Sullivan, Handbook of Oil and Gas Law § 238, p. 490 (1955); 4 W. Summers, The Law of Oil and Gas § 801 (1938). See, *e. g.*, La. Rev. Stat. Ann. §§ 47:633 (7) and (9) (West Supp. 1980). The Wisconsin Supreme Court therefore properly concluded that "[t]he fact that the producing states may impose . . . severance taxes which have been held to be occupation taxes or property taxes does not render unfair or unconstitutional Wisconsin's efforts to reach a proportionate share of the taxpayer's income." 90 Wis. 2d, at 731, 281 N. W. 2d, at 110-111 (footnotes omitted).

ing methods and attribute to exploration and production of crude oil and gas be allocated to the States in which those production centers are located. The geographic location of such raw materials does not alter the fact that such income is part of the unitary business of the interstate enterprise and is subject to fair apportionment among all States to which there is a sufficient nexus with the interstate activities of the business.

The judgment of the Supreme Court of Wisconsin is

Affirmed.

MR. JUSTICE STEWART took no part in the consideration or decision of this case.

Appendix G

Patent No. 1,507,439 is for an improvement in starting cages for racing dogs. The single claim is as follows:

"In a starting cage for racing dogs, a frame comprising a box-like structure divided into a plurality of compartments and comprising walls formed of wire mesh partially covered with fabric, individual rear doors for each of the compartments and a single front door hinged at its upper end to the top walls of the frame, divergent inclined members secured to the top of the said frame and extending upwardly and outwardly beyond the face of the front door and having their outer ends in the plane of the side walls of the box-like structure, springs secured to the outer ends of said inclined members and to the door and lying in the plane of the hinges, and a latch at the bottom of the cage for coaction with the lower edge of the front door to hold the front door normally closed against the tension of said springs, said springs adapted to raise the front door upon release of the latch."

In the light of the proceedings in the Patent Office upon the rejection of earlier claims, the claim can have but a narrow application. We agree with the Circuit Court of Appeals that the particular sort of spring support and the wire mesh partitions partially covered with fabric, as well as the other elements, are but forms of construction within the range of ordinary mechanical skill. There was an utter absence of invention justifying the issue of this patent.

Decree affirmed.

HANS REES' SONS, INCORPORATED, v. NORTH CAROLINA EX REL. MAXWELL, COMMISSIONER OF REVENUE.

APPEAL FROM THE SUPREME COURT OF NORTH CAROLINA.

No. 334. Argued March 18, 1931.—Decided April 13, 1931.

1. The State Supreme Court approved a ruling striking out evidence offered to prove a tax unconstitutional, but adjudged that even if the evidence were deemed competent the tax was valid. *Held* that

the case may be viewed as though the evidence had been received and held to have no bearing on the validity of the taxing statute. P. 126.

2. The method of allocating, for taxation, to a State that part of the net income of a foreign corporation which bears the same ratio to its entire net income as the value of its tangible property within that State bears to the value of all its tangible property, works an unconstitutional result if, in the particular case, the part of the income thus attributed to the State is out of all appropriate proportion to the business there transacted by the corporation. Pp. 129, 135.

   So *held* in the case of a North Carolina tax on income of a New York corporation, which bought leather, manufactured it in North Carolina, and sold its products at wholesale and retail in New York. *Underwood Typewriter Co.* v. *Chamberlin,* 254 U. S. 113; *Bass, Ratcliff & Gretton* v. *Tax Commission,* 266 U. S. 271, and *National Leather Co.* v. *Massachusetts,* 277 U. S. 413, distinguished.

3. The fact that a corporate enterprise is a unitary one, in the sense that the ultimate gain is derived from the entire business, does not mean that for the purpose of taxation the activities which are conducted in different jurisdictions are to be regarded as "component parts of a single unit" so that the entire net income may be taxed in one State regardless of the extent to which it may be derived from the conduct of the enterprise in another State. P. 133.

4. When there are different taxing jurisdictions, each competent to lay a tax with respect to what lies within, and is done within, its own borders, and the question is necessarily one of apportionment, evidence may always be received which tends to show that a State has applied a method, which, albeit fair on its face, operates so as to reach profits which are in no sense attributable to transactions within its jurisdiction. P. 134.

199 N. C. 42; 153 S. E. 850, reversed.

APPEAL from a judgment sustaining the dismissal of proceedings for readjustment of a state income tax assessment.

Mr. Louis H. Porter, with whom *Messrs. F. Carroll Taylor* and *Kingsland Van Winkle* were on the brief, for appellant.

Mr. Dennis G. Brummitt, Attorney General of North Carolina, with whom *Mr. Frank Nash*, Assistant Attorney General, was on the brief, for appellee.

MR. CHIEF JUSTICE HUGHES delivered the opinion of the Court.

The appellant, Hans Rees' Sons, Inc., a corporation organized under the laws of New York, began this action by an application to the Commissioner of Revenue of the State of North Carolina for the readjustment of the income tax assessed against the appellant by that State. The assessment was for the years 1923, 1924, 1925 and 1926, in accordance with the applicable state laws,[1] and the controversy related to the proper allocation of income to the State of North Carolina. The Commissioner of Revenue made his findings of fact and conclusions of law, the appellant's exceptions were overruled and the prayer for revision of the taxes was disallowed. Appeal, waiving a jury, was taken to the Superior Court of Buncombe County, North Carolina. On the trial in that court, evidence was introduced by the appellant with respect to the course of business and the amount and sources of income for the years in question. The appellant admitted that "(a) in assessing the tax the Commissioner of Revenue followed the statutory method . . .; (b) that the valuation of the real estate and tangible property of the taxpayer 'both within and without the State' is correct; (c) that the total net income used as a basis for the calculation of the tax is correct; (d) that the allocation of the net income for purposes of taxation was in full accord with the statute." The contention of the appellant was that the income tax statute as applied to the appellant, upon the facts disclosed, was arbitrary

[1] Laws of 1923, c. 4, § 201; 1925, c. 101, § 201; 1927, c. 80, § 311.

and unreasonable, and was repugnant to the commerce clause and to section 1 of the Fourteenth Amendment of the Federal Constitution. The Superior Court struck out the testimony offered by the appellant, as being immaterial, and held that the statute, as applied did not violate constitutional rights. The judgment dismissing the action was affirmed by the Supreme Court of the State, 199 N. C. 42, 153 S. E. 850. The case comes here on appeal.

As to the portions of the taxes for the years in question, which had been paid by the appellant voluntarily and as to which recovery was denied upon that ground, no question is raised here.

The Supreme Court of the State sustained the ruling of the trial court in striking out the evidence offered by the appellant, but held that, if the evidence were deemed to be competent, it would not change the result. The case may therefore be viewed as though the evidence had been received and held to have no bearing on the validity of the statute. *Fairmont Creamery Co.* v. *Minnesota,* 274 U. S. 1, 5. The evidence was thus summarized by the state court:

"This evidence tended to show that the petitioner" (the appellant here) "was incorporated in the State of New York in 1901 and is engaged in the business of tanning, manufacturing and selling belting and other heavy leathers. Many years prior to 1923 it located a manufacturing plant at Asheville, North Carolina, and after this plant was in full operation dismantled and abandoned all plants which it had heretofore operated in different states of the union. The business is conducted upon both wholesale and retail plans. The wholesale part of the business consists in selling certain portions of the hide to shoe manufacturers and others in carload lots. The retail part of the business consists in cutting the hide into innumerable pieces, finishing it in various ways and man-

ners and selling it in less than carload lots. In order to facilitate sales a warehouse is maintained in New York from which shipments are made of stock on hand to various customers. The tannery at Asheville is used as a manufacturing plant and a supply house, and when the quantity or quality of merchandise required by a customer is not on hand in the New York warehouse a requisition is sent to the plant at Asheville to ship to the New York warehouse or direct to the customer. The sales office is located in New York and the salesmen report to that office. Sales are made throughout this country and in Canada and Continental Europe. Some sales are also made in North Carolina. Certain finishing work is done in New York. The evidence further tended to show that 'between forty and fifty per cent of the output of the plant in Asheville is shipped from the Asheville tannery to New York. The other sixty per cent is shipped direct on orders from New York. . . . Shipment is made direct from Asheville to the customer.'

"The petitioner also offered evidence to the effect that the income from the business was derived from three sources, to-wit: (1) buying profit; (2) manufacturing profit; (3) selling profit. It contends that buying profit resulted from unusual skill and efficiency in taking advantage of fluctuations of the hide market; that manufacturing profit was based upon the difference between the cost of tanning done by contract and the actual cost thereof when done by the petitioner at its own plant in Asheville, and that selling profit resulted from the method of cutting the leather into small parts so as to meet the needs of a given customer.

"Without burdening this opinion with detailed compilations set out in the record, the evidence offered by the petitioner tends to show that for the years 1923, 1924, 1925, and 1926, the average income having its source in the manufacturing and tanning operations within the State of North Carolina was seventeen per cent."

According to the assessments in question, as revised by the Commissioner of Revenue and sustained, there was allocated to the State of North Carolina, pursuant to the prescribed statutory method, for the year 1923, 83+ per cent. of the appellant's income; for 1924, 85+ per cent; for 1925, 66+ per cent; and for 1926, 85+ per cent.

The applicable statutory provisions, as set forth by the state court, are as follows:

"Every corporation organized under the laws of this State shall pay annually an income tax, equivalent to four per cent of the entire net income as herein defined, received by such corporation during the income year; and every foreign corporation doing business in this State shall pay annually an income tax equivalent to four per cent of a proportion of its entire income to be determined according to the following rules:

"(a) In case of a company other than companies mentioned in the next succeeding section, deriving profits principally from the ownership, sale or rental of real estate or from the manufacture, purchase, sale of, trading in, or use of tangible property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property in this State on the date of the close of the fiscal year of such company in the income year is to the fair cash value of its entire real estate and tangible personal property then owned by it, with no deductions on account of encumbrances thereon.

"(b) In case of a corporation deriving profits principally from the holding or sale of intangible property, such proportion as its gross receipts in this State for the year ended on the date of the close of its fiscal year next preceding is to its gross receipts for such year within and without the State.

"(c) The words 'tangible personal property' shall be taken to mean corporeal personal property, such as ma-

chinery, tools, implements, goods, wares and merchandise and shall not be taken to mean money deposits in bank, shares of stock, bonds, notes, credits or evidence of an interest in property and evidences of debt."

Relying upon the decisions of this Court with respect to statutes of a similar sort enacted by other States, the Supreme Court of the State held that the statute of North Carolina was not invalid upon its face. *Underwood Typewriter Co.* v. *Chamberlain,* 254 U. S. 113, 120, 121; *Bass, Ratcliff & Gretton, Ltd.,* v. *State Tax Commission,* 266 U. S. 271, 280–283; *National Leather Co.* v. *Massachusetts,* 277 U. S. 413, 423. In *Underwood Typewriter Co.* v. *Chamberlain, supra,* a statute of Connecticut imposed upon foreign corporations doing business partly within and partly without the State, an annual tax of two per cent. upon the net income earned during the preceding year on business carried on within the State, ascertained by taking such proportion of the whole net income on which the corporation was required to pay a tax to the United States as the value of its real and tangible personal property within the State bore to the value of all its real and tangible personal property. All the manufacturing by the corporation was done in Connecticut, but the greater part of its sales were made from branch offices in other States. It was contended that the tax was an unconstitutional burden upon interstate commerce and that it violated the Fourteenth Amendment in that it imposed a tax on income arising from business conducted without the State. In support of the latter objection, the corporation showed that while 47 per cent. of its real estate and tangible personal property was located in Connecticut, almost all its net profits were received in other States. This Court said: "But this showing wholly fails to sustain the objection. The profits of the corporation were largely earned by a series of trans-

actions beginning with manufacture in Connecticut and ending with sale in other States. In this it was typical of a large part of the manufacturing business conducted in the State. The legislature in attempting to put upon this business its fair share of the burden of taxation was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders. It, therefore, adopted a method of apportionment which, for all that appears in this record, reached, and was meant to reach, only the profits earned within the State. 'The plaintiff's argument on this branch of the case,' as stated by the Supreme Court of Errors, 'carries the burden of saying that 47 per cent. of its net income is not reasonably attributable, for purposes of taxation, to the manufacture of products from the sale of which 80 per cent. of its gross earnings was derived after paying manufacturing costs.' The corporation has not even attempted to show this; and for aught that appears the percentage of net profits earned in Connecticut may have been much larger than 47 per cent. There is, consequently, nothing in this record to show that the method of apportionment adopted by the State was inherently arbitrary, or that its application to this corporation produced an unreasonable result." In this view, the validity of the Connecticut statute was sustained.

In the case of *Bass, Ratcliff & Gretton, Ltd.*, v. *State Tax Commission, supra,* the State of New York imposed an annual franchise tax at the rate of three per cent. upon the net income of the corporation. The Court, describing the statute, said that "if the entire business of the corporation is not transacted within the State, the tax is to be based upon the portion of such ascertained net income determined by the proportion which the aggregate value of specified classes of the assets of the corporation within the State bears to the aggregate value of all such classes of

assets wherever located." The corporation in that case was British, engaged in brewing and selling Bass' ale. Its brewing was done, and a large part of its sales were made, in England, but it had imported a portion of its product into the United States which it sold in branch offices located in New York and Chicago. The Court regarded the question of the constitutional validity of the New York tax as controlled in its essential aspect by the decision in *Underwood Typewriter Co.* v. *Chamberlain, supra.* And, referring to the facts of that case, the Court said: "So in the present case we are of opinion that, as the Company carried on the unitary business of manufacturing and selling ale, in which its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places—the process of manufacturing resulting in no profits until it ends in sales—the State was justified in attributing to New York a just proportion of the profits earned by the Company from such unitary business. . . Nor do we find that the method of apportioning the net income on the basis of the ratio of the segregated assets located in New York and elsewhere, was inherently arbitrary or a mere effort to reach profits earned elsewhere, under the guise of legitimate taxation. . . It is not shown in the present case, any more than in the *Underwood* case, that this application of the statutory method of apportionment has produced an unreasonable result."

In the instant case, the state court, having considered these decisions and held that the Statute of North Carolina was valid upon its face, sought to justify its view that the evidence offered by the appellant was without effect, upon the following grounds:

"The fallacy of this conclusion" (that is, the appellant's contention that the application of the statute had been shown to be unreasonable and arbitrary, and hence

repugnant to the Federal Constitution) "lies in the fact that the petitioner undertakes to split into independent sources, income which the record discloses was created and produced by a single business enterprise. Hides were bought for the purpose of being tanned and manufactured into leather at Asheville, North Carolina, and this product was to be shipped from the plant and sold and distributed from New York to the customer. The petitioner was not exclusively a hide dealer or a mere tanner of leather or a leather salesman. It was a manufacturer and seller of leather goods, involving the purchase of raw material and the working up of that raw material into acceptable commercial forms, for the ultimate purpose of selling the finished product for a profit. Therefore, the buying, manufacturing and selling were component parts of a single unit. The property in North Carolina is the hub from which the spokes of the entire wheel radiate to the outer rim." And, in its final conclusion, the state court said that, if it were conceded that the evidence offered by the appellant was competent, still, as it showed that the appellant "was conducting a unitary business as contemplated and defined by the courts of final jurisdiction," it was "not permissible to lop off certain elements of the business constituting a single unit, in order to place the income beyond the taxing jurisdiction of this State."

We are unable to agree with this view. Evidence which was found to be lacking in the *Underwood* and *Bass* cases is present here. These decisions are not authority for the conclusion that where a corporation manufactures in one State and sells in another, the net profits of the entire transaction, as a unitary enterprise, may be attributed, regardless of evidence, to either State. In the *Underwood* case, it was not decided that the entire net profits of the total business were to be allocated to Connecticut because that was the place of manufacture, or, in the *Bass* case,

that the entire net profits were to be allocated to New York because that was the place where sales were made. In both instances, a method of apportionment was involved which, as was said in the *Underwood* case, "for all that appears in the record, reached, and was meant to reach, only the profits earned within the State." The difficulty with the evidence offered in the *Underwood* case was that it failed to establish that the amount of net income with which the corporation was charged in Connecticut under the method adopted was not reasonably attributable to the processes conducted within the borders of that State; and in the *Bass* case the court found a similar defect in proof with respect to the transactions in New York.

Undoubtedly, the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits. The difficulty of making an exact apportionment is apparent and hence, when the State has adopted a method not intrinsically arbitrary, it will be sustained until proof is offered of an unreasonable and arbitrary application in particular cases. But the fact that the corporate enterprise is a unitary one, in the sense that the ultimate gain is derived from the entire business, does not mean that for the purpose of taxation the activities which are conducted in different jurisdictions are to be regarded as "component parts of a single unit" so that the entire net income may be taxed in one State regardless of the extent to which it may be derived from the conduct of the enterprise in another State. As was said in the *Bass* case with regard to "the unitary business of manufacturing and selling ale" which began with manufacturing in England and ended in sales in New York, that State "was justified in attributing to New York its proportion of the profits earned by the Company from such unitary business."

And the principle that was recognized in *National Leather Co.* v. *Massachusetts, supra,* was that a tax could lawfully be imposed upon a foreign corporation with respect to "the proportionate part of its total net income which is attributable to the business carried on within the State." When, as in this case, there are different taxing jurisdictions, each competent to lay a tax with respect to what lies within, and is done within, its own borders, and the question is necessarily one of apportionment, evidence may always be received which tends to show that a State has applied a method, which, albeit fair on its face, operates so as to reach profits which are in no just sense attributable to transactions within its jurisdiction.

Nor can the evidence be put aside in the view that it merely discloses such negligible criticisms in allocation of income as are inseparable from the practical administration of a taxing system in which apportionment with mathematical exactness is impossible. The evidence in this instance, as the state court puts it, "tends to show that for the years 1923, 1924, 1925, and 1926, the average income having its source in the manufacturing and tanning operations within the State of North Carolina was seventeen per cent.," while under the assessments in question, there was allocated to the State of North Carolina approximately eighty per cent. of the appellant's income.

An analysis has been submitted by the appellant for the purpose of showing that the percentage of its income attributable to North Carolina, for the years in question, did not in any event exceed 21.7 per cent. As pointed out by the state court, the appellant's evidence was to the effect that the income from its business was derived from three sources, buying profit, manufacturing profit, and selling profit. The appellant states that its sales were both wholesale and retail; that the profits from the wholesale business were in part attributable to the manufacturing in Asheville and in part to the selling in New York,

but that the appellant's accountants made no attempt to separate this, and that the entire wholesale profit was credited to manufacturing and allocated to North Carolina. Similarly, it is said that no attempt was made to separate profits from manufacturing in New York from profits derived from manufacturing in Asheville, and that all manufacturing profits were allocated to North Carolina. It is insisted that, in the retail part of the business, the leather is cut into small pieces and finished in particular ways and supplied in small lots to meet the particular needs of individual customers, and that this part of the business is essential to the retail merchandising business conducted from the New York office. The so-called " buying profit " is said to result from the skill with which hides are bought and the contention is that these buying operations were not conducted in North Carolina. If as to the last, it be said that the buying of raw material for the manufacturing plant should be regarded as incident to the manufacturing business, and as reflected in the value at wholesale of the manufactured product as turned out at the factory, still it is apparent that the amount of the asserted buying profit is not enough to affect the result so far as the constitutional question is concerned.

For the present purpose, in determining the validity of the statutory method as applied to the appellant, it is not necessary to review the evidence in detail, or to determine as a matter of fact the precise part of the income which should be regarded as attributable to the business conducted in North Carolina. It is sufficient to say that, in any aspect of the evidence, and upon the assumption made by the state court with respect to the facts shown, the statutory method, as applied to the appellant's business for the years in question operated unreasonably and arbitrarily, in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted by the appellant in that State. In this view,

the taxes as laid were beyond the State's authority. *Shaffer* v. *Carter*, 252 U. S. 37, 52, 53, 57.

For this reason the judgment must be reversed and the cause remanded for further proceedings not inconsistent with this opinion.

Reversed.

SOUTHERN RAILWAY COMPANY v. HUSSEY.

CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

No. 342. Argued March 18, 19, 1931.—Decided April 13, 1931.

1. Evidence offered by a litigant and excluded, but preserved in the record, may be considered upon review in determining his liability. P. 138.
2. Under an arrangement between two railroad companies a section of the main line of one was used by coal trains of the other by means of a switch connection. Due to a defect in the mechanism for turning the switch signal-light, which could have been discovered by due care, the switch was left open by men operating a train of the second company at night, leaving the green light showing the main line clear, with the result that a passenger train of that line was deflected and a passenger injured. *Held* that the company owning the main line was responsible to the passenger for the condition of the signal and liable for his injuries. P. 139.

42 F. (2d) 70, affirmed.

Certiorari, 282 U. S. 826, to review a judgment of the Circuit Court of Appeals, affirming a recovery in an action for personal injuries, which was removed from a state court on the ground of diversity of citizenship.

Mr. Charles A. Houts, with whom *Messrs. Samuel B. McPheeters* and *H. N. Quigley* were on the brief, for petitioner.

Mr. William H. Allen, with whom *Messrs. Jesse W. Barrett, Ellison A. Poulton,* and *Mark D. Eagleton* were on the brief, for respondent.

Appendix H

No. 37516-8-II
The Court of Appeals of Washington, Division Two

Lamtec Corp. v. Department of Revenue

215 P.3d 968 (Wash. Ct. App. 2009) · 151 Wn. App. 451 · 151 Wash. App. 451 · 213 P.3d 968
Decided Aug 4, 2009

Philip Albert Talmadge, Talmadge/Fitzpatrick, Tukwila, WA, Jeffrey Duane Dunbar, E. Ross Farr, Ogden Murphy Wallace PLLC, Seattle, WA, for Appellant.

Peter B. Gonick, Asst. Atty. Gen. Revenue Division, Olympia, WA, for Respondent.

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BRIDGEWATER, P.J.

[151 Wn.App. 454] ¶ 1 Lamtec, a New Jersey corporation, appeals from a summary judgment in favor of the Washington State Department of Revenue (Department) and its imposition of business and occupation (B & O) taxes. We hold that Lamtec's Washington customers did not receive the products in New Jersey even though the products were shipped free on board (F.O.B.) Flanders, New Jersey [1] BECAUSE THE COMMON Carriers had no authority to accept, reject, or inspect on behalf of the Washington customers. We also hold that Lamtec's activities in Washington establish a nexus for B & O tax purposes, even though they do not have an office in the state and do no direct sales, because it visited customers to establish and maintain their market. We affirm. *970

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FACTS

[1] F.O.B. means " without charge for delivery to and placing on board a carrier at a specified point." Webster's Third New International Dictionary 906 (2002).

¶ 2 Lamtec is a New Jersey corporation that manufactures vapor barriers and insulation facings. It manufactures its products, including insulation rolls, duct wrap, duct board, and pipe insulation, at its Flanders, New Jersey headquarters. Lamtec sells these products wholesale to customers throughout the country, primarily by telephone orders that customers place to its headquarters in New Jersey. It employs approximately 120 employees in New Jersey and one employee in Ohio.

¶ 3 Lamtec does not have any employees, property, or inventory in Washington. Rather, it ships its wholesale products from its New Jersey manufacturing plant to its Washington customers. The terms are F.O.B. Flanders, [151 Wn.App. 455] New Jersey, using a common carrier, with the title passing to the Washington customer at the time of shipment. The Washington customers bear the risk of loss and are responsible for the cost of shipment. There is no evidence that Lamtec's Washington customers or the common carrier inspects the products prior to shipment from New Jersey to Washington. Lamtec maintains, however, that its Washington customers inspect its manufacturing plant to ensure Lamtec's products meet their needs.

¶ 4 In an effort to maintain its existing customers and encourage continued business, Lamtec employees visit, at most, 12 longstanding Washington customers. During 1997 through 2003, the tax period at issue here, three Lamtec employees each visited existing Washington customers approximately two to three times per

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year. These employees held titles such as " sales manager; " " vice president of sales and marketing" ; and generally, " sales representatives." CP at 297, 334, 370.

¶ 5 Although Lamtec maintains that these employees neither solicited nor accepted individual orders during their visits to Washington, it admits that its employees engaged in efforts to maintain Lamtec's Washington market. During visits to the Washington customers, Lamtec employees provided information, listened to concerns about and answered questions concerning Lamtec products, participated in telephone calls that the customers placed to Lamtec's technical and customer service departments in New Jersey, fielded questions concerning potential price increases and new products, and maintained general client relations.

¶ 6 In 2004, the Department contacted Lamtec in regard to its wholesale sales to Washington. Subsequently, the Department concluded that Lamtec's sales activities between 1997 and June 30, 2004, were subject to the State's taxing authority. Accordingly, the Department assessed a B & O tax on Lamtec's wholesale sales activities in Washington for 1997 through June 30, 2004. During this time, Lamtec maintained sales between $1.1 million and $1.4 million in Washington. The Department determined that [151 Wn.App. 456] Lamtec owed $45,599.76 in back taxes, $11,399.96 in delinquent penalties, and $14,556.40 in assessment interest and penalties. The total amount that Lamtec owed was $71,566.12.

¶ 7 Lamtec protested and appealed the assessment to the Department Appeals Board. The Board affirmed the assessment. Lamtec then paid the assessment and filed a refund claim in Thurston County Superior Court.[2] On cross-motions for summary judgment, the superior court granted summary dismissal in the Department's favor. Lamtec now appeals.

2 Lamtec incorrectly asserts that interest continues to run on the assessment. Because Lamtec paid the assessment, as required by RCW 82.32.180 to file a refund claim in superior court, no interest is accruing. See RCW 82.32.150.

ANALYSIS

I. Standard of Review

¶ 8 We review summary judgment orders de novo, engaging in the same inquiry as the trial court and viewing the facts and inferences in the light most favorable to the non-moving party. *Berrocal v. Fernandez,* 155 Wash.2d 585, 590, 121 P.3d 82 (2005). Summary judgment is proper only when there are no genuine issues as to any material fact and the moving party is entitled to 971 judgment as a matter of law. CR 56(c); *971 *Berrocal,* 155 Wash.2d at 590, 121 P.3d 82. Here, Lamtec agrees that there are no genuine issues of material fact. But it contends that the trial court should have granted summary judgment in its favor.

¶ 9 Lamtec makes both a statutory argument and a constitutional argument. It contends that under the Department's rules set forth in WAC 458-20-193(7), Washington's B & O tax does not apply to its wholesale sales to Washington customers. Lamtec also contends that the Department's imposition of B & O taxes on it offends the commerce clause of the United States Constitution. Alternatively, Lamtec argues that it is exempt from B & O taxes [151 Wn.App. 457] because its Washington activities were dissociated from its Washington sales. Lamtec's arguments lack merit.

II. B & O Tax

¶ 10 A B & O tax is an excise tax that a jurisdiction imposes for " ‘ the privilege of doing business' " in that particular jurisdiction. *Ford Motor Co. v. City of Seattle,* 160 Wash.2d 32, 39, 156 P.3d 185 (2007) (quoting 1B Kelly Kunsch et al., Washington Practice: Methods of Practice §

72.7, at 452 (1997)), *cert. denied,* __ U.S. __, 128 S.Ct. 1224, 170 L.Ed.2d 61 (2008); RCW 82.04.220.[3] In adopting Washington's B & O tax scheme, " the legislature intended to impose the business and occupation tax upon virtually all business activities carried on within the state ... and to leave practically no business and commerce free of ... tax." *Simpson Inv. Co. v. Dep't of Revenue,* 141 Wash.2d 139, 149, 3 P.3d 741 (2000) (internal quotations omitted). Indeed, RCW 82.04.270 authorizes the state to impose the B & O tax " [u]pon every person engaging within this state in the business of making sales at wholesale." RCW 82.04.270.

3 RCW 82.04.220 reads in pertinent part:

¶ 11 The Department has promulgated specific rules to address circumstances under which it applies the B & O tax to interstate sales of tangible property. *See* WAC 458-20-193(1).[4] One such circumstance is when goods originating outside of Washington are received by a purchaser in Washington and the out-of-state seller has a nexus with Washington. WAC 458-20-193(7).[5] Here, Lamtec maintains that both elements are missing: It did not have a nexus with [151 Wn.App. 458] Washington, nor did its customers receive Lamtec goods in Washington.

4 WAC 458-20-193(1) reads in pertinent part:

5 WAC 458-20-193(7) reads in pertinent part:

A. Receipt of Goods

¶ 12 Lamtec contends that its Washington customers received its goods in New Jersey and not in Washington because it ships the goods F.O.B. Flanders, New Jersey. This reasoning lacks merit in the context of B & O taxes.

¶ 13 Lamtec cites several cases in which courts have determined that the parties' commercial contract established where, for tax purposes, the sale is made. *See, e.g., McLeod v. J.E. Dilworth Co.,* 322 U.S. 327, 64 S.Ct. 1023, 88 L.Ed. 1304 (1944); *McGoldrick v. Berwind-White Coal Mining Co.,* 309 U.S. 33, 60 S.Ct. 388, 84 L.Ed. 565 (1940); *Weyerhaeuser Co. v. Dep't of Revenue,* 106 Wash.2d 557, 723 P.2d 1141 (1986). But these cases are not relevant to the issue here because they address the propriety of state and local sales and use taxes rather than B & O taxes. *See Ford Motor,* 160 Wash.2d at 44, 156 P.3d 185.

¶ 14 In *McLeod,* for example, Arkansas sought to impose a *sales tax* on a sale completed in Tennessee but delivered in Arkansas. *McLeod,* 322 U.S. at 328, 64 S.Ct. 1023. The United States Supreme Court held that Arkansas could not apply a *sales tax* to personal property consummated outside the *972 state. *McLeod,* 322 U.S. at 331, 64 S.Ct. 1023. In rendering its decision, the *McLeod* court specifically distinguished a *sales tax* from other types of taxes, such as, use taxes. *McLeod,* 322 U.S. at 330-32, 64 S.Ct. 1023. Likewise, the issue in *McGoldrick* involved a *sales tax. McGoldrick,* 309 U.S. at 41, 60 S.Ct. 388. There, the Supreme Court [151 Wn.App. 459] upheld the imposition of a *sales tax* on transactions made by a Pennsylvania corporation that maintained its sales office in New York City, took its contracts in New York City, and made actual deliveries in New York City. *McGoldrick,* 309 U.S. at 44, 60 S.Ct. 388. The same is true of *Weyerhaeuser,* where the issues involved the Department's imposition of a retail *sales tax* on Weyerhaeuser. *Weyerhaeuser,* 106 Wash.2d at 558-59, 723 P.2d 1141.

¶ 15 Lamtec's reliance on these cases is unfounded because sales tax is inherently different from B & O tax. *See Ford Motor,* 160 Wash.2d at 44, 156 P.3d 185. In *Ford Motor,* the Washington Supreme Court emphasized this inherent difference:

> Looking at the place of sale is proper in the sales tax context because the incident of tax in that situation is the individual transaction. Such is not the case where a B & O tax is involved because, as we have observed above, the B & O tax is imposed upon activities associated with the privilege of doing business in the taxing jurisdiction.

Ford Motor, 160 Wash.2d at 44, 156 P.3d 185. Not only is this language instructive, but the context of the *Ford Motor* case is instructive. Ford challenged the imposition of B & O taxes by the cities of Seattle and Tacoma on wholesale sales by Ford automotive dealers in those cities. *Ford Motor,* 160 Wash.2d at 41, 156 P.3d 185. The Supreme Court held that under the municipal codes, Ford was engaging in the business of wholesaling in both Seattle and Tacoma. *Ford Motor,* 160 Wash.2d at 42-43, 156 P.3d 185.

¶ 16 In deciding *Ford,* the Supreme Court rejected Ford's argument that the terms of its contracts controlled the location of sale. *Ford Motor,* 160 Wash.2d at 43, 156 P.3d 185. The court held that the cities' imposition of B & O tax was proper because Ford engaged in business under the municipal codes when it solicited sales, performed warranty work, and met with customers and potential customers. *Ford Motor,* 160 Wash.2d at 42, 44, 156 P.3d 185.

¶ 17 Like the municipalities in *Ford Motor,* Washington State imposes B & O taxes on sellers for the privilege of engaging in business activities in our state. RCW 82.04.220. Also like *Ford Motor,* Lamtec's shipping contracts [151 Wn.App. 460] do not control the location of sale for purposes of applying B & O taxes. *See Ford Motor,* 160 Wash.2d at 43, 44, 156 P.3d 185. It is appropriate for the Department to impose B & O taxes to persons engaging in business activities in Washington. *See* RCW 82.04.270. And again, the first prong of the test requires that goods originating outside of Washington must be received by a purchaser inside of Washington. WAC 458-20-193.

¶ 18 The Department's promulgated rules address receipt of goods from out-of-state sellers:

> Delivery of the goods to a freight consolidator, freight forwarder or for-hire carrier located outside this state merely utilized to arrange for and/or transport the goods into this state is not receipt of the goods by the purchaser or its agent unless the consolidator, forwarder or for-hire carrier has express written authority to accept or reject the goods for the purchaser with the right of inspection.

WAC 458-20-193(7)(a).

¶ 19 Lamtec implies that its business activities fall within the situations categorized in WAC 458-20-193(7)(a), but it argues that the regulation overreaches because it requires more than the Uniform Commercial Code (UCC) requires in terms of receipt.

¶ 20 UCC provisions may govern transfer of title for the purpose of sales. *See Weyerhaeuser,* 106 Wash.2d at 562-63, 723 P.2d 1141 (UCC applies to the terms of the parties' transportation agreement to determine where a sale is made and, from that determination, what *sales tax* classification follows). But the UCC provisions regarding ownership or the passage of title of goods do not determine whether Washington's B & O tax applies. *973 *See Ford Motor,* 160 Wash.2d at 43-44, 156 P.3d 185; *see also Gen. Motors v. State,* 60 Wash.2d 862, 876, 376 P.2d 843 (1962) (upholding the imposition of B & O tax on an out-of-state company that shipped merchandise f.o.b., reasoning that " the substance of each transaction occurs in Washington where the customer is located."). Furthermore, WAC 458-20-193 does not purport to interpret or apply

[151 Wn.App. 461] Washington's UCC provisions. On the contrary, it interprets and applies Washington's taxing statutes.

¶ 21 Here, Lamtec has provided no evidence that the common carriers have express written authority to accept or reject Lamtec goods for its Washington customers. It has provided no evidence that the common carriers have the right of inspection. In fact, there is deposition testimony from a Lamtec employee indicating that the common carriers did not have authority to inspect the Lamtec products for the Washington customers. Accordingly, given the evidence provided, the superior court properly determined that under WAC 458-20-193, Lamtec's Washington customers receive Lamtec goods in Washington.

B. Nexus With Washington

¶ 22 Next, Lamtec claims that its activities within Washington do not satisfy the statutory nexus requirement under WAC 458-20-193(7), which parallels the rule for determining nexus under federal commerce clause analysis. Lamtec makes a constitutional nexus argument. It contends that the Department violated the commerce clause of article I, section 8 of the United States Constitution when it imposed the B & O tax on Lamtec. This contention lacks merit.

¶ 23 The United States Supreme Court has developed a four-part test to determine whether a state tax on interstate commerce meets the constitutional requirements of the federal commerce clause. A state tax is valid if (1) there is a sufficient nexus or connection between the state and the activities taxed; (2) the tax is fairly apportioned; (3) the tax does not discriminate against interstate commerce in favor of local commerce; and (4) the tax is fairly related to state-provided services. *Ford Motor,* 160 Wash.2d at 48, 156 P.3d 185 (citing *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977)). If a taxing scheme fails any one of these requirements, it is invalid. *Ford Motor,* 160 Wash.2d at 48, 156 P.3d 185. But it is " ‘ not the purpose of [151 Wn.App. 462] the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business.’ " *Gen. Motors Corp. v. Washington,* 377 U.S. 436, 439, 84 S.Ct. 1564, 12 L.Ed.2d 430 (1964) (quoting *W. Live Stock v. Bureau of Revenue,* 303 U.S. 250, 254, 58 S.Ct. 546, 82 L.Ed. 823 (1938)), *overruled on other grounds by Tyler Pipe Indus., Inc.,* 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199 (1987). Here, Lamtec contends that the Department's imposition of B & O taxes offends the federal commerce clause because it does not have a sufficient nexus with Washington.

¶ 24 A tax passes constitutional muster only if it is applied to " ‘ an activity with a substantial nexus with the taxing State.’ " *Quill Corp. v. N. Dakota,* 504 U.S. 298, 311, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992) (quoting *Complete Auto,* 430 U.S. at 279, 97 S.Ct. 1076). In *Quill,* the United States Supreme Court reversed an opinion of the North Dakota Supreme Court that permitted a tax on a mail-order business with no physical presence in the state. *Quill,* 504 U.S. at 301-02, 112 S.Ct. 1904. Confirming the " bright-line" rule articulated in *National Bellas Hess, Inc. v. Department of Revenue,* 386 U.S. 753, 758, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), the *Quill* court held that a use tax is impermissible where the seller's only connection with a particular state is orders placed and merchandise delivered through a common carrier or the United States mail; a seller must have a physical presence in a state to satisfy the commerce clause. *Quill,* 504 U.S. at 301, 112 S.Ct. 1904. As the United States Supreme Court has observed, " ‘ the crucial factor governing nexus is whether the activities performed in [the] state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in [the] state for the sales.’ " *Tyler Pipe Indus., Inc.,* 483 U.S. at 250, 107 S.Ct. 2810 (quoting *974 *Tyler Pipe Indus., Inc. v.*

Washington Dep't of Revenue, 105 Wash.2d 318, 323, 715 P.2d 123 (1986), *overruled on other grounds by Tyler Pipe Indus., Inc.,* 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199). *See also* WAC 458-20-193(2)(f) (adopting the *Tyler Pipe* test for nexus).

[151 Wn.App. 463] ¶ 25 Lamtec's primary argument is that it does not have a substantial nexus with Washington because it does not maintain a physical presence in the state. Relying on *Quill,* it contends that to show substantial nexus, the Department must establish that Lamtec has a physical presence akin to " a small sales force, plant, or office" within the taxing state. Br. of Appellant at 15 (quoting *Quill,* 504 U.S. at 315, 112 S.Ct. 1904).

¶ 26 In *Quill,* the United States Supreme Court determined that, in the context of sales and use taxes, an entity must be physically present in the taxing jurisdiction to establish the constitutional requisite " substantial nexus." *Quill,* 504 U.S. at 311, 112 S.Ct. 1904. Since *Quill,* courts have developed a split in authority as to whether the Supreme Court's holding was limited to sales and use taxes. *See, e.g., A & F Trademark, Inc. v. Tolson,* 167 N.C.App. 150, 605 S.E.2d 187, 193-96 (2004) (holding that North Carolina may impose corporate franchise and income taxes on companies not physically present in North Carolina), *cert. denied,* 546 U.S. 821, 126 S.Ct. 353, 163 L.Ed.2d 62 (2005); *J.C. Penney Nat'l Bank v. Johnson,* 19 S.W.3d 831, 838-39 (Tenn.Ct.App.1999) (holding that Tennessee may not impose franchise and excise tax on a company not physically present in Tennessee), *cert. denied,* 531 U.S. 927, 121 S.Ct. 305, 148 L.Ed.2d 245 (2000).

¶ 27 A close reading of *Quill* reveals that its language supports those courts that have limited *Quill* to cases involving sales and use taxes. Plainly stated, the *Quill* Court did not attempt to equate the substantial nexus requirement with a universal physical presence requirement. *See Quill,* 504 U.S. at 314, 112 S.Ct. 1904 (" [W]e have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes."). On the contrary, the Supreme Court carefully and specifically limited its language to a discussion of sales and use taxes. *See Quill,* 504 U.S. at 316, 112 S.Ct. 1904 (acknowledging the benefits of imposing bright-line rule " in the area of sales and use taxes"). Therefore, the *Quill* language does not support Lamtec's proposition that a physical presence is required to establish substantial nexus [151 Wn.App. 464] in the context of B & O taxes. *See Gen. Motors Corp. v. City of Seattle,* 107 Wash.App. 42, 55, 25 P.3d 1022, *review denied,* 145 Wash.2d 1014, 84 P.3d 1230 (2001), *cert. denied,* 535 U.S. 1056, 122 S.Ct. 1915, 152 L.Ed.2d 825 (2002).

¶ 28 Indeed, Washington case law supports this reading of *Quill.* In *General Motors,* Division One of this court expressly declined to extend the physical presence requirement to the context of B & O taxes. *Gen. Motors,* 107 Wash.App. at 55, 25 P.3d 1022. There, the court affirmed Seattle's imposition of its B & O tax on General Motors and Chrysler Corporation, reasoning that the companies engaged in the business of making wholesale sales within Seattle city limits. Both General Motors and Chrysler received orders for autos and parts via computer and shipped those goods f.o.b. factory via common carrier. *Gen. Motors,* 107 Wash.App. at 46, 25 P.3d 1022. Although neither company engaged in direct selling activities in the city, the court found that the companies' other business activities were intended to maintain a share of the market within Seattle and thus sufficient to subject them to Seattle B & O tax. *Gen. Motors,* 107 Wash.App. at 48, 25 P.3d 1022. The companies' business activities included national advertising directed at Seattle, marketing and selling warranties, sending sales, service, and parts representatives on a monthly basis to visit Seattle dealers, and

requiring dealers to use large, permanent signage. *Gen. Motors,* 107 Wash.App. at 46-47, 25 P.3d 1022.

¶ 29 The Washington State Supreme Court denied review in *General Motors,* but it later expressly approved the *General Motors* reasoning in a subsequent case, *Ford Motor.* The *Ford Motor* court affirmed B & O taxes imposed on Ford by Seattle and Tacoma. It rejected Ford's argument that the B & O tax was inappropriate since it did 975 not engage in *975 any direct selling in the cities. *Ford Motor,* 160 Wash.2d at 44-45, 156 P.3d 185.[6]

[6] Ford did not challenge that its activities within the cities satisfied the substantial nexus prong of Complete Auto Transit test; thus, the Ford court did not reach that issue. Ford Motor, 160 Wash.2d at 49, 156 P.3d 185.

¶ 30 Moreover, the United States Supreme Court approved Washington's substantial nexus analysis in [151 Wn.App. 465] *Tyler Pipe. See Tyler Pipe,* 483 U.S. at 251, 107 S.Ct. 2810. Writing for the majority, Justice Stevens held that Tyler Pipe had a sufficient nexus with Washington because Tyler's " ‘ sales representatives perform[ed] any local activities necessary for maintenance of Tyler Pipe's market and protection of its interests.’ " *Tyler Pipe,* 483 U.S. at 251, 107 S.Ct. 2810 (quoting *Tyler Pipe,* 105 Wash.2d at 321, 715 P.2d 123). In other words, the business activities performed on Tyler's behalf in Washington were " significantly associated with [its] ability to establish and maintain a market in this state for the sales." *Tyler Pipe,* 483 U.S. at 250, 107 S.Ct. 2810 (quoting *Tyler Pipe,* 105 Wash.2d at 323, 715 P.2d 123).

¶ 31 Here, Lamtec's business activities in Washington significantly contributed to its ability to establish and maintain its market in the state. Given Lamtec's business strategy-maintaining long-term relationships with a small number of customers-its in-person customer visits were critical to maintaining its existing Washington customers. And, as the Department suggests, when one is maintaining a customer relationship, it is establishing its market for future sales. While in Washington, Lamtec employees provided information, listened to concerns about and answered questions concerning Lamtec products, participated in telephone calls that the customers placed to Lamtec's technical and customer service departments in New Jersey, fielded questions concerning potential price increases and new products, and maintained general client relations.

¶ 32 Lamtec's distinction that its employees solicited no sales during their visits to Washington is of no consequence. *See Tyler Pipe,* 483 U.S. at 249, 107 S.Ct. 2810; *Gen. Motors,* 107 Wash.App. at 52, 25 P.3d 1022 (stating that substantial nexus has never turned on whether an out-of-state company engages in direct selling activities); *see also Orvis Co. v. Tax Appeals Tribunal of New York,* 86 N.Y.2d 165, 630 N.Y.S.2d 680, 654 N.E.2d 954, *cert. denied sub nom. Vermont Information Processing, Inc. v. Dep't of Taxation and Finance,* 516 U.S. 989, 116 S.Ct. 518, 133 L.Ed.2d 426 (1995) (holding that there is no requirement under *Quill* and commerce clause jurisprudence requiring that an out-of-state company's sales representative be engaged in solicitation of sales or in sales transactions to satisfy the [151 Wn.App. 466] substantial nexus requirement). Likewise, Lamtec's distinction that it has no permanent employees in Washington is of no consequence. The test is whether Lamtec's in-state activities were significantly associated with its ability to establish and maintain its market in Washington, not whether it employed people within the state. *See Tyler Pipe,* 483 U.S. at 250, 107 S.Ct. 2810. *See also Orvis,* 86 N.Y.2d at 178, 180, 630 N.Y.S.2d 680, 654 N.E.2d 954 (finding a sufficient nexus based on the " slightest presence" of an out-of-state corporation's out-of-state employees visiting the state as many as 19 wholesale customers an average of four times a year).

¶ 33 Finally, Lamtec's citation to *City of Tacoma v. Fiberchem, Inc.,* 44 Wash.App. 538, 722 P.2d 1357 (1986), *review denied,* 107 Wash.2d 1008 (1986), is misguided. In *Fiberchem* we relied on a state constitutional due process law to resolve the challenged intrastate commerce issues, which did not implicate the federal constitutional commerce clause. *Fiberchem,* 44 Wash.App. at 542, 722 P.2d 1357. Likewise, Lamtec's reliance on *KMS Financial Services, Inc. v. City of Seattle,* 135 Wash.App. 489, 146 P.3d 1195 (2006), *review denied,* 161 Wash.2d 1011, 166 P.3d 1217 (2007), is equally misguided. The issue in *KMS* was whether Seattle's imposition of its B & O tax on KMS was fairly apportioned, sufficient to meet constitutional requirements of the federal commerce clause. *KMS,* 135 Wash.App. at 504, 146 P.3d 1195. The nexus prong of the *Complete Auto* test was not at issue, as it is here. Thus, *KMS* provides no guidance. *976

976 ¶ 34 In sum, based on the undisputed evidence presented, the superior court correctly determined that Lamtec has a substantial nexus with Washington. Its employees' activities within the state are significantly associated with its ability to establish and maintain its market, particularly in light of Lamtec's business model that entails maintaining a small number of high-volume customers long-term. *See Tyler Pipe,* 483 U.S. at 250, 107 S.Ct. 2810.

[151 Wn.App. 467] ¶ 35 Because there are no genuine issues of material fact as to whether Lamtec has a sufficient nexus with Washington, and Lamtec's customers receive Lamtec products in Washington, the trial court properly granted summary dismissal in the Department's favor.

III. Disassociation

¶ 36 Nevertheless, Lamtec contends that even if we find its goods were received in Washington and it has a substantial nexus with Washington, Lamtec's Washington activities are not significantly associated in any way with sales to the state. Thus, it concludes that the Department is barred from imposing B & O taxes under WAC 458-20-193(7)(c). This argument is not convincing.

¶ 37 Lamtec's " disassociation" argument significantly overlaps with its substantial nexus argument. It relies on *Norton Co. v. Illinois Department of Revenue,* 340 U.S. 534, 71 S.Ct. 377, 95 L.Ed. 517 (1951), to support its argument that its activities in Washington were " ‘ not significantly associated in any way with the sales into this state.’ " Br. of Appellant at 19 (quoting WAC 458-20-193(7)(c)).

¶ 38 In *Norton,* the United States Supreme Court articulated the following test:

> [W]hen, as here, the corporation has gone into the State to do local business by state permission and has submitted itself to the taxing power of the State, it can avoid taxation on some [state] sales only by showing that particular transactions are dissociated from the local business and interstate in nature. The general rule, applicable here, is that a taxpayer claiming immunity from tax has the burden of establishing his exemption.

Norton, 340 U.S. at 537, 71 S.Ct. 377. Applying this test to the facts presented here, Lamtec has not met its burden of proving that its transactions within Washington are dissociated from its business. Moreover, Lamtec's argument that *Norton* compels this court to find that its Washington [151 Wn.App. 468] activities were dissociated is not well taken. *Norton* is distinguishable.

¶ 39 In *Norton,* the United States Supreme Court held that only when a nonresident's activities are in no way associated with the business taxed that the business is immune from taxation. *Norton,* 340 U.S. at 537, 71 S.Ct. 377. The Supreme Court found no nexus for orders sent directly to an out-of-state manufacturer, filled there, and shipped directly to the customer, even

though there was a sales office in the taxing state. The Supreme Court reached this conclusion because the taxpayer established a complete absence of any connection between the local office and the interstate sales. *Norton,* 340 U.S. at 539, 71 S.Ct. 377. In other words, for that category of orders where the buyer ordered directly from the company's out-of-state headquarters and the goods were shipped directly to the buyer, the company engaged in no in-state activities associated with those orders. *See Norton,* 340 U.S. at 537-38, 71 S.Ct. 377. There was no customer relationship between the in-state customers and instate operations. *Norton,* 340 U.S. at 538, 71 S.Ct. 377.

¶ 40 This is not the case here. As we discussed above, Lamtec sends its employees to visit Washington to maintain its customers in the state. Lamtec's activities in Washington are not separate and independent from its sales to its Washington customers. Thus, Lamtec has failed to establish that its Washington activities are dissociated from its Washington sales.

¶ 41 Affirmed.

We concur: ARMSTRONG and HUNT, JJ.

There is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities.

This section explains Washington's B & O tax and retail sales tax applications to interstate sales of tangible personal property. It covers the ... inbound sales of goods originating outside this state to persons in this state.

Washington does not assert B & O tax on sales of goods which originate outside this state unless the goods are received by the purchaser in this state and the seller has nexus. There must be both the receipt of the goods in Washington by the purchaser and the seller must have nexus for the B & O tax to apply to a particular sale. The B & O tax will not apply if one of these elements is missing.

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Appendix I

IN THE SUPREME COURT OF THE STATE OF WASHINGTON

LAMTEC CORPORATION, Petitioner, v. DEPARTMENT OF REVENUE, STATE OF WASHINGTON, Respondent.	))))))))))	 No. 83579-9 En Banc Filed January 20, 2011

CHAMBERS, J. — Lamtec Corporation, based in New Jersey, manufactures insulation and vapor barriers. It sells its products nationwide and did more than $1.1 million in business in Washington State each year during the seven years at issue here. Lamtec has no offices or agents permanently in Washington but regularly sends representatives to visit customers. In 2004, the Department of Revenue (Department) determined that Lamtec's Washington sales were subject to Business and Occupation (B&O) tax. Lamtec argues that under the federal commerce clause it had an insufficient nexus to Washington to be subject to the State's B&O tax. Lamtec paid under protest and then filed a refund claim in

superior court. The trial court dismissed Lamtec's action, and the Court of Appeals affirmed. *Lamtec Corp. v. Dep't of Revenue,* 151 Wn. App. 451, 215 P.3d 968 (2009). We affirm the Court of Appeals.

Facts

Lamtec manufactures its products at its facility in New Jersey and has no permanent facilities, office, address, phone number, or employees in Washington. It sells its products wholesale to customers who place orders by telephone. Washington customers ordered over $9 million worth of Lamtec's products from 1997 to 2003. About two or three times a year during the tax period at issue, three Lamtec sales employees visited major customers in Washington. During those visits, the employees did not solicit sales directly, but they answered questions and provided information about Lamtec products. The trial court found that approximately 50-70 such visits occurred during the period at issue, and the purpose of these visits was to maintain Lamtec's Washington market.

In May 2004, the Department requested a statement from Lamtec regarding its Washington business activities. Based on the company's response, the Department required Lamtec to register and submit a Master Business License Application. The company's application listed its estimated gross annual income in the state as "$100,001 and above." Clerk's Papers (CP) at 427. The Department then assessed $45,599.76 in tax, $15,959.94 in penalties, and $9,996.42 in interest.[1]

[1] The Department assessed another $3,621.77 in tax, $949.21 in penalties, and $18.60 in interest for the first two quarters of 2004, but Lamtec has apparently not included these amounts in its petition. *Compare* CP at 63 *with* Pet'r's Suppl. Br. at 16.

Lamtec unsuccessfully petitioned the Department for a correction.[2] Lamtec paid the tax under protest and challenged the tax in Thurston County Superior Court. Both Lamtec and the Department moved for summary judgment. The court granted the Department's motion, finding a substantial nexus between the taxed activities and Washington, and it concluded that the commerce clause does not prevent Washington from imposing the tax. Lamtec unsuccessfully appealed to the Court of Appeals on several issues[3] and petitioned for review only on the substantial nexus question. We granted review. *Lamtec Corp. v. Dep't of Revenue,* 168 Wn.2d 1009, 226 P.3d 782 (2010).

Standards of Review

This case raises questions of law on appeal from summary judgment. Our review is de novo. *Dreiling v. Jain*, 151 Wn.2d 900, 908, 93 P.3d 861 (2004) (citing *Rivett v. City of Tacoma*, 123 Wn.2d 573, 578, 870 P.2d 299 (1994)). We interpret statutes so as to implement the legislature's intent. *Ski Acres, Inc. v. Kittitas County*, 118 Wn.2d 852, 856, 827 P.2d 1000 (1992) (citing *In re Bale*, 63

[2] The ruling does not appear in the record before this court, and we could not find it on the Board of Tax Appeals web site. We accept the characterization of it supplied by the parties.

[3] Among other things, Lamtec argued below that no tax was due because the sales actually took place in New Jersey since the orders were received there and shipped F.O.B. "F.O.B." means "free on board" and implies that risk of loss passes to the purchaser when the common carrier receives the goods. Black's Law Dictionary 737 (9th ed. 2009). The courts below rejected this argument, in large part because the tax code explicitly states that delivery of goods to a common carrier outside the state does not constitute receipt for purposes of the B&O tax unless the carrier has written authorization to inspect and then accept or reject the goods on behalf of the purchaser. No such authorization appears in the record. Verbatim Report of Proceedings at 41; *Lamtec,* 151 Wn. App. at 460 (citing WAC 458-20-193(7)(a)). As Lamtec does not raise the issue in its petition to this court, we do not reach it. RAP 13.7(b).

Wn.2d 83, 86, 385 P.2d 545 (1963)). When its meaning is in doubt, a tax statute "must be construed most strongly against the taxing power and in favor of the taxpayer." *Ski Acres*, 118 Wn.2d at 857 (citing *City of Puyallup v. Pac. Nw. Bell Tel. Co.*, 98 Wn.2d 443, 448, 656 P.2d 1035 (1982)). Taxes are presumed valid. However, while we interpret statutes to give effect to legislative intent and review summary judgments de novo, the taxpayers have the burden of proving they are factually exempt. RCW 82.32.180 ("At trial, the burden shall rest upon the taxpayer to prove that the tax as paid by the taxpayer is incorrect, either in whole or in part, and to establish the correct amount of the tax."); *Gen. Motors Corp. v. Washington*, 377 U.S. 436, 441, 84 S. Ct. 1564, 12 L. Ed. 2d 430 (1964) ("'a taxpayer claiming immunity from a tax has the burden of establishing his exemption.'" (quoting *Norton Co. v. Dep't of Revenue*, 340 U.S. 534, 537, 71 S. Ct. 377, 95 L. Ed. 517 (1951))).

Analysis

Washington imposes a gross receipts tax (B&O tax) "for the act or privilege of engaging in business activities" on "every person that has a substantial nexus with this state." Former RCW 82.04.220 (1961);[4] *see also Ford Motor Co. v. City of Seattle,* 160 Wn.2d 32, 39, 156 P.3d 185 (2007). A tax on an out-of-state

[4] The 2010 legislature rewrote this provision. It currently reads:

> There is levied and collected from every person that has a substantial nexus with this state a tax for the act or privilege of engaging in business activities. The tax is measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be.

Laws of 2010, 1st Spec. Sess., ch. 23, § 102. We do not consider the impact, if any, of the revision to this statute.

corporation must satisfy both the requirements of the due process clause of the Fourteenth Amendment and the commerce clause. *Quill Corp. v. North Dakota*, 504 U.S. 298, 305, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992)). The due process inquiry considers whether the corporation has sufficient contacts with the taxing state such that imposing the tax "does not offend 'traditional notions of fair play and substantial justice.'" *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316, 66 S. Ct. 154, 90 L. Ed. 95 (1945) (quoting *Milliken* v. *Meyer,* 311 U.S. 457, 463, 61 S. Ct. 339, 85 L. Ed. 278 (1940)). Although Lamtec calls our attention to a case where the Court of Appeals struck down a B&O tax assessment on due process grounds, it does not allege such a violation here. Pet'r's Suppl. Br. at 11-16 (citing *City of Tacoma v. Fiberchem, Inc.*, 44 Wn. App. 538, 722 P.2d 1357 (1986)).

Instead, Lamtec argues that the assessment violates the "negative" or "dormant" commerce clause. The dormant commerce clause "prevents state regulation of interstate commercial activity even when Congress has not acted . . . to regulate that activity" but does not "relieve those engaged in interstate commerce from their just share of state tax burden." Black's Law Dictionary 305 (9th ed. 2009); *W. Live Stock v. Bureau of Revenue*, 303 U.S. 250, 254, 58 S. Ct. 546, 82 L. Ed. 823 (1938). Under modern dormant commerce clause jurisprudence, in order for a state to tax an out-of-state corporation, the tax must be (1) "applied to an activity with a substantial nexus with the taxing State," (2) "fairly apportioned," (3) nondiscriminatory with respect to interstate commerce, and (4) "fairly related to the services provided by the State." *Complete Auto Transit, Inc. v. Brady*, 430 U.S.

274, 279, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977); *see also Ford,* 160 Wn.2d at 48-49. Lamtec disputes only whether it has a "substantial nexus" with Washington State.

Lamtec argues that an entity has sufficient nexus with Washington for purposes of the B&O tax only if it has a "physical presence" here and contends that it does not have such a presence. Pet'r's Suppl. Br. at 3 (citing *Nat'l Bellas Hess, Inc. v. Dep't of Revenue*, 386 U.S. 753, 758, 87 S. Ct. 1389, 18 L. Ed. 2d 505 (1967)); *Quill*, 504 U.S. at 309. The Department suggests that this case is not a good vehicle for considering whether physical presence is required because, in its view, Lamtec clearly maintains such a presence and, alternatively, that the physical presence requirement is limited to sales and use taxes and does not apply to the B&O tax. Instead, in the Department's view, a business is subject to Washington's B&O tax if "'the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales.'" Resp'ts' Suppl. Br. at 5 (quoting *Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue*, 483 U.S. 232, 250, 107 S. Ct. 2180, 97 L. Ed. 2d 199 (1987)).

We note that Lamtec and the Department each interprets "physical presence" differently. Lamtec contends that the physical presence test *requires* a "small sales force, plant, or office" in the taxing state. *Quill*, 504 U.S. at 315. Lamtec suggests a "brick and mortar" presence or at least an established sales force within the taxing state is required to establish the requisite nexus. Lamtec effectively urges us to

adopt the "bright-line" physical presence test required for sales and use taxes established by *Bellas Hess*, 386 U.S. at 758, in the mail order context. The Department concedes the company does not have a brick and mortar presence but argues that under *Tyler Pipe,* 483 U.S. at 250, significantly less activity within a state is sufficient to establish a nexus for B&O taxes.

The United States Supreme Court has made clear that an established sales force is *sufficient* to satisfy the nexus requirement. It has not held that an established sales force (or a physical presence) is a *requirement* to establish the requisite nexus. "Whether or not a State may compel a vendor to collect a sales or use tax *may* turn on the presence in the taxing State of a small sales force, plant, or office." *Quill,* 504 U.S. at 315 (emphasis added) (citing *Nat'l Geographic Soc. v. Cal. Bd. of Equalization*, 430 U.S. 551, 97 S. Ct. 1386, 51 L. Ed. 2d 631 (1977) (finding the presence of two small offices sufficient for imposition of a duty to collect sales and use tax even though the activities conducted, soliciting advertising, did not relate directly to the taxed sales)). In *National Geographic*, 430 U.S. at 556, the United States Supreme Court reserved judgment on California's "slightest presence" rule, finding the society's continuous presence "sufficient" for nexus. This language does not establish a "requirement."

Similarly, Lamtec suggests that the United States Supreme Court required "continuous local solicitation" to establish substantial nexus. *Scripto, Inc. v. Carson*, 362 U.S. 207, 211, 80 S. Ct. 619, 4 L. Ed. 2d 660 (1960) (finding the presence of 10 independent contractors sufficient for nexus). The court in the case

cited did in fact base its finding of substantial nexus in part on continuous local solicitation, but does not call it a requirement. *Id*. Lamtec further asserts that, in a similar case, the United States Supreme Court "found that the crucial factor supporting Washington's jurisdiction to impose [B&O] taxes was that the sales representatives' activities, allowing the taxpayer to establish and maintain a market, actually took place in Washington." Pet'r's Suppl. Br. at 16-17 (citing *Tyler Pipe*, 483 U.S. at 250-51).

The Department draws our attention to a number of cases where courts found sufficient presence for substantial nexus based on contacts with the taxing jurisdiction that are similar to those here. *E.g.*, *Standard Pressed Steel Co. v. Dep't of Revenue*, 419 U.S. 560, 562, 95 S. Ct. 706, 42 L. Ed. 2d 719 (1975) (taxpayer's denial of substantial nexus "verges on the frivolous" even though its only continuous presence in the state was one employee who did not solicit or accept orders); *Tyler Pipe*, 483 U.S. at 249-51 (finding substantial nexus where wholesaler's "solicitation of business in Washington is directed by executives who maintain their offices out-of-state and by an independent contractor located in Seattle"); *Orvis Co. v. Tax Appeals Tribunal of N.Y.*, 86 N.Y.2d 165, 180-81, 654 N.E.2d 954 (1995) (finding sufficient physical presence based only on 41 service visits over 3 years). The Department also cites a Washington Board of Tax Appeals opinion finding sufficient presence for purposes of the B&O tax based on even less significant contacts. *Carr Lane Mfg. Co. v. Dep't of Revenue*, No. 54917, 2001 WL 718027 (Wash. Bd. Tax Appeals Jan. 22, 2001). We find these authorities persuasive. A physical presence

in the taxing jurisdiction for purposes of B&O tax can be based on periodic visits.

We note that the United States Supreme Court itself has cast some doubt on the reach of the physical presence test it established in the sales and use context. The *Quill* Court stated that the case establishing the physical presence requirement, *Bellas Hess*, might have been decided differently under contemporary commerce clause jurisprudence and upheld it in the sales and use context largely due to stare decisis and the fact that the mail order industry had relied on it as a "bright line."[5] *Quill*, 504 U.S. at 311, 316-17. The *Quill* Court's main reason for upholding the physical presence requirement for sales and use taxes in the mail-order context was to "firmly establish[] the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduce[] litigation concerning those taxes." *Id.* at 315. The requirement suggested by Lamtec that the presence be "continuous" or

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[5] Some jurists dispute whether the line drawn by the physical presence test is really that "bright." In *Quill*, for example, Justice White pointed out in a separate opinion that

> the question of Quill's actual physical presence is sufficiently close to cast doubt on the majority's confidence that it is propounding a truly "bright-line" rule. Reasonable minds surely can, and will, differ over what showing is required to make out a "physical presence" adequate to justify imposing responsibilities for use tax collection. And given the estimated loss in revenue to States of more than $3.2 billion this year alone . . . it is a sure bet that the vagaries of "physical presence" will be tested to their fullest in our courts.

504 U.S. at 330-31 (White, J., concurring in part and dissenting in part). There has indeed been a great deal of litigation in this area, of which this case is one example. *See generally* Thomas Steele & Kirsten Wolff, *USC Gould School of Law 2009 Tax Institute: The Current State of "Attributional Nexus": When May a State Use the Presence of an In-State Entity to Claim Jurisdiction over an Out-of-State Seller?*, 2009 Emerging Issues 4522 (Nov. 3, 2009); Carol Schutz Vento, *Sufficient Nexus for State To Require Foreign Entity To Collect State's Compensating, Sales, or Use Tax—Post—Complete Auto Transit Cases*, 71 A.L.R.5th 671 (1999).

"constant" would, on the contrary, create considerable uncertainty. Take, for example, a company that relies on nonexclusive independent contractors who are continuously located in the taxing state, but who devote only a small or slight amount of time to the company's projects, or a company with a sales staff that spends a considerable amount of time in the taxing state but is based in a neighboring state. Establishing physical presence in such cases would likely depend on the time and activities conducted within the taxing state.

As New York's high court pointed out in a case almost indistinguishable from this one,

> acceptance of the thesis . . . that *Quill* made the substantial nexus prong of the *Complete Auto* test an in-State substantial physical presence requirement -- would destroy the bright-line rule the Supreme Court in *Quill* thought it was preserving in declining completely to overrule *Bellas Hess*. Inevitably, a *substantial* physical presence test would require a "case-by-case evaluation of the actual burdens imposed" on the individual vendor involving a weighing of factors such as number of local visits, size of local sales offices, intensity of direct solicitations, etc., rather than the clear-cut line of demarcation the Supreme Court sought to keep intact by its decision in *Quill*. Thus, ironically, the interpretation of *Quill* urged by the vendors here would undermine the principal justification the Supreme Court advanced for its decision in that case, the need to provide certainty in application of the standard and with it, repose from controversy and litigation for taxing States and the nearly $200 billion-a-year mail-order industry, with respect to sales and use taxes on interstate transactions.

Orvis, 86 N.Y.2d at 177 (quoting *Quill*, 504 U.S. at 315).[6]

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[6] In terms of its structure and reporting requirements, the B&O tax differs sharply from a sales or use tax: sales and use taxes are stated separately, imposed on a transaction by transaction basis,

There is also extensive language in *Quill* that suggests the physical presence requirement should be restricted to sales and use taxes. *See*, *e.g.*, *Quill*, 504 U.S. at 314 ("[W]e have not, in our review of other types of taxes, articulated the same physical-presence requirement . . . established for sales and use taxes."). Many of our sister courts have refused to apply the physical presence test to other kinds of taxes. *E.g.*, *Geoffrey, Inc. v. Comm'r of Revenue*, 453 Mass. 17, 899 N.E.2d 87, *cert. denied,* 129 S. Ct. 2853 (2009); *Lanco, Inc. v. Dir., Div. of Taxation*, 188 N.J. 380, 908 A.2d 176 (2006); *Tax Comm'r v. MBNA Am. Bank, N.A.*, 220 W.Va. 163, 640 S.E.2d 226 (2006). However, authorities are not unanimous: the Tennessee Court of Appeals has found "no basis for concluding that the analysis" should be different for franchise and excise taxes than for sales and use taxes, although it acknowledged that the *Quill* Court "expressed some reservations" about the requirement. *J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831, 839 (Tenn. Ct. App. 1999). But, as reviewed above, the great weight of authority concurs with the Department.

Even if a brick and mortar physical presence or substantial sales force is not required under due process and the dormant commerce clause, Lamtec urges us to

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and usually involve numerous limitations and exemptions intended to ensure that their burdens fall upon the final purchaser or consumer. By contrast, gross receipts taxes, such as Washington's B&O tax, are calculated quarterly or annually, are aimed at the seller, and seldom involve limitations or exemptions. *See generally* Walter Hellerstein et al., *Commerce Clause Restraints on State Taxation After* Jefferson Lines, 51 Tax L. Rev. 47, 86-93 (1995) (explaining distinctions between gross receipts and sales and use taxes). As a result, compliance with the B&O tax arguably poses much less of a problem for an out-of-state wholesaler than a duty to collect a sales tax does for a mail order catalog company.

adopt such a standard as a matter of policy for clarity sake. There is some appeal to a bright-line test for business taxation. However, we have already largely rejected Lamtec's invitation. We addressed a similar issue in *Tyler Pipe Industries v. Department of Revenue*, 105 Wn.2d 318, 715 P.2d 123 (1986), *vacated in part,* 483 U.S. 232. Tyler Pipe had its principal place of business in Tyler, Texas and distributed cast iron, pressure and plastic pipe, and fittings nationwide. *Id.* at 320. Tyler Pipe did not have a place of business or employees within Washington but utilized independent contractors to perform the function of sales representatives. These agents performed activities within Washington necessary to maintain a market for Tyler Pipe. *Id.* at 320-21. We approved the Department's stated requisite minimal connection of "nexus" in former WAC 458-20-193B (1970), "the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." *Tyler Pipe*, 105 Wn.2d at 323.[7] We concluded that Tyler Pipe had a substantial enough relationship with Washington State to satisfy the nexus requirement, despite the fact that it had "no personnel designated as employees residing in Washington." *Id.* at 321, 327. Instead of employees, Tyler Pipe used independent contractors to represent its interests. *Id.* at 324. We found the difference between employees and independent

[7] Since we decided *Tyler Pipe,* both the statute and the regulation have changed. Laws of 2010, 1st Spec. Sess., ch. 23, § 102; former WAC 458-20-193B, *repealed by* Wash. St. Reg. 91-24-020 (Jan. 1, 1992). The regulation has since become incorporated into WAC 458-20-193. There is no challenge to the current regulation before us, and we do not consider the impact, if any, of the new statute.

contractors to be "without constitutional significance." *Id.* (citing *Scripto,* 362 U.S. at 211). Instead, we looked to the actual activities "by the in-state sales representative which helped Tyler Pipe establish and maintain its market in this state." *Id.* We found the activities were substantial and affirmed the State's authority to impose the tax. *Id.* at 327. Although it reversed on other grounds, the United States Supreme Court affirmed our holding that there was an adequate nexus to support Washington's jurisdiction to tax.

> As the Washington Supreme Court determined, "the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." The court found this standard was satisfied because Tyler's "sales representatives perform any local activities necessary for maintenance of Tyler Pipe's market and protection of its interests . . . ." We agree that the activities of Tyler's sales representatives adequately support the State's jurisdiction to impose its wholesale tax on Tyler.

Tyler Pipe, 483 U.S. at 250-51 (quoting *Tyler Pipe*, 105 Wn.2d at 321, 323). We agree with the Department that the "crucial factor" in this language is that the activities were "significantly associated with the taxpayer's ability to establish and maintain" its market.

We conclude that to the extent there is a physical presence requirement, it can be satisfied by the presence of activities within the state. It does not require a "presence" in the sense of having a brick and mortar address within the state. We do not see a material difference whether the activities are performed by a staff

permanently employed within the state, by independent agents contracted to perform the activity within the state, or persons who travel into the state from without. The activities must be substantial and must be associated with the company's ability to establish and maintain the company's market within the state. The contacts by Lamtec's sales representatives were designed to maintain its relationships with its customers and to maintain its market within Washington State. Nor were the activities slight or incidental to some other purpose or activity. We hold that Lamtec's practice of sending sales representatives to meet with its customers within Washington was significantly associated with its ability to establish and maintain its market.

Conclusion

A B&O tax is a tax on conducting business within the state. Several requirements must be met under the commerce clause before a state may levy such a tax on an out-of-state business. Among other things, there must be a substantial nexus between the taxing state and the activity taxed. *Complete Auto*, 430 U.S. at 279. We find that this case is largely controlled by our decision in *Tyler Pipe*, 105 Wn.2d 318. Although Lamtec did not have a permanent presence within the state, by regularly sending sales representatives into the state to maintain its market, Lamtec satisfied the nexus requirement. We affirm the Court of Appeals and hold that the Department had authority under the commerce clause to impose a B&O tax.

AUTHOR:

Justice Tom Chambers

WE CONCUR:

Chief Justice Barbara A. Madsen	Justice Mary E. Fairhurst
Justice Charles W. Johnson	
	Justice Debra L. Stephens
Justice Susan Owens	

Appendix J

NORFOLK & WESTERN RAILWAY CO. ET AL. v. MISSOURI STATE TAX COMMISSION ET AL.

APPEAL FROM THE SUPREME COURT OF MISSOURI.

No. 324. Argued January 25, 1968.—Decided March 11, 1968.

Appellant N & W, a predominantly coal-carrying railroad with operations centered in the eastern part of the country and which owned no fixed property and only minimal rolling stock in Missouri, leased the property of the Wabash Railroad and became obligated to pay 1965 taxes on fixed property and rolling stock located in Missouri. A state statute prescribes a formula for determining the amount of rolling stock of an interstate railroad that Missouri shall assess for purposes of *ad valorem* taxation. The statute apportions to Missouri a part of the entire value of all rolling stock of an interstate railroad on the ratio of miles operated in Missouri to the railroad's total road mileage. Applying that formula, which resulted in the postulation that N & W's rolling stock in Missouri constituted 8.2824% of its total rolling stock, the Missouri Tax Commission put N & W's rolling stock assessment at $19,981,757. N & W challenged the assessment, which it showed was more than 2½ times the value of N & W's rolling stock in the State on tax day and more than twice Wabash's assessment for practically the same property in the previous year. Neither N & W's rolling stock in Missouri (about 2.71% of N & W's total rolling stock by number of units and 3.16% by value), the overwhelming amount of which had been leased from Wabash, nor the Missouri operations of N & W and Wabash had materially increased in the intervening period. N & W's coal operations require a great deal of specialized equipment, scarcely any of which enters Missouri, and traffic density on Missouri tracks is but 54% of traffic density on the N & W system as a whole. The Tax Commission's assessment against N & W was affirmed on appeal. The Missouri Supreme Court held that use of the mileage formula could be justified on the theory that the rolling stock regularly employed in one State has an "enhanced

value" when connected to "an integrated operational whole." *Held:*

1. Application of the mileage formula resulted in an assessment which on the record in this case went far beyond the value of appellants' rolling stock in Missouri and violated the Due Process and Commerce Clauses. Pp. 323-329.

(a) A State may impose a property tax upon its fair share of an interstate transportation enterprise, including a portion of the enterprise's intangible value. Pp. 323-324.

(b) Though a State has considerable latitude in devising formulas to measure tangible property within its borders, it is not entitled to tax tangible or intangible property unconnected with the State. Pp. 324-325.

(c) Appellants' evidence satisfied the burden which rests on a railroad attacking a mileage formula of showing that the formula reached assets outside the State, and Missouri has not countered such evidence here. Pp. 326-327.

(d) Though this Court's decisions recognize the practical difficulties in applying a mileage formula, they forbid an unexplained discrepancy as gross as that here revealed. P. 327.

(e) The record is totally barren of evidence relating to the enhanced value of property in Missouri by reason of the incorporation of such property into the entire N & W system. Pp. 327-329.

2. The Missouri Supreme Court may remand the case to the appropriate tribunal to reopen the record for additional evidence supporting the assessment. P. 330.

426 S. W. 2d 362, vacated and remanded.

William H. Allen argued the cause for appellants. With him on the briefs were *Charles L. Bacon, Frederick Beihl, James E. Carr, Melvin J. Strouse* and *Christopher S. Bond.*

William A. Peterson, Assistant Attorney General of Missouri, argued the cause for appellees. With him on the brief were *Norman H. Anderson,* Attorney General, *Thomas J. Downey,* First Assistant Attorney General, and *Walter W. Nowotny, Jr.,* Assistant Attorney General.

MR. JUSTICE FORTAS delivered the opinion of the Court.

This case brings before us, once again, troublesome problems arising from state taxation of an interstate commercial enterprise. At issue is a tax assessment pursuant to a Missouri statute specifying the manner in which railroad rolling stock is to be assessed for the State's *ad valorem* tax on that property.[1]

In 1964 the Norfolk & Western Railway Co. (N & W), a Virginia corporation with interstate rail operations, leased all of the property of appellant Wabash Railroad Company. The Wabash owned substantial fixed property and rolling stock, and did substantial business in Missouri as well as in other States. Prior to the lease, N & W owned no fixed property and only a minimal amount of rolling stock in Missouri. N & W is primarily a coal-carrying railroad. Much of its equipment and all of its specialized coal-carrying equipment are generally located in the coal regions of Virginia, West Virginia, and Kentucky, and along the coal-ferrying routes from those regions to the eastern seaboard and the Great Lakes. Scarcely any of the specialized equipment ever enters Missouri. According to appellants, the Wabash property in Missouri was leased by N & W in order to diversify its business, not to provide the opportunity for an integrated through movement of traffic.

By the terms of the lease, the N & W became obligated to pay the 1965 taxes on the property of the Wabash in Missouri and elsewhere.[2] Upon receiving notice of the

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[1] The tax in question applies to "all real property . . . [and] tangible personal property . . . owned, hired or leased by any railroad company . . . in this state." Intangible personal property is explicitly exempted from this tax. Mo. Rev. Stat. § 151.010 (1959).

[2] As of January 1, 1966, the N & W purchased the Wabash rolling stock that it had previously leased, while continuing to lease Wabash fixed property. This change in the relationship between N & W and the Wabash has no effect on the issues presented to us. Our

1965 assessment from the appellee Missouri Tax Commission, the N & W filed a request for an adjustment and hearing before the Commission. The hearing was held, and the Commission sustained its assessment against the taxpayer's challenge. On judicial review, the Commission's decision was affirmed without opinion by the Circuit Court of Cole County, and then by the Supreme Court of Missouri. Appellants filed an appeal in this Court, contending that the assessment in effect reached property not located in Missouri and thus violated the Due Process Clause and the Commerce Clause of the United States Constitution. We noted probable jurisdiction. 389 U. S. 810 (1967).

I.

The Missouri property taxable to the N & W was assessed by the State Tax Commission at $31,298,939. Of this sum, $12,177,597 relates to fixed property within the State, an assessment that is not challenged by appellants. Their attack is aimed only at that portion of the assessment relating to rolling stock, $19,981,757.[3]

With respect to the assessment of rolling stock, the Commission used the familiar mileage formula authorized by the Missouri statute. In relevant part, this provides (§ 151.060 subd. 3):

> ". . . when any railroad shall extend beyond the limits of this state and into another state in which a tax is levied and paid on the rolling stock of such road, then the said commission shall assess, equalize

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analysis would apply both before and after the purchase of the Wabash rolling stock.

[3] The Commission deducted from the sum of these two figures $860,415, representing an "economic factor" which is allowed to all railroads in varying amounts. Exactly the same deduction had been allowed the Wabash in each of the three preceding years.

> and adjust only such proportion of the total value of all the rolling stock of such railroad company as the number of miles of such road in this state bears to the total length of the road as owned or controlled by such company."

The Commission arrived at the assessment of rolling stock by first determining the value of all rolling stock, regardless of where located, owned or leased by the N & W as of the tax day, January 1, 1965. Value was ascertained by totaling the original cost, less accrued depreciation at 5% a year up to 75% of cost, of each locomotive, car, and other piece of mobile equipment. To the total value, $513,309,877, was applied an "equalizing factor" of 47%, employed in assessing all railroad property in an attempt to bring such assessments down to the level of other property assessments in Missouri. The Commission next found that 8.2824% of all the main and branch line road (excluding secondary and side tracks) owned, leased, or controlled by the N & W was situated in Missouri. This percentage was applied to the equalized value of all N & W rolling stock, and the resulting figure was $19,981,757.

There is no suggestion in this case that the Commission failed to follow the literal command of the statute. The problem arises because of appellants' contention that, in mechanically applying the statutory formula, the Commission here arrived at an unconscionable and unconstitutional result. It is their submission that the assessment was so far out of line with the actual facts of record with respect to the value of taxable rolling stock in the State as to amount to an unconstitutional attempt to exercise state taxing power on out-of-state property.

Appellants submitted evidence based upon an inventory of all N & W rolling stock that was actually in Missouri on tax day. The equalized value of this rolling

stock, calculated on the same cost-less-depreciation basis employed by the Commission, was approximately $7,600,000, as compared with the assessed value of $19,981,000. Appellants also submitted evidence to show that the tax-day inventory was not unusual. The evidence showed that, both before and in the months immediately after the Wabash lease, the equalized value of the N & W rolling stock actually in Missouri never ranged far above the $7,600,000 figure. In the preceding year, 1964, the rolling stock assessment against the Wabash was only $9,177,683, and appellants demonstrated that neither the amount of rolling stock in Missouri nor the Missouri operations of the N & W and Wabash had materially increased in the intervening period.[4] The assessment of the fixed properties (for which no mileage formula was applied) hardly increased between 1964 and 1965. In 1964, prior to the lease, the fixed properties in Missouri were assessed at $12,092,594; in 1965, after the lease, the assessment was $12,177,597.

The Supreme Court of Missouri concluded that the result reached by the Commission was justifiable. It pointed out that the statutory method used by the Commission proceeds on the assumption that "rolling stock is substantially evenly divided throughout the railroad's entire system, and the percentage of all units which are located in Missouri at any given time, or for any given period of time, will be substantially the same as the percentage of all the miles of road of the railroad located in Missouri." It then held that the evaluation found by the Commission could be justified on the theory of "enhance-

[4] Appellants further argue that the arbitrariness of the result reached here is shown by the fact that if the rolling stock in Missouri had been taxable to the Wabash in 1965, rather than to N & W, the application of the formula to the same rolling stock would have resulted in an assessment of little more than half of that which was actually levied ($10,103,340).

ment," although the Commission had not referred to that principle. The court described the theory as follows:

> "The theory underlying such method of assessment is that rolling stock regularly employed in one state has an enhanced or augmented value when it is connected to, and because of its connection with, an integrated operational whole and may, therefore, be taxed according to its value 'as part of the system, although the other parts be outside the State;—in other words, the tax may be made to cover the enhanced value which comes to the property in the State through its organic relation to the system.' *Pullman Co.* v. *Richardson,* 261 U. S. 330, 338."

The court correctly noted, however, that "even if the validity of such methods be conceded, the results, to be valid, must be free of excessiveness and discrimination." It concluded that in the present case, the result reached by the Commission was justifiable. We disagree. In our opinion, the assessment violates the Due Process and Commerce Clauses of the Constitution.

II.

Established principles are not lacking in this much discussed area of the law. It is of course settled that a State may impose a property tax upon its fair share of an interstate transportation enterprise. *Marye* v. *Baltimore & Ohio R. Co.,* 127 U. S. 117, 123–124 (1888); *Pullman's Palace Car Co.* v. *Pennsylvania,* 141 U. S. 18 (1891); *Ott* v. *Mississippi Valley Barge Line Co.,* 336 U. S. 169 (1949); *Braniff Airways, Inc.* v. *Nebraska State Board of Equalization and Assessment,* 347 U. S. 590 (1954). That fair share may be regarded as the value, appropriately ascertained, of tangible assets permanently or habitually employed in the taxing State, including a portion of the intangible, or "going-concern," value of

the enterprise. *Railway Express Agency* v. *Virginia,* 347 U. S. 359, 364 (1954); *Cudahy Packing Co.* v. *Minnesota,* 246 U. S. 450, 455 (1918); *Adams Express Co.* v. *Ohio State Auditor,* 166 U. S. 185, 218–225 (1897). The value may be ascertained by reference to the total system of which the intrastate assets are a part. As the Court has stated the rule, "the tax may be made to cover the enhanced value which comes to the [tangible] property in the State through its organic relation to the [interstate] system." *Pullman Co.* v. *Richardson,* 261 U. S. 330, 338 (1923). Going-concern value, of course, is an elusive concept not susceptible of exact measurement. *Rowley* v. *Chicago & N. W. R. Co.,* 293 U. S. 102, 109 (1934); *Nashville, C. & St. L. R. Co.* v. *Browning,* 310 U. S. 362, 365–366 (1940). As a consequence, the States have been permitted considerable latitude in devising formulas to measure the value of tangible property located within their borders. *Union Tank Line Co.* v. *Wright,* 249 U. S. 275, 282 (1919). Such formulas usually involve a determination of the percentage of the taxpayer's tangible assets situated in the taxing State and the application of this percentage to a figure representing the total going-concern value of the enterprise. See, *e. g., Rowley* v. *Chicago & N. W. R. Co.,* 293 U. S. 102 (1934); *Pittsburgh, C., C. & St. L. R. Co.* v. *Backus,* 154 U. S. 421 (1894). A number of such formulas have been sustained by the Court, even though it could not be demonstrated that the results they yielded were precise evaluations of assets located within the taxing State. See, *e. g., Nashville, C. & St. L. R. Co.* v. *Browning,* 310 U. S. 362, 365–366 (1940).

On the other hand, the Court has insisted for many years that a State is not entitled to tax tangible or intangible property that is unconnected with the State. *The Delaware Railroad Tax,* 18 Wall. 206, 229 (1874); *Fargo* v. *Hart,* 193 U. S. 490, 499 (1904). In some cases

the Court has concluded that States have, in fact, cast their tax burden upon property located beyond their borders. *Fargo* v. *Hart,* 193 U. S. 490, 499–503 (1904); *Union Tank Line Co.* v. *Wright,* 249 U. S. 275, 283–286 (1919); *Wallace* v. *Hines,* 253 U. S. 66, 69–70 (1920); *Southern R. Co.* v. *Kentucky,* 274 U. S. 76, 81–84 (1927). The taxation of property not located in the taxing State is constitutionally invalid, both because it imposes an illegitimate restraint on interstate commerce and because it denies to the taxpayer the process that is his due.[5] A State will not be permitted, under the shelter of an imprecise allocation formula or by ignoring the peculiarities of a given enterprise, to "project the taxing power of the state plainly beyond its borders." *Nashville, C. & St. L. R. Co.* v. *Browning,* 310 U. S. 362, 365 (1940). Any formula used must bear a rational relationship, both on its face and in its application, to property values connected with the taxing State. *Fargo* v. *Hart,* 193 U. S. 490, 499–500 (1904).[6]

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[5] We have said: "The problem under the Commerce Clause is to determine 'what portion of an interstate organism may appropriately be attributed to each of the various states in which it functions.' *Nashville, C. & St. L. R. Co.* v. *Browning,* 310 U. S. 362, 365. So far as due process is concerned the only question is whether the tax in practical operation has relation to opportunities, benefits, or protection conferred or afforded by the taxing State. See *Wisconsin* v. *J. C. Penney Co.,* 311 U. S. 435, 444. Those requirements are satisfied if the tax is fairly apportioned to the commerce carried on within the State." *Ott* v. *Mississippi Valley Barge Line Co.,* 336 U. S. 169, 174 (1949). Neither appellants nor appellees contend that these two analyses bear different implications insofar as our present case is concerned.

[6] As the Court stated in *Wallace* v. *Hines,* 253 U. S., at 69: "The only reason for allowing a State to look beyond its borders when it taxes the property of foreign corporations is that it may get the true value of the things within it, when they are part of an organic system of wide extent, that gives them a value above what they otherwise would possess. The purpose is not . . . to

III.

Applying these principles to the facts of the case now before us, we conclude that Missouri's assessment of N & W's rolling stock cannot be sustained. This Court has, in various contexts, permitted mileage formulas as a basis for taxation. See, *e. g., Pittsburgh, C., C. & St. L. R. Co.* v. *Backus,* 154 U. S. 421 (1894). A railroad challenging the result reached by the application of such a formula has a heavy burden. See *Butler Brothers* v. *McColgan,* 315 U. S. 501, 507 (1942); *Norfolk & Western R. Co.* v. *North Carolina,* 297 U. S. 682, 688 (1936). It is confronted by the vastness of the State's taxing power and the latitude that the exercise of that power must be given before it encounters constitutional restraints. Its task is to show that application of the mileage method in its case has resulted in such gross overreaching, beyond the values represented by the intrastate assets purported to be taxed, as to violate the Due Process and Commerce Clauses of the Constitution. Cf. *Capitol Greyhound Lines* v. *Brice,* 339 U. S. 542, 547 (1950). But here the appellants have borne that burden, and the State has made no effort to offset the convincing case that they have made.

Here, the record shows that rigid application of the mileage formula led to a grossly distorted result. The rolling stock in Missouri was assessed to N & W at $19,981,757. It was practically the same property that had been assessed the preceding year at $9,177,683 to the Wabash. Appellants introduced evidence of the results of an actual count of the rolling stock in Missouri.

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open to taxation what is not within the State. Therefore no property of . . . an interstate road situated elsewhere can be taken into account unless it can be seen in some plain and fairly intelligible way that it adds to the value of the road and the rights exercised in the State."

On the basis of this actual count, the equalized assessment would have been less than half of the value assessed by the State Commission. The Commission's mileage formula resulted in postulating that N & W's rolling stock in Missouri constituted 8.2824% of its rolling stock. But appellants showed that the rolling stock usually employed in the State comprised only about 2.71% by number of units (and only 3.16% by cost-less-depreciation value) of the total N & W fleet.

Our decisions recognize the practical difficulties involved and do not require any close correspondence between the result of computations using the mileage formula and the value of property actually located in the State, but our cases certainly forbid an unexplained discrepancy as gross as that in this case.[7] Such discrepancy certainly means that the impact of the state tax is not confined to intrastate property even within the broad tolerance permitted. The facts of life do not neatly lend themselves to the niceties of constitutionalism; but neither does the Constitution tolerate any result, however distorted, just because it is the product of a convenient mathematical formula which, in most situations, may produce a tolerable product.

The basic difficulty here is that the record is totally barren of any evidence relating to enhancement or to going-concern or intangible value, or to any other factor which might offset the devastating effect of the demonstrated discrepancy. The Missouri Supreme Court attempted to justify the result by reference to "en-

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[7] "[I]f the ratio of the value of the property in [the State] to the value of the whole property of the company be less than that which the length of the road in [the State] bears to its entire length, . . . a tax imposed upon the property in [the State] according to the ratio of the length of its road to the length of the whole road must necessarily fall upon property out of the State." *The Delaware Railroad Tax,* 18 Wall. 206, 230–231 (1874).

hanced" value, but the Missouri Commission made no effort to show such value or to measure the extent to which it might be attributed to the rolling stock in the State. In fact, N & W showed that it is chiefly a coal-carrying railroad, 70% of whose 1964 revenue was derived from coal traffic. It demonstrated that its coal operations require a great deal of specialized equipment, scarcely any of which ever enters Missouri. It showed that traffic density on its Missouri tracks was only 54% of traffic density on the N & W system as a whole. Finally, it proved that the overwhelming majority of its rolling stock regularly present in Missouri was rolling stock it had leased from the Wabash. As long ago as *Pittsburgh, C., C. & St. L. R. Co.* v. *Backus,* 154 U. S. 421 (1894), we indicated that an otherwise valid mileage formula might not be validly applied to ascertain the value of tangible assets within the taxing State in exceptional situations, for example, "where in certain localities the company is engaged in a particular kind of business requiring for sole use in such localities an extra amount of rolling stock." *Id.,* at 431.

The Missouri Supreme Court did not challenge the factual data submitted by the N & W. Its decision that these data did not place this case within the realm of "exceptional situations" recognized by this Court was apparently based on the conclusion that the lease transaction between Wabash and the N & W had increased the value of tangible assets formerly belonging to the two separate lines. This may be true, but it does not follow that the Constitution permits us, without evidence as to the amount of enhancement that may be assumed, to bridge the chasm between the formula and the facts of record. The difference between the assessed value and the actual value as shown by the evidence to which we have referred is too great to be explained by the mere assertion, without more, that it is due to an assumed and

nonparticularized increase in intangible value. See *Wallace* v. *Hines,* 253 U. S. 66, 69 (1920).

As the Court recognized in *Fargo* v. *Hart,* 193 U. S. 490, 499–500 (1904), care must be exercised lest the mileage formula

> "be made a means of unlawfully taxing the privilege, or property outside the State, under the name of enhanced value or good will, if it is not closely confined to its true meaning. So long as it fairly may be assumed that the different parts of a line are about equal in value a division by mileage is justifiable. But it is recognized in the cases that if for instance a railroad company had terminals in one State equal in value to all the rest of the line through another, the latter State could not make use of the unity of the road to equalize the value of every mile. That would be taxing property outside of the State under a pretense."

We repeat that it is not necessary that a State demonstrate that its use of the mileage formula has resulted in an exact measure of value. But when a taxpayer comes forward with strong evidence tending to prove that the mileage formula will yield a grossly distorted result in its particular case, the State is obliged to counter that evidence or to make the accommodations necessary to assure that its taxing power is confined to its constitutional limits. If it fails to do so and if the record shows that the taxpayer has sustained the burden of proof to show that the tax is so excessive as to burden interstate commerce, the taxpayer must prevail.

IV.

Accordingly, we conclude that, on the present record, Missouri has in this case exceeded the limits of her constitutional power to tax, as defined by the Due Process

and Commerce Clauses. It will be open to the Missouri Supreme Court, so far as our action today is concerned, to remand the case to the appropriate tribunal to reopen the record for additional evidence to support the assessment. We vacate the judgment of the Supreme Court of Missouri and remand the cause to it for further proceedings not inconsistent with our decision.

Vacated and remanded.

MR. JUSTICE BLACK, dissenting.

It is established law, as the Court apparently recognizes in its opinion, that an interstate company challenging a state apportionment of the company's property taxable in the State has the heavy burden of proving by "clear and cogent evidence" that the apportionment is grossly and flagrantly excessive. See, *e. g., Railway Express Agency* v. *Virginia,* 358 U. S. 434, 444, and cases cited. I agree with the Supreme Court of Missouri that appellant railroad failed to meet that burden and would therefore affirm its judgment. See its opinion at 426 S. W. 2d 362.

It is true that most of the cars used in Missouri by N & W were owned by the Wabash Railroad and that before transfer to N & W they had been assessed at $9,177,683 as against the assessment here of $19,981,757. But this, of course, does not prove that the higher assessment was too much. For, as the Supreme Court of Missouri pointed out, this Court has held that "a mere increase in the assessment does not prove that the last assessment is wrong. Something more is necessary before it can be adjudged that the assessment is illegal and excessive . . . ." *Pittsburgh, C., C. & St. L. R. Co.* v. *Backus,* 154 U. S. 421, 432. The court below held, and this Court agrees, that in pricing the value of the rolling stock the Commission was authorized to consider

intangible values, such as goodwill and values added because of the enhancement to the property in Missouri brought about by being merged into the entire N & W system. This consideration of enhanced value is not new (see, *e. g., Pullman Co.* v. *Richardson,* 261 U. S. 330, 338), and, as the Court points out, it is because of this intangible factor of enhancement that States are allowed wide discretion in determining the value of tangible property located within their borders. Thus, mileage formulas, such as the one used here, have generally been upheld. As this Court said in *Nashville, C. & St. L. R. Co.* v. *Browning,* 310 U. S. 362, "In basing its apportionment on mileage, the Tennessee Commission adopted a familiar and frequently sanctioned formula [cases cited]." 310 U. S., at 365. It has never been contended that mileage formulas are completely accurate, but because States must consider such intangibles as enhancement value, these formulas are allowed except where the taxpayer can show, as the Court puts it, "that application of the mileage method in its case has resulted in such gross overreaching, beyond the values represented by the intrastate assets purported to be taxed, as to violate the Due Process and Commerce Clauses of the Constitution." I do not believe that appellants have made such a showing here. The fatal flaw with the appellants' case is that they have not proved that the tax is excessive when possible enhancement of value due to the merger is considered. The Court's opinion admits as much when it says that "the record is totally barren of any evidence relating to enhancement or to going-concern or intangible value, or to any other factor . . . ." Where I differ with the Court is that I believe the burden of proof is on the railroad to show that the tax is excessive under all considerations rather than on the Commission to show sufficient enhancement of value to justify the tax.

This Court has recognized before, and indeed the majority pays lip service to the fact today, that it is impossible for a State to develop tax statutes with mathematical perfection. Indeed, as was stated in *International Harvester Co.* v. *Evatt,* 329 U. S. 416: "Unless a palpably disproportionate result comes from an apportionment, a result which makes it patent that the tax is levied upon interstate commerce rather than upon an intrastate privilege, this Court has not been willing to nullify honest state efforts to make apportionments." 329 U. S., at 422–423. And the "burden is on the taxpayer to make oppression manifest by clear and cogent evidence." *Norfolk & Western R. Co.* v. *North Carolina,* 297 U. S. 682, 688. Since appellants here did not prove that the *enhanced value** of the rolling stock was less than the tax assessment, or that the State was imposing on N & W taxes that were exorbitant on the full value of all its property, cf. *Capitol Greyhound Lines* v. *Brice,* 339 U. S. 542, I would affirm the decision of the Missouri Supreme Court.

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*This is a familiar principle of valuation in such tax cases. See *Fargo* v. *Hart,* 193 U. S. 490, 499; *Galveston, H. & S. A. R. Co.* v. *Texas,* 210 U. S. 217, 225; *United States Express Co.* v. *Minnesota,* 223 U. S. 335, 347; *Union Tank Line Co.* v. *Wright,* 249 U. S. 275, 282.

Appendix K

NORTON COMPANY *v.* DEPARTMENT OF REVENUE OF ILLINOIS.

CERTIORARI TO THE SUPREME COURT OF ILLINOIS.

No. 133. Argued December 6, 1950.—Decided February 26, 1951.

Under the Illinois Retailers' Occupation Tax Act of June 28, 1933, Illinois levied a tax on the gross receipts from all sales to persons in Illinois by petitioner, a Massachusetts corporation with its factory and head office in Massachusetts and a branch office in Chicago. At petitioner's head office are its general management, accounting, and credit offices, where it accepts all direct mail orders and orders forwarded by its Chicago office. The Chicago office makes local sales at retail from a limited inventory carried there, receives orders and forwards them to the head office for action there, and acts as an intermediary to reduce freight charges on goods shipped from the head office. The Supreme Court of Illinois found that the presence of petitioner's local retail outlet, in the circumstances of this case, was sufficient to attribute all income derived from Illinois sales to that outlet and render it taxable. *Held:* The tax is sustained on all sales to Illinois customers, except on orders sent directly by the customers to the head office and shipped directly to the customers from the head office. Pp. 535–539.

1. When a foreign corporation has gone into a state to do local business by state permission and has submitted itself to the taxing power of the state, it can avoid taxation on some sales to persons in that state only by sustaining the burden of showing that particular transactions are disassociated from the local business and interstate in nature. P. 537.

2. By submitting itself to the taxing power of the state, it likewise submits itself to the state's judicial power to construe and apply its tax laws, insofar as it keeps within constitutional bounds. P. 538.

3. In the light of all the evidence, the judgment of the Illinois court attributing to petitioner's Chicago branch income from all sales that utilized it either in receiving the orders or distributing the goods was within the realm of permissible judgment. Pp. 538–539.

4. The only transactions here involved that are so clearly interstate in character that the State could not reasonably attribute their proceeds to the local business are orders sent directly to its

head office by the customers and shipped directly to the customers from the head office; and such transactions are not subject to this tax. P. 539.

405 Ill. 314, 90 N. E. 2d 737, judgment vacated and remanded.

The Supreme Court of Illinois sustained a state tax on the gross receipts from all sales by petitioner to persons in Illinois. 405 Ill. 314, 90 N. E. 2d 737. This Court granted certiorari. 340 U. S. 807. *Judgment vacated and cause remanded,* p. 539.

Joseph B. Brennan argued the cause for petitioner. With him on the brief were *Roland Towle, Mac Asbill* and *W. A. Sutherland.*

William C. Wines, Assistant Attorney General of Illinois, argued the cause for respondent. With him on the brief were *Ivan A. Elliott,* Attorney General, and *Raymond S. Sarnow* and *James C. Murray,* Assistant Attorneys General.

MR. JUSTICE JACKSON delivered the opinion of the Court.

Petitioner, a Massachusetts corporation, manufactures and sells abrasive machines and supplies. Under consent from the State of Illinois to do business therein, it operates a branch office and warehouse in Chicago from which it makes local sales at retail. These sales admittedly subject it to an Illinois Occupation Tax "upon persons engaged in the business of selling tangible personal property at retail in this State." The base for computation of the tax is gross receipts. Ill. Rev. Stat., 1949, c. 120, § 441.

Not all of petitioner's sales to Illinois customers are over-the-counter, but the State has collected, under protest, the tax on the entire gross income of this company from sales to its inhabitants. The statute specifically exempts "business in interstate commerce" as required

by the Constitution, and the question is whether the State has exceeded the constitutional range of its taxing power by taxing all of petitioner's Illinois derived income.

In Worcester, Massachusetts, petitioner manufactures some 225,000 items, 18,000 of which it usually carries in stock. There are its general management, accounting, and credit offices, where it accepts or rejects all direct mail orders and orders forwarded by its Chicago office. If an order calls for specially built machines, it is there studied and accepted or rejected. Orders are filled by shipment f. o. b. Worcester either directly to the customer or via the Chicago office.

The Chicago place of business performs several functions. It carries an inventory of about 3,000 most frequently purchased items. From these it serves cash customers and those whose credit the home office has approved, by consummating direct sales. Income from these sales petitioner admits to be constitutionally taxable. But this office also performs useful functions for other classes of customers. For those of no established credit, those who order items not in local stock, and those who want special equipment, it receives their order and forwards it to the home office for action there. For many of these Illinois customers it also acts as an intermediary to reduce freight charges. Worcester packages and marks each customer's goods but accumulates them until a carload lot can be consigned to the Chicago office. Chicago breaks the carload and reconsigns the separate orders in their original package to customers. The Chicago office thus intervenes between vendor and Illinois vendees and performs service helpful to petitioner's competition for that trade in all Illinois sales except when the buyer orders directly from Worcester, and the goods are shipped from there directly to the buyer.

The Illinois Supreme Court recognized that it was dealing with interstate commerce. It reiterated its former

holdings "that there could be no tax on solicitation of orders only" in the State.[1] But no solicitors work the territory out of either the home office or the Chicago branch, although petitioner will supply engineering and technical advice. The Illinois court held that the presence of petitioner's local retail outlet, in the circumstances of this case, was sufficient to attribute all income derived from Illinois sales to that outlet and render it all taxable.

Where a corporation chooses to stay at home in all respects except to send abroad advertising or drummers to solicit orders which are sent directly to the home office for acceptance, filling, and delivery back to the buyer, it is obvious that the State of the buyer has no local grip on the seller. Unless some local incident occurs sufficient to bring the transaction within its taxing power, the vendor is not taxable. *McLeod* v. *Dilworth Co.*, 322 U. S. 327. Of course, a state imposing a sales or use tax can more easily meet this burden, because the impact of those taxes is on the local buyer or user. Cases involving them are not controlling here, for this tax falls on the vendor.[2]

But when, as here, the corporation has gone into the State to do local business by state permission and has submitted itself to the taxing power of the State, it can avoid taxation on some Illinois sales only by showing that particular transactions are dissociated from the local business and interstate in nature. The general rule, applicable here, is that a taxpayer claiming immunity from a tax has the burden of establishing his exemption.[3]

This burden is never met merely by showing a fair difference of opinion which as an original matter might be

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[1] 405 Ill. 314, 320, 90 N. E. 2d 737, 741.

[2] Cf. *Nelson* v. *Montgomery Ward & Co.*, 312 U. S. 373; *Nelson* v. *Sears, Roebuck & Co.*, 312 U. S. 359; *McGoldrick* v. *Berwind-White Co.*, 309 U. S. 33; *McLeod* v. *Dilworth Co.*, *supra.*

[3] *Compãnia General* v. *Collector*, 279 U. S. 306, 310; *New York ex rel. Cohn* v. *Graves*, 300 U. S. 308, 316.

decided differently. This corporation, by submitting itself to the taxing power of Illinois, likewise submitted itself to its judicial power to construe and apply its taxing statute insofar as it keeps within constitutional bounds. Of course, in constitutional cases, we have power to examine the whole record to arrive at an independent judgment as to whether constitutional rights have been invaded, but that does not mean that we will re-examine, as a court of first instance, findings of fact supported by substantial evidence.[4]

This corporation has so mingled taxable business with that which it contends is not taxable that it requires administrative and judicial judgment to separate the two. We conclude that, in the light of all the evidence, the judgment attributing to the Chicago branch income from all sales that utilized it either in receiving the orders or distributing the goods was within the realm of permissible judgment. Petitioner has not established that such services as were rendered by the Chicago office were not decisive factors in establishing and holding this market. On this record, no other source of the customer relationship is shown.

This corporation could have approached the Illinois market through solicitors only and it would have been entitled to the immunity of interstate commerce as set out in the *Dilworth* case. But, from a competitive point of view, that system has disadvantages. The trade may view the seller as remote and inaccessible. He cannot be reached with process of local courts for breach of contract, or for service if the goods are defective or in need of replacement. Petitioner elected to localize itself in the Illinois market with the advantages of a retail outlet in the State, to keep close to the trade, to supply

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[4] *Merchants' National Bank* v. *Richmond,* 256 U. S. 635, 638; *Carlson* v. *Curtiss,* 234 U. S. 103, 106.

locally many items and take orders for others, and to reduce freight costs to local consumers. Although the concern does not, by engaging in business within the State, lose its right to do interstate business with tax immunity, *Cooney* v. *Mountain States Telegraph Co.,* 294 U. S. 384, it cannot channel business through a local outlet to gain the advantage of a local business and also hold the immunities of an interstate business.

The only items that are so clearly interstate in character that the State could not reasonably attribute their proceeds to the local business are orders sent directly to Worcester by the customer and shipped directly to the customer from Worcester. Income from those we think was not subject to this tax.

The judgment below is vacated and the cause remanded for further proceedings not inconsistent herewith.

It is so ordered.

MR. JUSTICE REED, dissenting in part.

MR. JUSTICE REED concurs with the Court's opinion and judgment except as it permits Illinois to use as a base for the tax computation petitioner's sales, consummated in Massachusetts by the acceptance of orders forwarded to petitioner there by its Illinois branch office, filled in Massachusetts, and shipped from Massachusetts directly, and not by transhipment through the Illinois branch, to the buyer. In those sales title passes to buyer in Massachusetts. Illinois concedes in its brief the above facts as to this class of sales. From those facts I conclude that, nothing else appearing, the shipment was at the buyer's cost and risk.

The Illinois statute recognizes that interstate business is not to be taxed. The transactions described above are interstate business.

The pull to permit each state to measure its tax by gross receipts from all sales with some slight relation to the taxing state is strong. The Constitution, however, puts the regulation of interstate commerce in the hands of the Federal Government. We have gone far in interpretation of the Constitution to allow a state to collect tax money, but in view of the delegation to the Federal Government of the power over commerce carried on in more than one state, we should preserve interstate commerce itself from taxes levied on it directly or on the unapportioned gross receipts of that commerce. *Greyhound Lines* v. *Mealey,* 334 U. S. 653; *Joseph* v. *Carter & Weekes Stevedoring Co.,* 330 U. S. 422; *Interstate Pipe Line Co.* v. *Stone,* dissent, 337 U. S. 662, 676.

Our closest approach to the tax on the above interstate business was the tax on DuGrenier, Inc., in *McGoldrick* v. *Felt & Tarrant Mfg. Co.,* 309 U. S. 70, 77. Despite marked differences between the DuGrenier transactions and all others considered in *McGoldrick* v. *Berwind-White Co.,* 309 U. S. 33, without analysis of the effect of those differences and in reliance upon the fact that "possession" was transferred in New York from the transportation company to the buyer, we upheld the tax. If by the language used it was meant to say that the seller delivered the goods to the buyer, the transactions were, as we said, "controlled" by *Berwind-White.*

A few years later, however, in *McLeod* v. *Dilworth Co.,* 322 U. S. 327, an opinion in which the writer of the *DuGrenier* opinion, Chief Justice Stone, joined, we made it clear that a tax cannot be collected by the buyer's state on orders solicited in one state, accepted in another, and shipped at the purchaser's risk. That later clarifying holding seems to me to state the true rule applicable here. I can see no difference, constitutionally, between solicitation by salesmen in a branch office or on the road. Such sales, consummated by direct shipment to Illinois buyers

from out of the state are interstate business and free of the tax Illinois has levied. So far as the Supreme Court of Illinois holds those transactions taxable, it should be reversed.

MR. JUSTICE CLARK, dissenting in part.

I believe the respondent reasonably attributed all of the proceeds of petitioner's sales in Illinois to the company's local activities. I therefore agree with the Illinois Supreme Court that under the circumstances shipments sent directly to Illinois customers on orders sent directly to Worcester were subject to the tax.

As the Court points out, petitioner can avoid taxation on its direct sales only "by showing that . . . [they] are dissociated from the local business and [are] interstate in nature. The general rule, applicable here, is that a taxpayer claiming immunity from a tax has the burden of establishing his exemption." Petitioner has failed to meet this burden. In fact Illinois has shown that petitioner's Chicago office is its only source of customer relationship in Illinois; that the Chicago office provides the sole means through which petitioner can be reached with process by Illinois courts in the event a customer is aggrieved; that the local office affords service to machines after sale, as well as replacement of machines which are defective; that it stands ready to receive complaints and to offer engineering and technical advice; and that these multitudinous activities give to petitioner a local character which is most helpful in all its Illinois operations. Surely the Court's conclusion, that "Petitioner has not established that such services as were rendered by the Chicago office were not decisive factors in establishing and holding this market," applies with equal validity to the direct sales.

In maintaining a local establishment of such magnitude, petitioner has adopted the label of a home-town merchant.

After it has received the manifold advantages of that label, we should not give our sanction to its claim made at taxpaying time that with respect to direct sales it is only an itinerant drummer. For the foregoing and other reasons which need not be stated, I would affirm in its entirety the judgment below.

MR. JUSTICE BLACK and MR. JUSTICE DOUGLAS join in this opinion.

Appendix L

TYLER PIPE INDUSTRIES, INC. *v.* WASHINGTON STATE DEPARTMENT OF REVENUE

APPEAL FROM THE SUPREME COURT OF WASHINGTON

No. 85–1963. Argued March 2, 1987—Decided June 23, 1987*

Washington imposes a business and occupation (B & O) tax on the privilege of engaging in business activities in the State, including manufacturing in the State and making wholesale sales in the State. The measure of the wholesale tax is the gross proceeds of sales, and the measure of the manufacturing tax is the value of the manufactured product. However, under the B & O tax's "multiple activities exemption," local manufacturers are exempted from the manufacturing tax for the portion of their output that is subject to the wholesale tax. Application of the exemption results in local manufacturers' paying the wholesale tax on local sales, local manufacturers' paying only the manufacturing tax on their out-of-state sales, and out-of-state manufacturers' paying the wholesale tax on their sales in Washington. The same tax rate is applicable to both wholesaling and manufacturing activities. In both of the cases under review, which originated as state-court tax refund suits by appellants, local manufacturers who sold their goods outside Washington and out-of-state manufacturers who sold their goods in Washington, the trial court held that the multiple activities exemption did not discriminate against interstate commerce in violation of the Commerce Clause. In No. 85–1963, appellant Tyler Pipe Industries, Inc. (Tyler)—an out-of-state manufacturer who sold its products in Washington but had no property or employees in Washington, and whose solicitation of business in Washington was conducted by an independent contractor located in Washington—also asserted that its business did not have a sufficient nexus with Washington to justify the collection of the tax on its wholesale sales there. The trial court upheld the B & O tax. The Washington Supreme Court affirmed in both cases.

Held:

1. Washington's manufacturing tax discriminates against interstate commerce in violation of the Commerce Clause because, through the operation of the multiple activities exemption, the tax is assessed only on those products manufactured in Washington that are sold to out-of-state customers. The exemption for local manufacturers that sell their prod-

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*Together with No. 85–2006, *National Can Corp. et al.* v. *Washington State Department of Revenue*, also on appeal from the same court.

ucts within the State has the same facially discriminatory consequences as the West Virginia tax exemption that was invalidated in *Armco Inc.* v. *Hardesty*, 467 U. S. 638, and the reasons for invalidating the tax in that case also apply to the Washington tax. The facial unconstitutionality of Washington's tax cannot be alleviated by examining the effect of other States' tax legislation to determine whether specific interstate transactions are subject to multiple taxation. Nor can Washington's imposition of the manufacturing tax on local goods sold outside the State be saved as a valid "compensating tax." Manufacturing and wholesaling are not "substantially equivalent events," *id.*, at 643, such that taxing the manufacture of goods sold outside the State can be said to compensate for the State's inability to impose a wholesale tax on such goods. *Henneford* v. *Silas Mason Co.*, 300 U. S. 577, distinguished. To the extent that the ruling here is inconsistent with the ruling in *General Motors Corp.* v. *Washington*, 377 U. S. 436—where the B & O tax was upheld as against claims that it unconstitutionally taxed unapportioned gross receipts and did not bear a reasonable relation to the taxpayer's in-state activities—that case is overruled. Pp. 239–248.

2. The activities of Tyler's sales representative in Washington adequately support the State's jurisdiction to tax Tyler's wholesale sales to in-state customers. The showing of a sufficient nexus cannot be defeated by the argument that the taxpayer's representative was properly characterized as an independent contractor rather than an agent. Cf. *Scripto, Inc.* v. *Carson*, 362 U. S. 207. Nor is there any merit to Tyler's contention that the B & O tax does not fairly apportion the tax burden between its activities in Washington and its activities in other States. Such contention rests on the erroneous assumption that, through the B & O tax, Washington is taxing the unitary activity of manufacturing and wholesaling. The manufacturing tax and the wholesaling tax are not compensating taxes for substantially equivalent events, and, thus, the activity of wholesaling—whether by an in-state or an out-of-state manufacturer—must be viewed as a separate activity conducted wholly within Washington that no other State has jurisdiction to tax. Pp. 248–251.

3. Appellee's argument against retroactive application of any adverse decision here should be considered, in the first instance, by the Washington Supreme Court on remand. Cf. *Bacchus Imports, Ltd.* v. *Dias*, 468 U. S. 263. Pp. 251–253.

105 Wash. 2d 318, 715 P. 2d 123, and 105 Wash. 2d 327, 715 P. 2d 128, vacated and remanded.

STEVENS, J., delivered the opinion of the Court, in which BRENNAN, WHITE, MARSHALL, BLACKMUN, and O'CONNOR, JJ., joined, and in Part

IV of which SCALIA, J., joined. O'CONNOR, J., filed a concurring opinion, *post*, p. 253. SCALIA, J., filed an opinion concurring in part and dissenting in part, in Part I of which REHNQUIST, C. J., joined, *post*, p. 254. POWELL, J., took no part in the consideration or decision of the cases.

Neil J. O'Brien argued the cause for appellant in No. 85-1963. With him on the briefs was *Peter J. Turner*. *D. Michael Young* argued the cause for appellants in No. 85-2006. With him on the briefs were *John T. Piper* and *Franklin G. Dinces*.

William Berggren Collins, Assistant Attorney General of Washington, argued the cause for appellee in both cases. With him on the brief were *Kenneth O. Eikenberry*, Attorney General, and *James R. Tuttle*, *Leland T. Johnson*, and *Timothy R. Malone*, Assistant Attorneys General.†

JUSTICE STEVENS delivered the opinion of the Court.

In *Armco Inc.* v. *Hardesty*, 467 U. S. 638 (1984), we held that West Virginia's gross receipts tax on the business of selling tangible property at wholesale discriminated against interstate commerce because it exempted local manufacturers. The principal question in these consolidated appeals is whether Washington's manufacturing tax similarly violates the Commerce Clause of the Constitution because it is assessed only on those products manufactured within Washington that are sold to out-of-state purchasers. We conclude that our reasons for invalidating the West Virginia tax in *Armco* also apply to the Washington tax challenged here.

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For over half a century Washington has imposed a business and occupation (B & O) tax on "the act or privilege of engag-

†*E. Barrett Prettyman, Jr.*, and *John G. Roberts, Jr.*, filed a brief for Amcord, Inc., et al. as *amici curiae* urging reversal in No. 85-2006. *Jean A. Walker* filed a brief for the Committee on State Taxation of the Council of State Chambers of Commerce as *amicus curiae* urging reversal in both cases.

Benna Ruth Solomon and *Mark C. Rutzick* filed a brief for the National Governors' Association et al. as *amici curiae* urging affirmance.

ing in business activities" in the State. Wash. Rev. Code § 82.04.220 (1985). The tax applies to the activities of extracting raw materials in the State,[1] manufacturing in the State,[2] making wholesale sales in the State,[3] and making retail sales in the State.[4] The State has typically applied the same tax rates to these different activities. The measure of the selling tax is the "gross proceeds of sales," and the measure of the manufacturing tax is the value of the manufactured products. §§ 82.04.220, 82.04.240.

Prior to 1950, the B & O tax contained a provision that exempted persons who were subject to either the extraction tax or the manufacturing tax from any liability for either the wholesale tax or the retail tax on products extracted or manufactured in the State.[5] Thus, the wholesale tax applied to out-of-state manufacturers but not to local manufacturers. In 1948 the Washington Supreme Court held that this wholesale tax exemption for local manufacturers discriminated against interstate commerce and therefore violated the Commerce Clause of the Federal Constitution. *Columbia Steel Co.* v. *State*, 30 Wash. 2d 658, 192 P. 2d 976 (1948). The State Supreme Court rejected the State's argument that the taxpayer had not suffered from discrimination against interstate commerce because it had not proved that it paid manu-

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[1] Wash. Rev. Code § 82.04.230 (1985).

[2] § 82.04.240.

[3] § 82.04.270.

[4] § 82.04.250.

[5] The statute provided:

"'Every person engaging in activities which are within the purview of the provisions of two or more paragraphs (a), (b), (c), (d), (e), (f) and (g) of section 4 [§ 8370–4], shall be taxable under each paragraph applicable to the activities engaged in: *Provided, however, That persons taxable under paragraphs (a) or (b) of said section shall not be taxable under paragraphs (c) or (e) of said section with respect to making sales at retail or wholesale of products extracted or manufactured within this state by such persons'* (Italics ours)." See *Columbia Steel Co.* v. *State*, 30 Wash. 2d 658, 661, 192 P. 2d 976, 977–978 (1948).

facturing tax to another State.[6] The Washington Supreme Court also dismissed the State's contention that if the State in which a good was manufactured did not impose a manufacturing tax, the seller of the good would have a competitive advantage over Washington manufacturers:

> "[T]he situation obtaining in another state is immaterial. We must interpret the statute as passed by the legislature. In our opinion the statute marks a discrimination against interstate commerce in levying a tax upon wholesale activities of those engaged in interstate commerce, which tax is, because of the exemption contained in § 8370–6, not levied upon those who perform the same taxable act, but who manufacture in the state of Washington." *Id.*, at 664, 192 P. 2d, at 979.

Two years later, in 1950, the Washington Legislature responded to this ruling by turning the B & O tax exemption scheme inside out. The legislature removed the wholesale tax exemption for local manufacturers and replaced it with an exemption from the manufacturing tax for the portion of manufacturers' output that is subject to the wholesale tax.[7] The result, as before 1950, is that local manufacturers pay the manufacturing tax on their interstate sales and out-of-state manufacturers pay the wholesale tax on their sales in Washington. Local manufacturer-wholesalers continue to

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[6] "'The immunities implicit in the Commerce Clause and the potential taxing power of a State can hardly be made to depend, in the world of practical affairs, on the shifting incidence of the varying tax laws of the various States at a particular moment. Courts are not possessed of instruments of determination so delicate as to enable them to weigh the various factors in a complicated economic setting which, as to an isolated application of a State tax, might mitigate the obvious burden generally created by a direct tax on commerce.'" *Id.*, at 663, 192 P. 2d, at 978 (quoting *Freeman* v. *Hewit*, 329 U. S. 249, 256 (1946)).

[7] The Washington Supreme Court upheld this revised scheme against constitutional challenge in *B. F. Goodrich Co.* v. *State*, 38 Wash. 2d 663, 231 P. 2d 325, cert. denied, 342 U. S. 876 (1951).

pay only one gross receipts tax, but it is now applied to the activity of wholesaling rather than the activity of manufacturing. Although the tax rate has changed over the years—it is now forty-four hundredths of one percent, or 0.44%, of gross receipts—the relevant provisions of Washington's B & O tax are the same today as enacted in 1950.[8]

The constitutionality of the B & O tax has been challenged on several occasions,[9] most strenuously in *General Motors Corp.* v. *Washington*, 377 U. S. 436 (1964). In that case a bare majority of the Court upheld the tax; JUSTICE BRENNAN and Justice Goldberg filed dissenting opinions. The bulk of the Court's opinion was devoted to rejecting the claims that the statute unconstitutionally taxed unapportioned gross receipts and did not bear a reasonable relation to the taxpayer's in-state activities. At the end of its opinion, the Court declined to reach the argument that the tax imposed multiple tax burdens on interstate transactions, because the taxpayer had failed to demonstrate "what definite

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[8] The multiple activities exemption provides:

"(1) [E]very person engaged in activities which are within the purview of the provisions of two or more of sections RCW 82.04.230 to 82.04.290, inclusive, shall be taxable under each paragraph applicable to the activities engaged in.

"(2) Persons taxable under RCW 82.04.250 [tax on retailers] or 82.04.270 [tax on wholesalers and distributors] shall not be taxable under RCW 82.04.230 [tax on extractors], 82.04.240 [tax on manufacturers] or subsection (2), (3), (4), (5), or (7) of RCW 82.04.260 [tax on certain food processing activities] with respect to extracting or manufacturing of the products so sold.

"(3) Persons taxable under RCW 82.04.240 or RCW 82.04.260 subsection (4) shall not be taxable under RCW 82.04.230 with respect to extracting the ingredients of the products so manufactured." Wash. Rev. Code § 82.04.440 (1985).

[9] See, *e. g.*, *B. F. Goodrich Co.* v. *State, supra; General Motors Corp.* v. *Washington*, 377 U. S. 436 (1964); *Standard Pressed Steel Co.* v. *Washington Dept. of Revenue*, 419 U. S. 560 (1975); *Chicago Bridge & Iron Co.* v. *Washington Dept. of Revenue*, 98 Wash. 2d 814, 659 P. 2d 463, appeal dism'd, 464 U. S. 1013 (1983).

burden, in a constitutional sense" other States' laws had placed on "the identical interstate shipments by which Washington measures its tax." *Id.*, at 449. Justice Goldberg, joined by Justice Stewart and JUSTICE WHITE, dissented because "[t]he burden on interstate commerce and the dangers of multiple taxation" were apparent from the face of the statute. *Id.*, at 459.[10] Comparing the current statute

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[10] Justice Goldberg explained the functional equivalency for Commerce Clause purposes of the invalidated pre-1950 statute and its successor:

"The burden on interstate commerce and the dangers of multiple taxation are made apparent by considering Washington's tax provisions. The Washington provision here involved—the 'tax on wholesalers'—provides that every person 'engaging within this state in the business of making sales at wholesale' shall pay a tax on such business 'equal to the gross proceeds of sales of such business multiplied by the rate of one-quarter of one per cent.' Rev. Code Wash. 82.04.270; Wash. Laws 1949, c. 228, § 1 (e). In the same chapter Washington imposes a 'tax on manufacturers' which similarly provides that every person 'engaging within this state in business as a manufacturer' shall pay a tax on such business 'equal to the value of the products . . . manufactured, multiplied by the rate of one-quarter of one per cent.' Rev. Code Wash. 82.04.240; Wash. Laws 1949, c. 228, § 1 (b). Then in a provision entitled 'Persons taxable on multiple activities' the statute endeavors to insure that local Washington products will not be subjected both to the 'tax on manufacturers' and to the 'tax on wholesalers.' Rev. Code Wash. 82.04.440; Wash. Laws 1949, c. 228, § 2–A. Prior to its amendment in 1950 the exemptive terms of this 'multiple activities' provision were designed so that a Washington manufacturer-wholesaler would pay the manufacturing tax and be exempt from the wholesale tax. This provision, on its face, discriminated against interstate wholesale sales to Washington purchasers for it exempted the intrastate sales of locally made products while taxing the competing sales of interstate sellers. In 1950, however, the 'multiple activities' provision was amended, reversing the tax and the exemption, so that a Washington manufacturer-wholesaler would first be subjected to the wholesale tax and then, to the extent that he is taxed thereunder, exempted from the manufacturing tax. Rev. Code Wash. 82.04.440; Wash. Laws 1950 (special session), c. 5, § 2. See *McDonnell & McDonnell* v. *State*, 62 Wash. 2d 553, 557, 383 P. 2d 905, 908. This amended provision would seem to have essentially the same economic effect on interstate sales but has the advantage of appearing nondiscriminatory." *General Motors Corp.* v. *Washington*, 377 U. S., at 459–460 (dissenting opinion).

with its invalid predecessor, this dissent concluded that the "amended provision would seem to have essentially the same economic effect on interstate sales but has the advantage of appearing nondiscriminatory." *Id.*, at 460. Today we squarely address the claim that this provision discriminates against interstate commerce.

II

Two appeals are before us. In the first case (No. 85-2006), 71 commercial enterprises filed 53 separate actions for refunds of B & O taxes paid to the State. The Thurston County Superior Court joined the actions, found that the multiple activities exemption did not violate the Commerce Clause, and granted the State Department of Revenue's motion for summary judgment. In the second case (No. 85-1963), Tyler Pipe Industries, Inc. (Tyler), sought a refund of B & O taxes paid during the years 1976 through 1980 for its wholesaling activities in Washington. Again, the Superior Court upheld the B & O tax. The Washington Supreme Court affirmed in both cases. 105 Wash. 2d 327, 732 P. 2d 134 (1986); 105 Wash. 2d 318, 715 P. 2d 123 (1986).

The State Supreme Court concluded that the B & O tax was not facially discriminatory and rejected the appellants' arguments that our decision invalidating West Virginia's exemption for local wholesaler-manufacturers, *Armco Inc.* v. *Hardesty*, 467 U. S. 638 (1984), required that the B & O tax be invalidated. The state court expressed the view that the West Virginia wholesale tax imposed on out-of-state manufacturers in *Armco* could not be justified as a compensating tax because of the substantial difference between the State's tax rates on manufacturing activities (.0088) and wholesaling activities (.0027), and because West Virginia did not provide for a reduction in its manufacturing tax when the manufactured goods were sold out of State, but did reduce the tax when the goods were partly manufactured out of State. The Washington Supreme Court then concluded that our require-

ment that a tax must have "'what might be called internal consistency—that is the [tax] must be such that, if applied by every jurisdiction,' there would be no impermissible interference with free trade," *Armco*, 467 U. S., at 644, was not dispositive because it merely relieved the taxpayer of the burden of proving that a tax already demonstrated to be facially discriminatory had in fact resulted in multiple taxation. The Washington Supreme Court also rejected the taxpayers' arguments that the B & O tax is not fairly apportioned to reflect the amount of business conducted in the State and is not fairly related to the services rendered by Washington.

We noted probable jurisdiction of the taxpayers' appeals, 479 U. S. 810 (1986), and now reverse in part and affirm in part. We first consider the claims of the taxpayers that have manufacturing facilities in Washington and market their products in other States; their challenge is directed to the fact that the manufacturing tax is levied only on those goods manufactured in Washington that are sold outside the State. We then consider Tyler's claims that its activities in the State of Washington are not sufficient to subject it to the State's taxing jurisdiction and that the B & O tax is not fairly apportioned.

III

A person subject to Washington's wholesale tax for an item is not subject to the State's manufacturing tax for the same item. This statutory exemption for manufacturers that sell their products within the State has the same facially discriminatory consequences as the West Virginia exemption we invalidated in *Armco*. West Virginia imposed a gross receipts tax at the rate of 0.27% on persons engaged in the business of selling tangible property at wholesale. Local manufacturers were exempt from the tax, but paid a manufacturing tax of 0.88% on the value of products manufactured in the State. Even though local manufacturers bore a higher tax burden in dollars and cents, we held that their exemption from the wholesale tax violated the principle that "a State may not tax

a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State." 467 U. S., at 642.

In explaining why the tax was discriminatory on its face, we expressly endorsed the reasoning of Justice Goldberg's dissenting opinion in *General Motors Corp.* v. *Washington,* 377 U. S., at 459. We explained:

> "The tax provides that two companies selling tangible property at wholesale in West Virginia will be treated differently depending on whether the taxpayer conducts manufacturing in the State or out of it. Thus, if the property was manufactured in the State, no tax on the sale is imposed. If the property was manufactured out of the State and imported for sale, a tax of 0.27% is imposed on the sale price. See *General Motors Corp.* v. *Washington,* 377 U. S. 436, 459 (1964) (Goldberg, J., dissenting) (similar provision in Washington, 'on its face, discriminated against interstate wholesale sales to Washington purchasers for it exempted the intrastate sales of locally made products while taxing the competing sales of interstate sellers'); *Columbia Steel Co.* v. *State,* 30 Wash. 2d 658, 664, 192 P. 2d 976, 979 (1948) (invalidating Washington tax)." 467 U. S., at 642.

Our square reliance in *Armco* on Justice Goldberg's earlier dissenting opinion is especially significant because that dissent dooms appellee's efforts to limit the reasoning of *Armco* to the precise statutory structure at issue in that case. Justice Goldberg expressly rejected the distinction appellee attempts to draw between an exemption from a wholesaling tax—as was present in *Armco*—and the exemption from a manufacturing tax which was present in *General Motors* and is again present in these cases. See 377 U. S., at 459–460. Our holding in *Armco* requires that we now agree with Justice Goldberg's conclusion that the exemption before us is the practical equivalent of the exemption that the Washington Supreme Court invalidated in 1948.

General Motors is not a controlling precedent. As we have already noted, the result in that case did not depend on the Court's resolution of whether the tax burdened interstate commerce. Our reason for not passing on that question was that the taxpayer had "not demonstrated what definite burden, in a constitutional sense [the tax imposed by other States] places on the identical shipments by which Washington measures its tax." 377 U. S., at 449. Thus, when *General Motors* was decided, the Court required the taxpayer to prove that specific interstate transactions were subjected to multiple taxation in order to advance a claim of discrimination. See also *Standard Pressed Steel Co.* v. *Washington Revenue Dept.*, 419 U. S. 560, 563 (1975) (rejecting Commerce Clause claim because taxpayer made no showing of risk of multiple taxation). In *Armco*, however, we categorically rejected this requirement. The facial unconstitutionality of Washington's gross receipts tax cannot be alleviated by examining the effect of legislation enacted by its sister States. See *Moorman Mfg. Co.* v. *Bair*, 437 U. S. 267, 276–278 (1978).[11]

We also reject the Department's contention that the State's imposition of the manufacturing tax on local goods sold outside the State should be saved as a valid "compensating tax." As we noted in *Maryland* v. *Louisiana*, 451 U. S. 725, 758 (1981), the "concept of a compensatory tax first requires identification of the burden for which the State is attempting to compensate." In these cases the only bur-

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[11] In *Armco Inc.* v. *Hardesty*, 467 U. S. 638 (1984), we quoted with approval the following sentence from the Court's opinion in *Freeman* v. *Hewit*, 329 U. S., 249, 256 (1946):

"The immunities implicit in the Commerce Clause and the potential taxing power of a State can hardly be made to depend, in the world of practical affairs, on the shifting incidence of the varying tax laws of the various States at a particular moment." See 467 U. S., at 645, n. 8.

The Washington Supreme Court also relied on *Freeman* v. *Hewit* in *Columbia Steel Co.* v. *State*, 30 Wash. 2d, at 663, 192 P. 2d, at 978.

den for which the manufacturing tax exemption is arguably compensatory is the State's imposition of a wholesale tax on the local sales of local manufacturers; absent the exemption, a local manufacturer might be at an economic disadvantage because it would pay both a manufacturing and a wholesale tax, while the manufacturer from afar would pay only the wholesale tax. The State's justification for thus taxing the manufacture of goods in interstate commerce, however, fails under our precedents. The local sales of out-of-state manufacturers are also subject to Washington's wholesale tax, but the multiple activities exemption does not extend its ostensible compensatory benefit to those manufacturers. The exemption thus does not merely erase a tax incentive to engage in interstate commerce instead of intrastate commerce; it affirmatively places interstate commerce at a disadvantage.

"[T]he common theme running through the cases in which this Court has sustained compensating" taxes is "[e]qual treatment of interstate commerce." *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U. S. 318, 331 (1977). See also *Maryland* v. *Louisiana*, 451 U. S., at 759. In *Boston Stock Exchange*, a New York transfer tax on securities transactions taxed transactions involving an out-of-state sale more heavily than other transactions involving an in-state sale. We invalidated the tax, rejecting the State's claim that it was compensatory legislation designed to neutralize the competitive advantage enjoyed by stock exchanges outside New York. We concluded:

> "Because of the delivery or transfer in New York, the seller cannot escape tax liability by selling out of State, but he can substantially reduce his liability by selling in State. The obvious effect of the tax is to extend a financial advantage to sales on the New York exchanges at the expense of the regional exchanges. Rather than 'compensating' New York for a supposed competitive disadvantage resulting from § 270, the amendment forecloses tax-neutral decisions and creates both an ad-

vantage for the exchanges in New York and a discriminatory burden on commerce to its sister States." 429 U. S., at 331.

Similarly, in *Maryland* v. *Louisiana*, we held that a tax on the first use in Louisiana of gas brought into the State was not a "complement of a severance tax in the same amount imposed on gas produced within the State." *Armco*, 467 U. S., at 642–643, citing *Maryland* v. *Louisiana*, 451 U. S., at 758–759. We relied on the observation that severance and first use were not "substantially equivalent" events on which mutually compensating taxes might be imposed. And in *Armco* we squarely held that manufacturing and wholesaling are not substantially equivalent activities. As we wrote in that case:

> "The gross sales tax imposed on Armco cannot be deemed a 'compensating tax' for the manufacturing tax imposed on its West Virginia competitors. . . . Here, too, manufacturing and wholesaling are not 'substantially equivalent events' such that the heavy tax on in-state manufacturers can be said to compensate for the admittedly lighter burden placed on wholesalers from out of State. Manufacturing frequently entails selling in the State, but we cannot say which portion of the manufacturing tax is attributable to manufacturing, and which portion to sales." 467 U. S., at 642–643.

See also *Bacchus Imports, Ltd.* v. *Dias*, 468 U. S. 263, 272 (1984). In light of the facially discriminatory nature of the multiple activities exemption, we conclude, as we did in *Armco*, that manufacturing and wholesaling are not "substantially equivalent events" such that taxing the manufacture of goods sold outside the State can be said to compensate for the State's inability to impose a wholesale tax on those goods.[12]

[12] Nor may the tax be justified as an attempt to compensate the State for its inability to impose a similar burden on out-of-state manufacturers

Appellee also contends that its B & O tax is valid because of its asserted similarities to a tax and exemption system we have upheld. The State assessed a use tax on personal property used within the State but originally purchased elsewhere to compensate for the burden that a sales tax placed on similar property purchased within the State. See *Henneford* v. *Silas Mason Co.*, 300 U. S. 577 (1937). Appellee's reliance on *Henneford* v. *Silas Mason Co.*, however, does not aid its cause. That case addressed a use tax imposed by the State of Washington on the "privilege of using within this state any article of tangible personal property." The tax did not apply to "the use of any article of tangible personal property" the sale or use of which had already been taxed at an equal or greater rate under the laws of Washington or some other State. *Id.*, at 580–581. We upheld the tax because, in the context of the overall tax structure, the burden it placed on goods purchased out-of-state was identical to that placed on an equivalent purchase within the State. This identical impact was no fortuity; it was guaranteed by the statutory exemption from the use tax for goods on which a sales tax had already been paid,[13] regardless of whether the sales tax had been paid to Washington or to another State.[14]

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whose goods are sold in Washington, for Washington subjects those sales to wholesale tax.

[13] Many States provide tax credits that alleviate or eliminate the potential multiple taxation that results when two or more sovereigns have jurisdiction to tax parts of the same chain of commercial events. For example, the District of Columbia and all but three States with sales and use taxes provide a credit against their own use taxes for sales taxes paid to another State, although reciprocity may be required. See CCH State Tax Guide 6013–6014 (1986); *Williams* v. *Vermont*, 472 U. S. 14, 22 (1985). See also *Halliburton Oil Well Cementing Co.* v. *Reily*, 373 U. S. 64, 74–75 (1963).

[14] In his opinion for the Court in *Henneford* v. *Silas Mason Co.*, Justice Cardozo carefully described the relationship between the 2% "tax on retail sales" imposed by Title III of Washington's 1935 tax code and the "compensating tax" imposed by Title IV on the privilege of use. The compensating use tax was imposed on the use of an article of tangible personal property which had been purchased at retail but had not been subjected to

As we explained in *Halliburton Oil Well Cementing Co.* v. *Reily*, 373 U. S. 64, 70 (1963):

> "The conclusion is inescapable: equal treatment for in-state and out-of-state taxpayers similarly situated is the condition precedent for a valid use tax on goods imported from out-of-state."

The parallel condition precedent for a valid multiple activities exemption eliminating exposure to the burden of a multiple tax on manufacturing and wholesaling would provide a credit against Washington tax liability for wholesale taxes paid by local manufacturers to any State, not just Washington. The multiple activities exemption only operates to impose a unified tax eliminating the risk of multiple taxation when the acts of manufacturing and wholesaling are both carried out within the State. The exemption excludes similarly situated manufacturers and wholesalers which conduct one of those activities within Washington and the other activity out-

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a sales tax that was equal to or in excess of that imposed by the State of Washington. If the rate of the tax imposed by another jurisdiction was less than 2%, the rate of the compensating tax was measured by the difference. Explaining why such a compensating tax does not discriminate against interstate commerce, Justice Cardozo wrote:

"Equality is the theme that runs through all the sections of the statute. There shall be a tax upon the use, but subject to an offset if another use or sales tax has been paid for the same thing. This is true where the offsetting tax became payable to Washington by reason of purchase or use within the state. *It is true in exactly the same measure where the offsetting tax has been paid to another state by reason of use or purchase there.* No one who uses property in Washington after buying it at retail is to be exempt from a tax upon the privilege of enjoyment except to the extent that he has paid a use or sales tax somewhere. Every one who has paid a use or sales tax anywhere, or, more accurately, in any state, is to that extent to be exempt from the payment of another tax in Washington.

"When the account is made up, the stranger from afar is subject to no greater burdens as a consequence of ownership than the dweller within the gates. The one pays upon one activity or incident, and the other upon another, but the sum is the same when the reckoning is closed." 300 U. S., at 583–584 (emphasis added).

side the State. Washington's B & O tax scheme is therefore inconsistent with our precedents holding that a tax violates the Commerce Clause "when it unfairly burdens commerce by exacting more than a just share from the interstate activity." *Washington Dept. of Revenue* v. *Association of Washington Stevedoring Cos.*, 435 U. S. 734, 748 (1978).

As we explained in *Armco*, our conclusion that a tax facially discriminates against interstate commerce need not be confirmed by an examination of the tax burdens imposed by other States:

> "Appellee suggests that we should require Armco to prove actual discriminatory impact on it by pointing to a State that imposes a manufacturing tax that results in a total burden higher than that imposed on Armco's competitors in West Virginia. This is not the test. In *Container Corp. of America* v. *Franchise Tax Board*, 463 U. S. 159, 169 (1983), the Court noted that a tax must have 'what might be called internal consistency—that is the [tax] must be such that, if applied by every jurisdiction,' there would be no impermissible interference with free trade. In that case, the Court was discussing the requirement that a tax be fairly apportioned to reflect the business conducted in the State. A similar rule applies where the allegation is that a tax on its face discriminates against interstate commerce. A tax that unfairly apportions income from other States is a form of discrimination against interstate commerce. See also *id.*, at 170–171. Any other rule would mean that the constitutionality of West Virginia's tax laws would depend on the shifting complexities of the tax codes of 49 other States, and that the validity of the taxes imposed on each taxpayer would depend on the particular other States in which it operated." 467 U. S., at 644–645 (footnote omitted).[15]

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[15] Even the solitary dissenting opinion in the *Armco* case did not question the proposition that the constitutionality of the West Virginia tax

We conclude that Washington's multiple activities exemption discriminates against interstate commerce as did the tax struck down by the Washington Supreme Court in 1948 and the West Virginia tax that we invalidated in *Armco*. The current B & O tax exposes manufacturing or selling activity outside the State to a multiple burden from which only the activity of manufacturing in-state and selling in-state is exempt. The fact that the B & O tax "has the advantage of appearing nondiscriminatory," see *General Motors Corp.*, 377 U. S., at 460 (Goldberg, J., dissenting), does not save it from invalidation. To the extent that this conclusion is inconsistent with the Court's ruling in the *General Motors* case, that case is overruled.[16]

IV

Our holding that Washington's tax exemption for a local manufacturer-wholesaler violates the Commerce Clause disposes of the issues raised by those appellants in *National Can* that manufacture goods in Washington and sell them outside the State, as well as the claim of discrimination asserted by those appellants that manufacture goods outside Washington and sell them within the State. Compliance

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could properly be discerned merely by referring to the text of the tax statute itself:

"It is plain that West Virginia's tax would be unconstitutionally discriminatory if it levied no tax on manufacturing or taxed manufacturing at a lower rate than wholesaling, for then the out-of-state wholesaler would be paying a higher tax than the in-state manufacturer-wholesaler." 467 U. S., at 646 (REHNQUIST, J., dissenting).

Instead, the dissent argued that West Virginia's taxing scheme, taken in its entirety, did not discriminate against out-of-state manufacturers because the manufacturing tax paid by a local manufacturer-wholesaler was much higher than the wholesale tax exacted from an out-of-state manufacturer.

[16] In view of our holding on the discrimination issue, we need not reach the claim of local state manufacturers selling to interstate markets that the tax scheme does not fairly apportion tax liabilities between Washington and other States.

with our holding on the discrimination issue, however, would not necessarily preclude the continued assessment of a wholesaling tax. Either a repeal of the manufacturing tax or an expansion of the multiple activities exemption to provide out-of-state manufacturers with a credit for manufacturing taxes paid to other States would presumably cure the discrimination. We must therefore also consider the alternative challenge to the wholesale tax advanced by Tyler and the other appellants that manufacture products outside of Washington for sale in the State.

Tyler seeks a refund of wholesale taxes it paid on sales to customers in Washington for the period from January 1, 1976, through September 30, 1980. These products were manufactured outside of Washington. Tyler argues that its business does not have a sufficient nexus with the State of Washington to justify the collection of a gross receipts tax on its sales. Tyler sells a large volume of cast iron, pressure and plastic pipe and fittings, and drainage products in Washington, but all of those products are manufactured in other States. Tyler maintains no office, owns no property, and has no employees residing in the State of Washington. Its solicitation of business in Washington is directed by executives who maintain their offices out-of-state and by an independent contractor located in Seattle.

The trial court found that the in-state sales representative engaged in substantial activities that helped Tyler to establish and maintain its market in Washington. The State Supreme Court concluded that those findings were supported by the evidence, and summarized them as follows:

> "The sales representatives acted daily on behalf of Tyler Pipe in calling on its customers and soliciting orders. They have long-established and valuable relationships with Tyler Pipe's customers. Through sales contacts, the representatives maintain and improve the name recognition, market share, goodwill, and individual customer relations of Tyler Pipe.

> "Tyler Pipe sells in a very competitive market in Washington. The sales representatives provide Tyler Pipe with virtually all their information regarding the Washington market, including: product performance; competing products; pricing, market conditions and trends; existing and upcoming construction products; customer financial liability; and other critical information of a local nature concerning Tyler Pipe's Washington market. The sales representatives in Washington have helped Tyler Pipe and have a special relationship to that corporation. The activities of Tyler Pipe's agents in Washington have been substantial." 105 Wash. 2d, at 325, 715 P. 2d, at 127.

As a matter of law, the Washington Supreme Court concluded that this showing of a sufficient nexus could not be defeated by the argument that the taxpayer's representative was properly characterized as an independent contractor instead of as an agent. We agree with this analysis. In *Scripto, Inc.* v. *Carson*, 362 U. S. 207 (1960), Scripto, a Georgia corporation, had no office or regular employees in Florida, but it employed wholesalers or jobbers to solicit sales of its products in Florida. We held that Florida may require these solicitors to collect a use tax from Florida customers. Although the "salesmen" were not employees of Scripto, we determined that "such a fine distinction is without constitutional significance." *Id.*, at 211. This conclusion is consistent with our more recent cases. See *National Geographic Society* v. *California Equalization Board*, 430 U. S. 551, 556–558 (1977).

As the Washington Supreme Court determined, "the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." 105 Wash. 2d, at 323, 715 P. 2d, at 126. The court found this standard was

satisfied because Tyler's "sales representatives perform any local activities necessary for maintenance of Tyler Pipe's market and protection of its interests . . . ." *Id.*, at 321, 715 P. 2d, at 125. We agree that the activities of Tyler's sales representatives adequately support the State's jurisdiction to impose its wholesale tax on Tyler.

Tyler also asserts that the B & O tax does not fairly apportion the tax burden between its activities in Washington and its activities in other States. See *Complete Auto Transit, Inc.* v. *Brady*, 430 U. S. 274, 285 (1977). Washington taxes the full value of receipts from in-state wholesaling or manufacturing; thus, an out-of-state manufacturer selling in Washington is subject to an unapportioned wholesale tax even though the value of the wholesale transaction is partly attributable to manufacturing activity carried on in another State that plainly has jurisdiction to tax that activity. This apportionment argument rests on the erroneous assumption that through the B & O tax, Washington is taxing the unitary activity of manufacturing and wholesaling. We have already determined, however, that the manufacturing tax and wholesaling tax are not compensating taxes for substantially equivalent events in invalidating the multiple activities exemption. Thus, the activity of wholesaling—whether by an in-state or an out-of-state manufacturer—must be viewed as a separate activity conducted wholly within Washington that no other State has jurisdiction to tax. See *Moorman Mfg. Co.* v. *Bair*, 437 U. S., at 280–281 (gross receipts tax on sales to customers within State would be "plainly valid"); *Standard Pressed Steel Co.* v. *Washington Revenue Dept.*, 419 U. S., at 564 (selling tax measured by gross proceeds of sales is "apportioned exactly to the activities taxed").

V

The Department of Revenue argues that any adverse decision in these cases should not be applied retroactively because the taxes at issue were assessed prior to our opinion in

Armco and the holding in that case was not clearly foreshadowed by earlier opinions. See *Chevron Oil Co.* v. *Huson*, 404 U. S. 97, 106–107 (1971) (factors to consider in deciding whether to impose decision prospectively only). The State's argument is similar to an argument advanced by the State of Hawaii in *Bacchus Imports, Ltd.* v. *Dias*, 468 U. S., at 276–277. The State urged that, if we invalidated the tax at issue, we should not require the payment of refunds to taxpayers. We did not resolve the merits of that issue, concluding that this Court should not take it upon itself in this complex area of state tax structures to determine how to apply its holding:

> "These refund issues, which are essentially issues of remedy for the imposition of a tax that unconstitutionally discriminated against interstate commerce, were not addressed by the state courts. Also, the federal constitutional issues involved may well be intertwined with, or their consideration obviated by, issues of state law. Also, resolution of those issues, if required at all, may necessitate more of a record than so far has been made in this case. We are reluctant, therefore, to address them in the first instance. Accordingly, we reverse the judgment of the Supreme Court of Hawaii and remand for further proceedings not inconsistent with this opinion." *Id.*, at 277 (footnote omitted).

We followed this approach in *Williams* v. *Vermont*, 472 U. S. 14 (1985), an opinion which invalidated the State's residency restriction on the availability of a sales tax credit for use tax paid to another State. We expressed no opinion on the appropriate remedy, instead remanding to the Supreme Court of Vermont "in light of the fact that the action was dismissed on the pleadings, and given the possible relevance of state law, see *Bacchus Imports, Ltd.* v. *Dias*, 468 U. S. 263, 277 (1984) . . . ." *Id.*, at 28. Cf. *Hooper* v. *Bernalillo County Assessor*, 472 U. S. 612, 622–623 (1985). We con-

clude that it is likewise appropriate for the Supreme Court of Washington to address in the first instance the refund issues raised by our rulings in these cases.

VI

We hold Washington's multiple activities exemption invalid because it places a tax burden upon manufacturers in Washington engaged in interstate commerce from which local manufacturers selling locally are exempt. We reject appellant Tyler's nexus and fair apportionment challenges to the State's wholesale tax. Our partial invalidation of the State's taxing scheme raises remedial issues that are better addressed by the State Supreme Court on remand. Accordingly, we vacate the judgments of the Supreme Court of Washington and remand for further proceedings not inconsistent with this opinion.

It is so ordered.

JUSTICE POWELL took no part in the consideration or decision of these cases.

JUSTICE O'CONNOR, concurring.

I join the Court's opinion holding that "[i]n light of the facially discriminatory nature of the multiple activities exemption," *ante*, at 244, see *Maryland* v. *Louisiana*, 451 U. S. 725, 756–757 (1981), the Washington taxpayers need not prove actual discriminatory impact "by an examination of the tax burdens imposed by other States." *Ante*, at 247. I do not read the Court's decision as extending the "internal consistency" test described in *Armco Inc.* v. *Hardesty*, 467 U. S. 638, 644–645 (1984), to taxes that are not facially discriminatory, contra, *post*, at 257–258 (SCALIA, J., concurring in part and dissenting in part), nor would I agree with such a result in these cases. See *American Trucking Assns., Inc.* v. *Scheiner*, *post*, p. 298 (O'CONNOR, J., dissenting).

JUSTICE SCALIA, with whom THE CHIEF JUSTICE joins in Part I, concurring in part and dissenting in part.

I join Part IV of the Court's opinion, upholding Washington's unapportioned wholesale tax and rejecting Tyler Pipe's claim that it did not have a sufficient nexus with Washington to give the State taxing jurisdiction. I dissent, however, from the remainder of the opinion, invalidating the State's manufacturing tax as unconstitutionally discriminatory under the Commerce Clause. The standard for discrimination adopted by the Court, which drastically limits the States' discretion to structure their tax systems, has no basis in the Constitution, and is not required by our past decisions.

I

Implicitly in these cases, *ante*, at 245–248, and explicitly in *American Trucking Assns., Inc.* v. *Scheiner*, *post*, at 284, the Court imposes on state taxes a requirement of "internal consistency," demanding that they "'be such that, if applied by every jurisdiction,' there would be no impermissible interference with free trade." *Armco Inc.* v. *Hardesty*, 467 U. S. 638, 644 (1984) (quoting *Container Corp. of America* v. *Franchise Tax Board*, 463 U. S. 159, 169 (1983)).[1] It is clear, for the reasons given by the Court, *ante*, at 246–247, that the Washington business and occupation (B & O) tax fails that test. So would any unapportioned flat tax on multistate activities, such as the axle tax or marker fee at issue in *Scheiner*, *post*, p. 266. It is equally clear to me, however, that this internal consistency principle is nowhere to be found in the Constitution. Nor is it plainly required by our prior decisions. Indeed, in order to apply the internal consistency

[1] The majority finds Washington's manufacturing tax exemption for local wholesalers discriminatory because it "excludes similarly situated manufacturers and wholesalers which conduct one of those activities within Washington and the other activity outside the State." *Ante*, at 246–247. That exclusion, however, can only be deemed *facially* discriminatory if one assumes that every State's taxing scheme is identical to Washington's.

rule in this case, the Court is compelled to overrule a rather lengthy list of prior decisions, from *Hinson* v. *Lott*, 8 Wall. 148 (1869), to *General Motors Corp.* v. *Washington*, 377 U. S. 436 (1964), and including, as is made explicit in *Scheiner*, *post*, p. 266, *Capitol Greyhound Lines* v. *Brice*, 339 U. S. 542 (1950), *Aero Mayflower Transit Co.* v. *Board of Railroad Comm'rs*, 332 U. S. 495 (1947), and *Aero Mayflower Transit Co.* v. *Georgia Public Service Comm'n*, 295 U. S. 285 (1935). Moreover, the Court must implicitly repudiate the approval given in dicta 10 years ago to New York's pre-1968 transfer tax on securities. See *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U. S. 318, 330 (1977).[2] Finally, we noted only two Terms ago—and one Term after *Armco*, *supra*, was decided—that we had never held that "a State must credit a sales tax paid to another State against its own use tax." *Williams* v. *Vermont*, 472 U. S. 14, 21–22 (1985). See *Southern Pacific Co.* v. *Gallagher*, 306 U. S. 167, 172 (1939). If we had applied an internal consistency rule at that time, the need for such a credit would have followed as a matter of mathematical necessity. The Court's presumed basis for creating this rule now, 198 years after adoption of the Constitution, is that the reasoning of *Armco* requires it. See *Scheiner*, *post*, at 284. In my view, however, that reasoning was dictum, which we should explicitly reject. And if one insists on viewing it as holding, and thus

[2] The New York statute taxed, *inter alia*, both the sale and delivery of securities if either event occurred in New York, 429 U. S., at 321, but imposed only one tax if both events occurred in that State. While the Court invalidated as discriminatory an amendment to that law reducing the tax for in-state sales by nonresidents and placing a cap on the tax payable on transactions involving in-state sales, it also declared that the statute prior to the amendment "was neutral as to in-state and out-of-state sales." *Id.*, at 330. That is plainly not true if internal consistency is a requirement of neutrality: assuming that all States had New York's pre-1968 scheme, if sale and delivery both took place in New York, there would be a single tax, while if sale took place in New York and delivery in New Jersey, there would be double taxation.

as conflicting with decades of precedents upholding internally inconsistent state taxes, it seems to me that *Armco* rather than those numerous other precedents ought to be overruled.

Prior to *Armco*, the internal consistency test was applied only in cases involving apportionment of the net income of businesses that more than one State sought to tax. That was the issue in *Container Corp.*, see 463 U. S., at 169–171, the only case cited by *Armco* in support of an internal consistency rule, see 467 U. S., at 644–645, and there is no reason automatically to require internal consistency in other contexts. A business can of course earn net income in more than one State, but the total amount of income is a unitary figure. Hence, when more than one State has taxing jurisdiction over a multistate enterprise, an inconsistent apportionment scheme could result in taxation of more than 100% of that firm's net income. Where, however, tax is assessed not on unitary income but on discrete events such as sale, manufacture, and delivery, which can occur in a single State or in different States, that apportionment principle is not applicable; there is simply no unitary figure or event to apportion. That we have not traditionally applied the internal consistency test outside the apportionment context is amply demonstrated by the lengthy list of cases that the Court has (openly or tacitly) had to overrule here and in *Scheiner*.

It is possible to read *Armco* as requiring such a test in all contexts, but it is assuredly not necessary to do so. *Armco* dealt with West Virginia's 0.27% selling tax and 0.88% manufacturing tax, and its exemption from the selling tax for in-state but not out-of-state manufacturers. We discussed the internal consistency of that taxing scheme only after finding the selling tax discriminatory "[o]n its face," 467 U. S., at 642, because "[t]he tax provides that two companies selling tangible property at wholesale in West Virginia will be treated differently depending on whether the taxpayer conducts manufacturing in the State or out of it." *Ibid.* Combined with the finding that the selling tax imposed on

out-of-state producers could not be deemed to "compensate" for the higher manufacturing tax imposed only on West Virginia producer/sellers, *id.*, at 642–643, that was enough to invalidate the tax. We went on to address the internal consistency rule in response to the State's argument that the taxpayer had not shown "actual discriminatory impact on it by pointing to a State that imposes a manufacturing tax that results in a total burden higher than that imposed on Armco's competitors in West Virginia." *Id.*, at 644. After reciting the internal consistency principle applicable in apportionment cases, we said that "[a] similar rule applies where the allegation is that a tax on its face discriminates against interstate commerce," *ibid.*, regardless of "the shifting complexities of the tax codes of 49 other States . . . ." *Id.*, at 645. The holding of *Armco* thus establishes only that a facially discriminatory taxing scheme that is not internally consistent will not be saved by the claim that in fact no adverse impact on interstate commerce has occurred. To expand that brief discussion into a holding that internal consistency is always required, and thereby to revolutionize the law of state taxation, is remarkable.

Rather than use isolated language, written with no evident consideration of its potential significance if adopted as a general rule, to overturn a lengthy list of settled decisions, one would think that we would instead use the settled decisions to limit the scope of the isolated language. As the cases from the past few Terms indicate, the internal consistency test invalidates a host of taxing methods long relied upon by the States and left unhampered by Congress. We are already on shaky ground when we invoke the Commerce Clause as a self-operative check on state legislation, see Part II, *infra*, requiring us to develop rules unconstrained by the text of the Constitution. Prudence counsels in favor of the least intrusive rule possible.

Applying more traditional tests, the Washington B & O tax is valid. It is not facially discriminatory. Unlike the

West Virginia tax in *Armco*, Washington's selling tax is imposed on all goods, whether produced in-state or out-of-state. No manufacturing tax is (or could be) imposed on out-of-state manufacturers, so no discrimination is present (or possible) there. All the State does is to relieve local producer/sellers from the burden of double taxation by declining to assess a manufacturing tax on local businesses with respect to goods on which a selling tax is paid. Nor does this arrangement, notwithstanding its nondiscriminatory appearance, have discriminatory effects in and of itself. An in-state manufacturer selling in-state pays one tax to Washington; an in-state manufacturer selling out-of-state pays one tax to Washington; and an out-of-state manufacturer selling in-state pays one tax to Washington. The State collects the same tax whether interstate or intrastate commerce is involved. The tax can be considered to have discriminatory effects only if one consults what other States are in fact doing (a case-by-case inquiry that appeals to no one, *ante*, at 247) or unless one adopts an assumption as to what other States are doing. It is the latter course that the internal consistency rule adopts, assuming for purposes of our Commerce Clause determination that other States have the same tax as the tax under scrutiny. As noted earlier, I see no basis for that assumption in the tradition of our cases; and I see little basis for it in logic as well. Specifically, I see no reason why the fact that other States, by adopting a *similar* tax, might cause Washington's tax to have a discriminatory effect on interstate commerce, is of any more significance than the fact that other States, by adopting a *dissimilar* tax, might produce such a result. The latter, of course, does not suffice to invalidate a tax. To take the simplest example: A tax on manufacturing (without a tax on wholesaling) will have a discriminatory effect upon interstate commerce if another State adopts a tax on wholesaling (without a tax on manufacturing)—for then a company manufacturing and selling in the former State would pay only a single tax, while a company

manufacturing in the former State but selling in the latter State would pay two taxes. When this very objection was raised in *Armco*, we replied that, unlike the situation in *Armco* itself, "such a result would not arise from impermissible discrimination against interstate commerce . . . ." 467 U. S., at 645. That response was possible there because the West Virginia tax was facially discriminatory; it is not possible here because the Washington B & O tax is not.

It seems to me that we should adhere to our long tradition of judging state taxes on their own terms, and that there is even less justification for striking them down on the basis of assumptions as to what other States *might* do than there is for striking them down on the basis of what other States *in fact* do. Washington's B & O tax is plainly lawful on its own. It may well be that other States will impose similar taxes that will increase the burden on businesses operating interstate—just as it may well be that they will impose *dis*similar taxes that have the same effect. That is why the Framers gave Congress the power to regulate interstate commerce. Evaluating each State's taxing scheme on its own gives this Court the power to eliminate evident discrimination, while at the same time leaving the States an appropriate degree of freedom to structure their revenue measures. Finer tuning than this is for the Congress.

II

I think it particularly inappropriate to leap to a restrictive "internal consistency" rule, since the platform from which we launch that leap is such an unstable structure. It takes no more than our opinions this Term, and the number of prior decisions they explicitly or implicitly overrule, to demonstrate that the practical results we have educed from the so-called "negative" Commerce Clause form not a rock but a "quagmire," *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U. S. 450, 458 (1959). Nor is this a recent liquefaction. The fact is that in the 114 years since

the doctrine of the negative Commerce Clause was formally adopted as holding of this Court, see *Case of the State Freight Tax*, 15 Wall. 232 (1873), and in the 50 years prior to that in which it was alluded to in various dicta of the Court, see *Cooley* v. *Board of Wardens*, 12 How. 299, 319 (1852); *Gibbons* v. *Ogden*, 9 Wheat. 1, 209 (1824); *id.*, at 226–229, 235–239 (Johnson, J., concurring in judgment), our applications of the doctrine have, not to put too fine a point on the matter, made no sense. See generally D. Currie, The Constitution in the Supreme Court: The First Hundred Years 1789–1888, pp. 168–181, 222–236, 330–342, 403–416 (1985).[3]

That uncertainty in application has been attributable in no small part to the lack of any clear theoretical underpinning for judicial "enforcement" of the Commerce Clause. The text of the Clause states that "Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." Art. I, § 8, cl. 3. On its face, this is a charter for Congress, not the courts, to ensure "an area of trade free from interference by the States." *Boston Stock Exchange*, 429 U. S., at 328. The pre-emption of state legislation would automatically fol-

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[3] Professor Currie's discussion of the Commerce Clause decisions of the Marshall and Taney Courts is summed up by his assessment of the leading Taney Court decision: "Taken by itself, *Cooley* [v. *Board of Wardens*, 12 How. 299 (1852),] may appear arbitrary, conclusory, and irreconcilable with the constitutional text. Nevertheless, anyone who has slogged through the Augean agglomeration preceding Curtis's labors must find them scarcely less impressive than those of the old stable-cleaner himself." D. Currie, The Constitution in the Supreme Court: The First Hundred Years 1789–1888, p. 234 (1985). He concludes his discussion of the Chase Court's Commerce Clause jurisprudence by noting: "In doctrinal terms the Court's efforts in this field can be described only as a disaster." *Id.*, at 342 (footnote omitted). And the Waite Court receives the following testimonial: "It is a relief that with the *Bowman* decision [*Bowman* v. *Chicago & Northwestern R. Co.*, 125 U. S. 465 (1888),] we have reached the end of the commerce clause decisions of the Waite period, for they do not make elevating reading." *Id.*, at 416 (footnote omitted). Future commentators are not likely to treat recent eras much more tenderly.

low, of course, if the grant of power to Congress to regulate interstate commerce were exclusive, as Charles Pinckney's draft constitution would have provided, see Abel, The Commerce Clause in the Constitutional Convention and in Contemporary Comment, 25 Minn. L. Rev. 432, 434 (1941), and as John Marshall at one point seemed to believe it was. See *Gibbons* v. *Ogden*, *supra*, at 209. However, unlike the District Clause, which empowers Congress "To exercise exclusive Legislation," Art. I, § 8, cl. 17, the language of the Commerce Clause gives no indication of exclusivity. See *License Cases*, 5 How. 504, 579 (1847) (opinion of Taney, C. J.). Nor can one assume generally that Congress' Article I powers are exclusive; many of them plainly coexist with concurrent authority in the States. See *Kewanee Oil Co.* v. *Bicron Corp.*, 416 U. S. 470, 479 (1974) (patent power); *Goldstein* v. *California*, 412 U. S. 546, 560 (1973) (copyright power); *Houston* v. *Moore*, 5 Wheat. 1, 25 (1820) (court-martial jurisdiction over the militia); *Sturges* v. *Crowninshield*, 4 Wheat. 122, 193–196 (1819) (bankruptcy power). Furthermore, there is no correlative denial of power over commerce to the States in Art. I, § 10, as there is, for example, with the power to coin money or make treaties. And both the States and Congress assumed from the date of ratification that at least some state laws regulating commerce were valid. See *License Cases*, *supra*, at 580–581. The exclusivity rationale is infinitely less attractive today than it was in 1847. Now that we know interstate commerce embraces such activities as growing wheat for home consumption, *Wickard* v. *Filburn*, 317 U. S. 111 (1942), and local loan sharking, *Perez* v. *United States*, 402 U. S. 146 (1971), it is more difficult to imagine what state activity would survive an exclusive Commerce Clause than to imagine what would be precluded.

Another approach to theoretical justification for judicial enforcement of the Commerce Clause is to assert, as did Justice Curtis in dicta in *Cooley* v. *Board of Wardens*, *supra*, at 319, that "[w]hatever subjects of this power are in their

nature national, or admit only of one uniform system, or plan of regulation, may justly be said to be of such a nature as to require exclusive legislation by Congress." That would perhaps be a wise rule to adopt (though it is hard to see why judges rather than legislators are fit to determine what areas of commerce "in their nature" require national regulation), but it has the misfortune of finding no conceivable basis in the text of the Commerce Clause, which treats "Commerce . . . among the several States" as a unitary subject. And attempting to limit the Clause's pre-emptive effect to state laws *intended* to regulate commerce (as opposed to those intended, for example, to promote health), see *Gibbons* v. *Ogden, supra,* at 203, while perhaps a textually possible construction of the phrase "regulate Commerce," is a most unlikely one. Distinguishing between laws with the *purpose* of regulating commerce and "police power" statutes with that *effect* is, as Taney demonstrated in the *License Cases, supra,* at 582–583, more interesting as a metaphysical exercise than useful as a practical technique for marking out the powers of separate sovereigns.

The least plausible theoretical justification of all is the idea that in enforcing the negative Commerce Clause the Court is not applying a constitutional command at all, but is merely interpreting the will of Congress, whose silence in certain fields of interstate commerce (but not in others) is to be taken as a prohibition of regulation. There is no conceivable reason why congressional inaction under the Commerce Clause should be deemed to have the same pre-emptive effect elsewhere accorded only to congressional action. There, as elsewhere, "Congress' silence is just that—silence . . . ." *Alaska Airlines, Inc.* v. *Brock,* 480 U. S. 678, 686 (1987). See Currie, *supra* n. 3, at 334 (noting "the recurring fallacy that in some undefined cases congressional inaction was to be treated as if it were permissive or prohibitory legislation—though

the Constitution makes clear that Congress can act only by affirmative vote of both Houses" (footnotes omitted)).[4]

The historical record provides no grounds for reading the Commerce Clause to be other than what it says—an authorization for Congress to regulate commerce. The strongest evidence in favor of a negative Commerce Clause—that version of it which renders federal authority over interstate commerce exclusive—is Madison's comment during the Convention: "Whether the States are now restrained from laying tonnage duties depends on the extent of the power 'to regulate commerce.' These terms are vague but seem to exclude this power of the States." 2 M. Farrand, Records of the Federal Convention of 1787, p. 625 (1937). This comment, however, came during discussion of what became Art. I, § 10, cl. 3: "No State shall, without the Consent of Congress, lay any Duty of Tonnage . . . ." The fact that it is difficult to conceive how the power to regulate commerce would *not* include the power to impose duties; and the fact that, despite this apparent coverage, the Convention went on to adopt a provision prohibiting States from levying duties on tonnage without congressional approval; suggest that Madison's as-

[4] Unfortunately, this "legislation by inaction" theory of the negative Commerce Clause seems to be the only basis for the doctrine, relied upon by the Court in *Scheiner*, *post*, at 289, n. 23, that Congress can authorize States to enact legislation that would otherwise violate the negative Commerce Clause. See *Prudential Ins. Co.* v. *Benjamin*, 328 U. S. 408 (1946). Nothing else could explain the *Benjamin* principle that what was invalid state action can be rendered valid state action through "congressional consent." There is surely no area in which Congress can permit the States to violate the Constitution. Thus, in *Cooley* v. *Board of Wardens*, 12 How. 299 (1852), Justice Curtis, to whom there had not occurred the theory of congressional legislation by inaction, wrote of the relationship between States and the negative Commerce Clause as follows: "If the States were divested of the power to legislate on this subject by the grant of the commercial power to Congress, it is plain this Act could not confer upon them power thus to legislate. If the Constitution excluded the States from making any law regulating commerce, certainly Congress cannot regrant, or in any manner reconvey to the States that power." *Id.*, at 318.

sumption of exclusivity of the federal commerce power was ill considered and not generally shared.

Against this mere shadow of historical support there is the overwhelming reality that the Commerce Clause, in its broad outlines, was not a major subject of controversy, neither during the constitutional debates nor in the ratifying conventions. Instead, there was "nearly universal agreement that the federal government should be given the power of regulating commerce," Abel, 25 Minn. L. Rev., at 443–444, in much the form provided. "The records disclose no constructive criticisms by the states of the commerce clause as proposed to them." F. Frankfurter, The Commerce Clause under Marshall, Taney and Waite 12 (1937). In The Federalist, Madison and Hamilton wrote numerous discourses on the virtues of free trade and the need for uniformity and national control of commercial regulation, see The Federalist No. 7, pp. 62–63 (C. Rossiter ed. 1961); *id.*, No. 11, pp. 89–90; *id.*, No. 22, pp. 143–145; *id.*, No. 42, pp. 267–269; *id.*, No. 53, p. 333, but said little of substance specifically about the Commerce Clause—and that little was addressed primarily to foreign and Indian trade. See generally Abel, *supra*, at 470–474. Madison does not seem to have exaggerated when he described the Commerce Clause as an addition to the powers of the National Government "which few oppose and from which no apprehensions are entertained." The Federalist No. 45, p. 293. I think it beyond question that many "apprehensions" would have been "entertained" if supporters of the Constitution had hinted that the Commerce Clause, despite its language, gave this Court the power it has since assumed. As Justice Frankfurter pungently put it: "the doctrine that state authority must be subject to such limitations as the Court finds it necessary to apply for the protection of the national community . . . [is] an audacious doctrine, which, one may be sure, would hardly have been publicly avowed in support of the adoption of the Constitution." Frankfurter, *supra*, at 19.

In sum, to the extent that we have gone beyond guarding against rank discrimination against citizens of other States—which is regulated not by the Commerce Clause but by the Privileges and Immunities Clause, U. S. Const., Art. IV, § 2, cl. 1 ("The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States")—the Court for over a century has engaged in an enterprise that it has been unable to justify by textual support or even coherent nontextual theory, that it was almost certainly not intended to undertake, and that it has not undertaken very well. It is astonishing that we should be expanding our beachhead in this impoverished territory, rather than being satisfied with what we have already acquired by a sort of intellectual adverse possession.

Appendix M

TRINOVA CORP. *v.* MICHIGAN DEPARTMENT OF TREASURY

CERTIORARI TO THE SUPREME COURT OF MICHIGAN

No. 89-1106. Argued October 1, 1990—Decided February 19, 1991

Michigan's single business tax (SBT) is a value added tax (VAT) levied against entities having "business activity" within the State. As part of the SBT computation, a taxpayer doing business both within and without the State must determine its apportioned tax base by multiplying its total value added—which consists of its profit, as represented by its federal taxable income, plus compensation paid to labor, depreciation on capital, and other factors—by the portion of its business activity attributable to Michigan—which consists of the average of three ratios: (1) Michigan payroll to total payroll, (2) Michigan property to total property, and (3) Michigan sales to total sales. During 1980, the tax year in question, petitioner Trinova, an Ohio corporation, maintained a 14-person sales office in Michigan. Under the SBT formula, its 1980 payroll and property apportionment factors were only 0.2328% and 0.0930% respectively, while its sales factor was 26.5892%, representing Michigan sales of over $100 million. Although its 1980 federal taxable income showed a loss of almost $42.5 million, Trinova's SBT computation resulted in a tax of over $293,000. Trinova paid the tax, but subsequently filed an amended return and refund claim, alleging that it was entitled to relief under Michigan law because the SBT's apportionment provisions did not fairly represent the extent of its business activity within the State. The amended return proposed that Trinova's company-wide compensation and depreciation be excluded from its preapportionment value added, and that its actual Michigan compensation and depreciation be added back into its apportioned tax base, which would result in a negative value added apportioned to Michigan and entitle the company to a refund for its entire 1980 SBT payment. When respondent Department of Treasury denied relief, Trinova sued for a refund in the State Court of Claims, which ruled in its favor. However, the State Court of Appeals held that Trinova was not entitled to statutory relief, and the State Supreme Court affirmed, holding, among other things, that the SBT's three-factor apportionment formula did not violate either the Due Process Clause or the Commerce Clause of the Federal Constitution.

Held: As applied to Trinova during the tax year at issue, the SBT's three-factor apportionment formula does not violate either the Due Process Clause or the Commerce Clause. Pp. 372–387.

(a) Under the test stated in *Complete Auto Transit, Inc.* v. *Brady*, 430 U. S. 274, 279, a state tax levied upon multistate businesses is valid under the Commerce Clause if, as relevant here, it is fairly apportioned and does not discriminate against interstate commerce. Moreover, the *Complete Auto* test encompasses the Due Process Clause requirement that, *inter alia*, a rational relationship exist between the income attributed to the State and the intrastate values of the enterprise. See, *e. g.*, *Mobil Oil Corp.* v. *Commissioner of Taxes of Vt.*, 445 U. S. 425, 436–437. Pp. 372–373.

(b) Because the SBT attempts to tax a base that cannot be assigned to one geographic location with any precision, the decision to apportion the tax is not unconstitutional. Although Trinova's compensation and depreciation may appear in isolation to be susceptible of geographic designation, those elements cannot be separated from income, which cannot be located in a single State. The SBT is not a combination or series of several smaller taxes on compensation, depreciation, and income, but is an indivisible tax upon a different, bona fide measure of business activity, the value added. This conclusion is no different from the one this Court has reached in upholding the validity of state apportionment of income taxes. The same factors that prevent determination of the geographic location where income is generated—such as functional integration of the intrastate and extrastate activities of a unitary business enterprise, centralization of management, and economies of scale—make it impossible to determine the location of value added with exact precision. See, *e. g.*, *Mobil Oil Corp.*, *supra*, at 438; *Amerada Hess Corp.* v. *Director, Div. of Taxation, N. J. Dept. of Treasury*, 490 U. S. 66, 74. Thus, although Trinova had no federal income during 1980, it cannot be relieved of tax upon its Michigan business. Such relief would be incompatible with the rationale of a VAT, under which tax becomes due even if the taxpayer was unprofitable, and is unsupported by the record. Trinova's approach would require the conclusion that it added value only at the factory through the consumption of capital and labor, while the record would as easily support a finding that its production operations added little value and its sales offices added significant value. Although Trinova's 14 Michigan sales personnel need not be relied on as the sole, or even a substantial, source of all the value added that can be apportioned fairly to Michigan, it cannot be doubted that, without the company's $100 million in Michigan sales, its total value added would have been

lower to a remarkable degree. It distorts the SBT both in application and theory to confine value added consequences of the Michigan market solely to the labor and capital expended by the resident sales force. Pp. 373–379.

(c) The SBT's three-factor apportionment formula cannot be ruled unfair, since Trinova has failed to meet its burden of proving, by clear and cogent evidence, that there is no rational relationship between its tax base measure attributed to Michigan and the contribution of its Michigan business activity to the entire value added process. Cf., *e. g.*, *Container Corp. of America* v. *Franchise Tax Bd.*, 463 U. S. 159, 169, 180–181; *Moorman Mfg. Co.* v. *Bair*, 437 U. S. 267, 274. This Court has approved the same formula for apportionment of income, see, *e. g.*, *Butler Bros.* v. *McColgan*, 315 U. S. 501, and the formula has gained wide acceptance in that context "because payroll, property, and sales appear in combination to reflect a very large share of the activities *by which value is generated*," *Container Corp.*, *supra*, at 183 (emphasis added). Trinova's argument—that the formula leads to a distorted result, out of all proportion to the company's Michigan business, because sales have no relationship to, and add nothing to, the value that compensation and depreciable plant contribute to the Michigan tax base—is rejected, since sales (as a measure of market demand) do have a profound impact upon the amount of an enterprise's value added, and since there is no basis for distinguishing similar arguments that were pressed, and rejected by this Court, with regard to the apportionment of income. Because the three-factor formula causes no distortion, the SBT does not tax value earned outside Michigan. The argument that the value was added in Ohio, by labor and capital, and that no value has been added in Michigan, wrongly assumes that value added is subject to geographic ascertainment and that a sales factor is inappropriate in apportionment. Trinova gives no estimate of the value added that would take account of both its Michigan sales activity and Michigan market demand for its products, whereas the State has consistently applied the three-factor formula and has enacted further provisions giving relief to labor intensive taxpayers like Trinova. Pp. 379–384.

(d) The SBT does not discriminate against interstate commerce. Trinova cannot point to any treatment of in-state and out-of-state firms that is discriminatory on its face. Although *American Trucking Assns., Inc.* v. *Scheiner*, 483 U. S. 266, 281, states that the Commerce Clause has a "deeper meaning" that may be implicated even absent facial discrimination, that meaning is embodied in the requirement of fair apportionment and does not encompass Trinova's vague accusation of discrimination. Nor is that accusation supported by a statement of Michigan's Governor that the SBT was enacted to promote business

development and investment within the State. Such promotion is a laudable goal in the absence of evidence of an impermissible motive to export tax burdens or import tax revenues. Pp. 384-386.

433 Mich. 141, 445 N. W. 2d 428, affirmed.

KENNEDY, J., delivered the opinion of the Court, in which REHNQUIST, C. J., and WHITE, MARSHALL, and O'CONNOR, JJ., joined. SCALIA, J., filed an opinion concurring in the judgment, *post*, p. 387. STEVENS, J., filed a dissenting opinion, in which BLACKMUN, J., joined, *post*, p. 388. SOUTER, J., took no part in the consideration or decision of the case.

Peter S. Sheldon argued the cause for petitioner. With him on the briefs were *Thomas D. Hammerschmidt, Jr., Jeffery V. Stuckey, Benjamin O. Schwendener, Jr., William F. Sheehan, Collette C. Goodman,* and *Walter Hellerstein.*

Richard R. Roesch, Assistant Attorney General of Michigan, argued the cause for respondent. With him on the brief were *Frank J. Kelley,* Attorney General, *Gay Secor Hardy,* Solicitor General, and *Thomas L. Casey,* Assistant Solicitor General.*

JUSTICE KENNEDY delivered the opinion of the Court.

The principal question before us is whether the three-factor apportionment formula of the Michigan single business tax (SBT), Mich. Comp. Laws § 208.1 *et seq.* (1979), violates either the Due Process Clause or the Commerce Clause of the Federal Constitution. The applicability of a three-factor formula to a state income tax is well settled, but we have not considered whether a similar apportionment formula may be applied to a value added tax (VAT). We granted certiorari to consider this question and to determine whether the Michigan SBT discriminates against out-of-state businesses.

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*Briefs of *amici curiae* urging reversal were filed for Alcan Aluminum Corp. et al. by *Patrick R. Van Tiflin, Myra L. Willis,* and *James H. Geary;* and for Caterpillar Inc. by *Don S. Harnack* and *Richard A. Hanson.*

Benna Ruth Solomon and *Charles Rothfeld* filed a brief for the Council of State Governments et al. as *amici curiae* urging affirmance.

I

Although in Europe and Latin America VAT's are common, see Lindholm, The Origin of the Value-Added Tax, 6 J. Corp. L. 11 (1980); Due, Economics of the Value Added Tax, 6 J. Corp. L. 61 (1980), in the United States they are much studied but little used. Michigan is the first and, the parties tell us, the only State to have enacted a VAT as a tax on business activity. We begin with a description of value added and VAT's in general, and then discuss the Michigan SBT.

A

Value added is an economic concept. "Value added is defined as the increase in the value of goods and services brought about by whatever a business does to them between the time of purchase and the time of sale." Haughey, The Economic Logic of the Single Business Tax, 22 Wayne L. Rev. 1017, 1018 (1976) (hereinafter Haughey). The value a business adds to a single product is "the difference between the value of the product at sale and the cost of goods purchased from other businesses that went into the product." Taxation and Economic Policy Office, Michigan Department of Treasury, Analysis of the Michigan Single Business Tax 20–21 (1985) (hereinafter SBT Analysis). It follows that the sale price of a product is the total of all value added by each step of the production process to that point. "The value added of a loaf of bread is the sum of the value contributed at each stage of the production and distribution process. Among others, it includes the contribution of the farmer, miller, baker, wholesaler and retailer." Haughey 1019.

A business "adds value by handling or processing these [goods] with its labor force, machinery, buildings and capital." R. Kleine, Advisory Commission on Intergovernmental Relations, The Michigan Single Business Tax: A Different Approach to State Business Taxation 1 (1978) (hereinafter Kleine). In this litigation, value added usually refers to the

activities of a single business enterprise. The term can, however, be used with regard to a single product, or even an entire economy. "[Value added] is a means of consistently measuring the size of business firms and other economic enterprises comprising the total economy . . . . Gross National Product is virtually equivalent to national value added." Haughey 1017.

One of the acknowledged advantages of value added as a measure of taxation is its neutrality. A VAT is neutral in the sense that it taxes all business activity alike: Under a pure VAT, all forms of business organization (corporation, partnership, proprietorship), all types of financing (debt, equity) and all methods of production (capital intensive, labor intensive) bear the same tax burden.

> "[T]ax factors are minimized in business decisions; inherent advantages and relative efficiencies are allowed to operate in the market economy with minimum tax distortions.
>
> "This neutrality of a value-added tax is in notable contrast to the effects of both the corporation income tax and the payroll taxes. The former, by definition, is applied only to corporations and varies with their reliance on equity rather than debt capital and the efficiency with which they use equity capital—that is, their net profits." Smith, Value-added tax: the case for, 48 Harv. Bus. Rev. 77, 79 (Nov.-Dec. 1970).

Though neutral in theory, VAT's often depart in practice from the pure value added model because of special exemptions, deductions, and other adjustments. These features can eliminate much of the claim to neutrality. See generally The Value-Added Tax: Lessons from Europe (H. Aaron ed. 1981).

A VAT differs in important respects from a corporate income tax. A corporate income tax is based on the philosophy of ability to pay, as it consists of some portion of the profit remaining after a company has provided for its work-

ers, suppliers, and other creditors. A VAT, on the other hand, is a much broader measure of a firm's total business activity. Even if a business entity is unprofitable, under normal circumstances it adds value to its products and, as a consequence, will owe some VAT. Because value added is a measure of actual business activity, a VAT correlates more closely to the volume of governmental services received by the taxpayer than does an income tax. Further, because value added does not fluctuate as widely as net income, a VAT provides a more stable source of revenue than the corporate income tax. See generally Kleine 3, figure 1. "'The logic or rationale of the [VAT] rests squarely on the benefits received principle of taxation—government services are essential to the operation of any business enterprise . . . and a part of these public service costs should properly be included in the cost of doing business.'" *Id.*, at 4 (citation omitted).

The SBT Analysis, at 20–21, provides us with the following simplified example of how value added is determined. Assume a bakery's sole revenue comes from the sale of bread. The bakery's costs consist of materials (flour, sugar, spices, utilities), labor (baker, sales clerk), capital (building, mixer, utensils, oven), and credit (interest paid on loans). Any excess of revenues over costs represents profit. Thus:

Revenues = Cost of Labor + Cost of Materials + Depreciation[1] + Interest + Profit.

Because value added is defined as the difference between the value of products sold (revenues), and the cost of materials going into the products, we can represent value added (for the entire firm) by a second simple equation:

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[1] In calculating value added, a firm's use of capital is represented by depreciation. Depreciation is the reduction in value of a firm's assets, through wear and tear, obsolescence, or other factors, and thus roughly measures consumption of capital. See McGraw-Hill Dictionary of Modern Economics 130 (3d ed. 1983); P. Samuelson & W. Nordhaus, Economics 902 (12th ed. 1985).

Value added = Revenues − Cost of Materials.

The same result is reached by another common method. If we subtract Cost of Materials from each side of the first equation above, we have:

Revenues − Cost of Materials = Cost of Labor + Depreciation + Interest + Profit.

So in practice value added can be calculated as *either* Revenues − Cost of Materials; *or* Cost of Labor + Depreciation + Interest + Profit. Not surprisingly, these are referred to as the "subtraction" and the "addition" methods. Each provides an identical measurement of a taxpayer's value added.[2] Once value added is determined, the VAT is assessed as a percentage of the value added for the relevant fiscal period.[3]

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[2] See, *e. g.*, Aaron, Introduction and Summary, in The Value-Added Tax: Lessons from Europe 1, 2 (H. Aaron ed. 1981) (hereinafter Aaron); Haughey 1018; Special Committee on the Value-Added Tax of the Section of Taxation, American Bar Association, The Choice Between Value-Added and Sales Taxation at Federal and State Levels in the United States, 29 Tax Lawyer 457, 459 (1976) (addition and subtraction methods "reac[h] the same result by the opposite means"); SBT Analysis 20 (addition and subtraction are "two *alternative,* but *equivalent* ways of calculating value added. . . . The important point is that, conceptually, these two calculations are *equal*").

[3] The nations of the European Economic Community (EEC) each levy a VAT under yet a third method, as a multistage sales tax. See generally Aaron. Under the EEC system, the bakery in our example would be taxed on each sale of bread and would receive a credit for each purchase of materials going into production of the bread. Similarly, at each other link in the chain of production and distribution, tax is assessed on sales, but credit is provided on purchases. This multistage sales tax system places the burden on the taxpayer to demonstrate that it did, in fact, purchase goods for which it requests a credit. The multistage sales tax version of the VAT has been advocated as promoting tax compliance, though the evidence does not necessarily support this view. See Oldman & Woods, Would a Value-Added Tax System Relieve Tax Compliance Problems, in Income Tax Compliance: A Report of the ABA Section of

B

The Michigan SBT went into effect on January 1, 1976. 1975 Mich. Pub. Acts 228.[4] The SBT replaced seven different business taxes. Kleine 22; Brief for Respondent 8. Before 1976, a typical manufacturer with business activity in

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Taxation Invitational Conference on Income Tax Compliance 317 (1983) (multistage consumption VAT has traditionally been regarded as self-enforcing because the tax credit mechanism is said to induce firms to report transactions accurately).

The requirement of "fiscal frontiers" to record and tax interstate transactions makes the multistage sales tax approach impracticable for an individual State. McLure, State and Federal Relations in the Taxation of Value Added, 6 J. Corp. L. 127, 130–131 (1980); see also Haughey 1025 ("invoice credit method is not workable in a subeconomy without the legal authority and means to control the flow of imports and exports").

On international transactions, the EEC's VAT's are assessed in the jurisdiction of destination. As a result, no tax is applied on exports, while full tax is applied to imports. See *id.*, at 1024–1025; Aaron 4. The destination principle does not, however, purport to determine whether value was added in the jurisdiction of destination, or the jurisdiction of origin.

[4] The SBT was not Michigan's first experiment with a VAT. Between 1953 and 1967, Michigan had utilized a Business Activities Tax (BAT) similar to the Michigan SBT. Although the BAT was a subtraction method VAT, and permitted different adjustments than the SBT, the BAT tax base included "a company's payroll, profits, and capital outlay less depreciation allowed," Lock, Rau, & Hamilton, The Michigan Value-Added Tax, 8 Nat. Tax J. 357, 363 (1955), and was apportioned among States by the same three-factor formula that is challenged here. See Mich. Stat. Ann. §§ 7.557(1)–7.557(24) (Supp. 1955), repealed, 1967 Mich. Pub. Acts 281. The Michigan Supreme Court upheld the BAT against a challenge on facts remarkably similar to those presented here by Trinova. *Armco Steel Corp.* v. *State*, 359 Mich. 430, 102 N. W. 2d 552, 555–556 (1960) (Ohio corporation had nominal Michigan property and payroll, but substantial Michigan sales). We dismissed an appeal of the judgment in *Armco* for want of a substantial federal question. *Armco Steel Corp.* v. *Michigan*, 364 U. S. 337 (1960). The arguments in that case focused on whether the BAT was best characterized as a tax on income or a tax on gross receipts, with the concern that under our jurisprudence of the time a "direct" tax on gross receipts from interstate commerce would be unconstitutional.

Michigan would have been subject to a franchise tax, an income tax, an intangible property tax, and an ad valorem property tax upon inventories. Mitchell, Taxes Repealed and Amended, 22 Wayne L. Rev. 1029 (1976); Brief for Respondent 8–9. After enactment of the SBT, the same manufacturer would pay only one tax.

The Michigan SBT is an addition method VAT, although it inevitably permits various exclusions, exemptions, and adjustments that depart from the simple value added examples described above. Subject to exemptions contained at Mich. Comp. Laws § 208.35 (1979), the Michigan SBT is levied against any person with "business activity" within the State of Michigan. § 208.31(1).[5] In order to calculate the amount of a taxpayer's SBT the taxpayer must, first, determine its total tax base. The total tax base consists of the taxpayer's value added, calculated by the addition method: Cost of Labor + Depreciation + Interest + Profit. Under § 208.9, the taxpayer begins with federal taxable income (representing profit), adds other elements that reflect consumption of labor and capital including compensation, depreciation, dividends, and interest paid by the taxpayer, and makes other detailed adjustments.

Second, if a taxpayer does business both within and without Michigan, it must determine the portion of its total value added attributable to Michigan. That portion, the crux of this case, is the average of three ratios: (1) Michigan payroll

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[5] "Business activity" is broadly defined as "a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, within this state, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others, but shall not include the services rendered by an employee to his employer, services as a director of a corporation, or a casual transaction. . . ." Mich. Comp. Laws § 208.3 (1979).

to total payroll, (2) Michigan property to total property, and (3) Michigan sales to total sales. §§208.45, 208.46, 208.49, 208.51. The total tax base is multiplied by the portion of business activity attributable to Michigan (under the three-factor formula), and the result, subject to several further adjustments, is the taxpayer's "adjusted tax base." §208.31(2).

Two further adjustments are relevant here: §208.23(a), which permits a taxpayer to deduct a portion of its capital acquisitions, and §208.31(5), which permits a labor-intensive taxpayer to reduce its adjusted tax base by a percentage equal to the percentage by which compensation exceeds 63% of the total tax base, but with such reduction not to exceed a maximum of 37%. Actual tax liability equals the adjusted tax base multiplied by a tax rate of 2.35%.[6]

II

Trinova, an Ohio corporation, manufactures automobile components. Its principal office is located in Maumee, Ohio, a suburb of Toledo located near the Michigan border. During 1980, the tax year in question, Trinova maintained a fixed presence in Michigan: a sales office of 14 employees who solicited orders, maintained contact with Trinova's Michigan customers, and performed clerical work. Michigan, with its automobile industry, was a major market for Trinova's products. Indeed, Trinova made $103,981,354 worth of sales to Michigan during 1980, 26.5892% of its total sales of $391,065,866. Trinova calculated its 1980 SBT adjusted tax base as follows:

[6] Any taxpayer can, in the alternative, calculate its adjusted tax base as total gross receipts multiplied by the apportionment figure (derived using the three-factor formula) divided by two. This figure is then multiplied by the 2.35% tax rate to give actual tax liability. § 208.31(2). Under this alternative calculation, no firm's Michigan SBT liability will ever exceed 1.175% of apportioned gross receipts.

U. S. taxable income (loss)	($42,466,114)
Add:	
Compensation	$226,356,271
Depreciation	$23,262,909
Dividends, interest, and royalties paid	$22,908,950
Other	$549,526
Subtotal	$230,611,542
Subtract:	
Dividends, interest, and royalties received	($9,486,223)
Total Tax Base	$221,125,319
Apportionment:	
Payroll Factor	0.2328%
Property Factor	0.0930%
Sales Factor	26.5892%
Average Factor	8.9717%
Apportioned Tax Base:	
	$221,125,319
	× 8.9717%
	= $19,838,700

See 433 Mich. 141, 150–152, 445 N. W. 2d 428, 431–433 (1989). Trinova further adjusted its tax base by subtracting a capital acquisition deduction ($9,063) and by taking the maximum (37%) reduction for labor-intensive taxpayers. These adjustments resulted in a 1980 adjusted tax base of $12,492,671. When multiplied by the tax rate of 2.35%, Trinova's tax liability amounted to $293,578 ($12,492,671 × 2.35%).[7] Trinova timely filed its return and paid its tax liability.

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[7] Trinova could have calculated its tax liability under the alternative gross receipts method, Mich. Comp. Laws § 208.31(2) (1979), as follows:

In 1985, a Michigan intermediate Court of Appeals ruled that taxpayers similarly situated to Trinova were entitled to "relief" under Mich. Comp. Laws § 208.69 (1979), a provision of the SBT. *Jones & Laughlin Steel Corp.* v. *Department of Treasury*, 145 Mich. App. 405, 377 N. W. 2d 397, leave to appeal and reconsideration denied, 424 Mich. 895 (1986). At the time, § 208.69 provided that if the apportionment provisions of the SBT did not "fairly represent the extent of the taxpayer's business activity" in Michigan, the taxpayer could, among other alternatives, petition for the employment of "any other method to effectuate an equitable allocation and apportionment of the taxpayer's tax base."

Soon after the decision in *Jones & Laughlin*, Trinova filed an amended return and refund claim for the 1980 tax year. Based on the relief granted in *Jones & Laughlin*, Trinova proposed that despite admitted company-wide value added of $221 million and Michigan sales of over $100 million, for purposes of the Michigan SBT it should be treated as if it had negative total value added. Value added apportioned to Michigan would also have been negative, and Trinova would have been entitled to a refund for its entire 1980 SBT payment.[8] Upon denial of relief by the Michigan Department of

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Total gross receipts ($391,065,866) multiplied by Michigan apportionment factor (8.9717%) divided by two (equals $17,542,628) multiplied by 2.35% equals tax liability of $412,251. This figure amounts to less than 0.4% of Trinova's Michigan sales. Of course, Trinova did not use this method, as it was required to pay only $293,578 (or 0.28% of Michigan sales) under the apportionment method challenged here.

[8] The amended return proposed that Trinova's company-wide compensation and depreciation be excluded from the preapportionment tax base, and actual Michigan compensation and depreciation be added back into the apportioned tax base, as follows:

Total Tax Base—statutory formula:	$221,125,319
Deduct Compensation	($226,356,271)
Deduct Depreciation	($23,262,909)
Trinova's Proposed Total Tax Base:	($28,493,861)

Treasury, Trinova sued for a refund in the Michigan Court of Claims, which ruled in Trinova's favor on the authority of *Jones & Laughlin.* No. 86–10430–CM (May 5, 1987); App. to Pet. for Cert. 42a–51a.

While the Department of Treasury's appeal was pending in the Michigan Court of Appeals, the legislature amended § 208.69. 1987 Mich. Pub. Acts 39. The amended § 208.69 creates a presumption that the statutory apportionment formula fairly represents the taxpayer's business activity in Michigan unless the adjusted tax base meets one of two tests, neither of which Trinova could satisfy, and which do not merit discussion here. See Mich. Comp. Laws Ann. § 208.69(3) (West Supp. 1990). The Court of Appeals referred to the legislature's statement that its Act was intended to be

> "curative, expressing the original intent of the legislature that the single business tax . . . is an indivisible value added type of tax and not a combination or series of several smaller taxes and that relief from formulary apportionment should be granted only under extraordinary circumstances." 1987 Mich. Pub. Acts 39, § 2.

Relying upon this language, the Court of Appeals determined that the amendment was to be given retroactive effect as a "remedial and procedural" statute and that Trinova was not entitled to statutory relief. 166 Mich. App. 656, 666, 421 N. W. 2d 258, 262 (1988).

The Michigan Supreme Court affirmed the Court of Appeals. 433 Mich. 141, 445 N. W. 2d 428 (1989). Without addressing retroactive application of the amendments to § 208.69, it construed § 208.69 as a "constitutional 'circuit

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Apportionment (8.9717%)	($2,556,384)
Add Michigan Compensation	$511,774
Add Michigan Depreciation	$2,152
Apportioned Tax Base:	($2,042,458)

433 Mich. 141, 147, n. 4, 445 N. W. 2d 428, 431, n. 4 (1989).

breaker'" to be applied only if required in order to save the SBT against unconstitutional application. *Id.*, at 156, 445 N. W. 2d, at 434. The court then upheld the SBT against Trinova's federal constitutional challenges. The Michigan Supreme Court noted that formulary apportionment of income taxes is uncontroversial and that it did "not believe that 'business activity' as defined under the [SBT] is susceptible to accurate analysis when only one component of the total business effort is examined." *Id.*, at 163, 445 N. W. 2d, at 438. The court concluded that Trinova's averaged ratios of payroll, property, and sales are a fair representation of the extent of its business activity in Michigan, making it ineligible for relief on statutory or constitutional grounds. *Id.*, at 163–166, 445 N. W. 2d, at 438–439. We granted Trinova's petition for a writ of certiorari. 494 U. S. 1015 (1990).

III

The principles which govern the validity of state taxes levied upon multistate businesses seek to accommodate the necessary abstractions of tax theory to the realities of the marketplace. Under the test stated in *Complete Auto Transit, Inc.* v. *Brady*, 430 U. S. 274, 279 (1977), we will sustain a tax against Commerce Clause challenge so long as "the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." We applied this four-part test in later cases addressing a wide variety of taxes. See *Goldberg* v. *Sweet*, 488 U. S. 252, 260, n. 12 (1989) (citing applications in cases involving sales, severance, use, corporate income, and business and occupation taxes).

In *Complete Auto*, we renounced the formalistic approach of *Spector Motor Service, Inc.* v. *O'Connor*, 340 U. S. 602 (1951), which had prohibited a State from taxing the privilege of doing business in the State, treating it as a tax upon interstate commerce and so beyond the authority of the

State. We seek to avoid formalism and to rely upon a "consistent and rational method of inquiry [focusing on] the practical effect of a challenged tax." *Mobil Oil Corp.* v. *Commissioner of Taxes of Vt.*, 445 U. S. 425, 443 (1980). The *Complete Auto* test, while responsive to Commerce Clause dictates, encompasses as well the due process requirement that there be "a 'minimal connection' between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise." *Mobil Oil Corp., supra,* at 436- 437; see also *Amerada Hess Corp.* v. *Director, Div. of Taxation, N. J. Dept. of Treasury,* 490 U. S. 66, 80 (1989) (SCALIA, J., concurring).

In this Court, Trinova does not dispute that its business activities have a substantial nexus with Michigan and subject it to the State's taxing authority. Nor does Trinova argue that the amount of tax it is required to pay bears no fair relation to the services provided by the State. *Complete Auto, supra,* at 279. Trinova instead contends that Michigan's SBT fails the other two prongs of the *Complete Auto* test: that the SBT is not fairly apportioned as applied to Trinova and that the tax discriminates against interstate commerce. We consider these claims and begin with the matter of apportionment.

A

Trinova's claim that apportionment of the tax is unconstitutional concentrates on the elements of the apportionment formula. The original rationale for apportionment of income was the difficulty of identifying the geographic source of the income earned by a multistate enterprise. See *Underwood Typewriter Co.* v. *Chamberlain,* 254 U. S. 113, 120–121 (1920) (legislature "faced with the impossibility of allocating specifically the profits earned by the [taxpayer's] processes conducted within its borders"). As we stated the problem in *Container Corp. of America* v. *Franchise Tax Bd.*, 463 U. S. 159, 192 (1983): "Allocating income among various taxing ju-

risdictions bears some resemblance . . . to slicing a shadow." Trinova argues that because its SBT tax base is composed in large part of compensation and depreciation, elements which can be assigned to a geographic source, we must reject apportionment altogether.

We can accept the premise that apportionment is permitted only when precise geographic measurement is not feasible, for to allow apportionment where there is no practical or theoretical justification could provide the opportunity for a State to export tax burdens and import tax revenues. The Commerce Clause prohibits this competitive mischief. The issue becomes whether, without an apportionment formula, Michigan can assign the SBT tax base and its principal components to separate geographic locations and to separate accounts in each State. Michigan has decided it cannot do so without serious theoretical and practical difficulty, and upon review of the case we accept that determination.

We reject at the outset, however, arguments by Michigan and some *amici curiae* that the Michigan SBT can be analyzed as a tax upon "business activity." Brief for Council of State Governments et al. as *Amici Curiae* 11. The statute does not say that the SBT is a tax upon business activity, but rather that it is a "tax of 2.35% *upon the adjusted tax base* of every person *with business activity in this state* which is allocated or apportioned to this state." Mich. Comp. Laws §208.31(1) (1979) (emphasis added). While Michigan business activity is a threshold requirement for the tax, and value added is its measure, labeling the SBT a tax on "business activity" does not permit us to forgo examination of the actual tax base and apportionment provisions. "A tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes." Jenkins, State Taxation of Interstate Commerce, 27 Tenn. L. Rev. 239, 242 (1960).

Trinova errs in the opposite direction. It would dissect the tax base as if the SBT were three separate and independent taxes: a tax on compensation, a tax on depreciation, and a

tax on income, each apportioned. Trinova insists that compensation and depreciation can be located and can be separated from the total value added calculation. As a result, Trinova would be taxed upon its Michigan compensation and Michigan depreciation. It would owe no additional tax upon income apportionable to Michigan, because it had no income during the relevant tax year.

This characterization, and with it Trinova's constitutional argument, fails. Doubtless Trinova can identify the location of its plant and equipment and much of its compensation. The Michigan SBT, however, is not three separate and independent taxes, and Trinova cannot purport to identify the geographic source of value added by assuming that two elements can be located in a single State while the third cannot. Trinova's proposed apportionment for the 1980 tax year, n. 8, *supra*, provides a good example of the problems that accompany its argument.

In 1980, Trinova's company-wide value added amounted to much less than its compensation plus depreciation. In short, Trinova was unprofitable. Under a VAT, however, tax becomes due in any event. Trinova's approach would require us to conclude that Trinova added value at the factory through the consumption of capital and labor, but that its products somehow lost value outside of this process, perhaps between the time they left the factory and the time they were delivered to customers in Michigan. This approach is incompatible with the rationale of a VAT and is unsupported in the record.

For all this record shows, Trinova's production operations might have added little value and its sales offices might have added significant value, through superior marketing skill, liaison between the company and its customers, or mere fortuity. See *Moorman Mfg. Co.* v. *Bair*, 437 U. S. 267, 272 (1978) (record lacked analysis of what portion of profits was apportionable to sales, to manufacturing, or to other phase of company's operations).

But we need not rely upon Trinova's 14 Michigan sales personnel as the source of all the value added that can be apportioned fairly to Michigan. In a unitary enterprise, compensation, depreciation, and profit are not independent variables to be adjusted without reference to each other. If Trinova had paid an additional $100 million in compensation during 1980, there is no way of knowing whether, or to what extent, value added would have increased. In fact, value added would not have increased so long as revenues did not increase. These elements of value added are inextricable, codependent variables.

Without Trinova's $100 million in 1980 Michigan sales, the company's value added would have been lower to a remarkable degree. The market demand that sustained those sales did not arise solely, perhaps not even substantially, from the activities of Trinova's 14 Michigan sales personnel. But there can be little doubt that requirements of the Michigan market determined the direction of Trinova's design, production, and distribution process. By serving that market and meeting its demands, Trinova generated value added in the sums that it did. We can and must assume that Michigan sales were a part of the company's essential economic strategies and were an integral part of company-wide value added. It distorts the tax both in application and theory to confine value added consequences of the Michigan market solely to the labor and capital expended by the resident sales force.

Trinova's attempted characterization is arguable only because Michigan calculates value added by the addition method. The addition and subtraction methods of calculating value, however, are but two different paths to the same result. See n. 2, *supra*. Had Michigan calculated the SBT tax base by the subtraction method, reporting total revenues minus total cost of materials, Trinova's characterization would collapse of its own weight. Trinova could geographically locate its revenues and even determine where it purchased its materials. The Michigan apportionment formula

assumes as much. But were Trinova to calculate value added based upon the location of its revenues, it would apportion a much greater share of its value added to Michigan (26.5892%) than was apportioned under Michigan's three-factor formula (8.9717%). An apportionment of value added based solely on the source of revenues is no less justifiable than an apportionment based solely upon the location of compensation or depreciation.

The difference between the addition and subtraction methods is one of form and lacks constitutional significance. Michigan chose the addition method of calculating value added as a convenience to taxpayers, for whom federal taxable income provided an easy starting point. Kleine 6–7 (discussing advantages of addition method); SBT Analysis 21 (same). The Constitution does not require a formalistic analysis resulting in a penalty for Michigan's selection of an easier calculation method for its taxpayers.

Both methods of calculation, moreover, illustrate the justification for the State's adoption of an apportionment formula. Under either method, value added includes a remainder or residual that cannot be located with economic precision. Under the addition method, value added contains the element of income, one calculated by and dependent upon factors (revenues minus total costs) not included in the addition method equation; under the subtraction method, value added is itself a remainder, no more assignable than income. It would be impractical to locate value added by a geographic test. We thus agree with the Michigan Legislature's statement that the SBT is not, for apportionment purposes, "a combination or series of several smaller taxes," 1987 Mich. Pub. Acts 39, § 2, but an "indivisible," *ibid.*, tax upon a different, bona fide measure of business activity, the value added.

This conclusion is no different from the one we have reached in upholding the validity of state apportionment of income taxes. As with a VAT, the discrete components of a state income tax may appear in isolation susceptible of geo-

graphic designation. Nevertheless, since *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113 (1920), we have recognized the impracticability of assuming that all income can be assigned to a single source. In this respect, Trinova's argument becomes a familiar and often rejected genre of taxpayer challenge:

> "[A]pportionability often has been challenged by the contention that . . . the source of [particular] income may be ascertained by separate geographical accounting. The Court has rejected that contention so long as the intrastate and extrastate activities formed part of a single unitary business. See *Butler Bros.* v. *McColgan*, 315 U. S. 501, 506–508 (1942); *Ford Motor Co.* v. *Beauchamp*, 308 U. S. 331, 336 (1939); cf. *Moorman Mfg. Co.* v. *Bair*, 437 U. S., at 272. In these circumstances, the Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. *Butler Bros.* v. *McColgan*, 315 U. S., at 508–509. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable 'source.' Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required." *Mobil Oil Corp.*, 445 U. S., at 438.

In a recent challenge to this unitary business principle, we rejected the argument that particular assignable costs of a business should be excluded from a broader tax base. *Amerada Hess Corp.* v. *Director, Div. of Taxation, N. J. Dept. of Treasury*, 490 U. S. 66 (1989). We considered the New Jersey corporate income tax, which used federal taxable income as a benchmark and required certain adjustments (as does the Michigan SBT). New Jersey required oil companies to

add back into income any deduction taken for taxes paid under the federal windfall profits tax. The taxpayers objected that the windfall profits tax is "an exclusively out-of-state expense because it is associated with the production of oil outside New Jersey." *Id.*, at 74.

In like manner, Trinova objects to the SBT's requirement that it add compensation and depreciation to federal taxable income on the grounds that these are, with limited exception, out-of-state expenses. In *Amerada Hess Corp.* we rejected outright the idea that geographically assignable costs of production must be excluded from an apportionment of income:

> "[J]ust as each [taxpayer's] oil-producing revenue—as part of a unitary business—is not confined to a single State, *Exxon Corp.*, 447 U. S., at 226, . . . so too the costs of producing this revenue are unitary in nature. See *Container Corp.*, 463 U. S., at 182 (the costs of a unitary business cannot be deemed confined to the locality in which they are incurred)." *Ibid.*

The reasoning of *Amerada Hess Corp.* applies with equal force to the case here. The same factors that prevent determination of the geographic location where income is generated, factors such as functional integration, centralization of management, and economies of scale, make it impossible to determine the location of value added with exact precision. In concluding that Michigan can apportion the SBT, we merely reaffirm what we have written before: "In the case of a more-or-less integrated business enterprise operating in more than one State, . . . arriving at precise territorial allocations of 'value' is often an elusive goal, both in theory and in practice." *Container Corp.*, 463 U. S., at 164.

B

Having determined that Michigan's SBT attempts to tax a base that cannot be assigned to one location with any precision, and that apportionment is proper, we must next

consider whether Michigan's apportionment formula for Trinova's value added is fair.

Container Corp. states our test for fair income apportionment:

> "The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed. The second and more difficult requirement is what might be called external consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." *Id.*, at 169.

Trinova does not contest the internal consistency of the SBT's apportionment formula, and we need not consider that question.

Instead, Trinova argues that the SBT apportionment formula fails the external consistency test. In order to prevail on such a challenge, an income taxpayer must prove "by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted . . . in that State,' *[Hans Rees' Sons, Inc.,]* 283 U. S., at 135, or has 'led to a grossly distorted result,' *[Norfolk & Western R. Co.,]* 390 U. S., at 326." *Moorman Mfg. Co.*, 437 U. S., at 274. We conclude that the same test applies to apportionment of a VAT. Trinova must demonstrate that, in the context of a VAT, there is no rational relationship between the tax base measure attributed to the State and the contribution of Michigan business activity to the entire value added process. See *Container Corp., supra*, at 180–181.

The Michigan SBT uses the same three-factor apportionment formula we first approved for apportionment of income in *Butler Brothers* v. *McColgan*, 315 U. S. 501 (1942). This standard has become "something of a benchmark against

which other apportionment formulas are judged." *Container Corp., supra,* at 170; see also *Moorman Mfg. Co., supra,* at 282 (BLACKMUN, J., dissenting); *id.,* at 283–284 (Powell, J., dissenting). Although the one-third weight given to each of the three factors—payroll, property, and sales—is not a precise apportionment for every case, the formula "has gained wide approval precisely because payroll, property, and sales appear in combination to reflect a very large share of the activities *by which value is generated.*" *Container Corp., supra,* at 183 (emphasis added). The three-factor formula is widely used and is included in the Uniform Division of Income for Tax Purposes Act, 7A U. L. A. 331 (1990 Cum. Supp.) (approved in 1957 by the National Conference of Commissioners on Uniform State Laws and the American Bar Association).

Trinova argues that on the facts of this case, the three-factor formula leads to a distorted result, out of all proportion to the business done by Trinova in Michigan. Trinova's Michigan payroll constituted 0.2328% of total payroll, its Michigan property constituted 0.0930% of total property, and its Michigan sales constituted 26.5892% of total sales. The three-factor formula averages these ratios, with the result that 8.9717% of Trinova's value added, or $19,838,700, is assigned to Michigan. Because Trinova is a labor-intensive taxpayer, and can deduct capital acquisitions, the tax base is further reduced to $12,492,671.

In this Court, Trinova proposes an alternative two-factor apportionment, excluding the sales factor. Under the two-factor formula, only 0.1629% of Trinova's value added, or $360,213, would be assigned to Michigan. Brief for Petitioner 33–34.[9]

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[9] Trinova's proposed two-factor apportionment differs drastically from the apportionment Trinova requested in the Michigan state courts. Under the approach Trinova took in state court, following *Jones & Laughlin Steel Corp.* v. *Department of Treasury,* 145 Mich. App. 405, 377 N. W. 2d 397 (1985), Trinova's apportioned tax base would be −$2,042,458. See n. 8,

Although the three-factor formula "can be justified as a rough, practical approximation of the distribution of either a corporation's sources of income or the social costs which it generates," *General Motors Corp.* v. *District of Columbia*, 380 U. S. 553, 561 (1965), Trinova argues that the formula does not reflect how the value added tax base is generated. The principal flaw, it contends, is that the formula includes a sales factor. "Sales have no relationship to, and add nothing to, the value that [compensation and depreciable plant] contribute to the tax base in Michigan." Brief for Petitioner 31. Trinova's position finds some support among economists. See Barlow & Connell, The Single Business Tax, in Michigan's Fiscal and Economic Structure 673, 704 (H. Brazer ed. 1982); Kleine 7, 14, n. 5.

We have, *supra*, at 376, already concluded that sales (as a measure of market demand) do have a profound impact upon the amount of an enterprise's value added, and therefore reject the complete exclusion of sales as somehow resulting in more accurate apportionment. We further reject this critique because it cannot distinguish application of the three-factor formula to a VAT from application to an income tax. In fact, nearly identical criticisms were levied against the three-factor formula as a method for apportioning income by economists who theorize that income (like value added) is the product of labor and capital, and that the marketplace contributes nothing to production of income. See Studenski, The Need for Federal Curbs on State Taxes on Interstate Commerce: An Economist's Viewpoint, 46 Va. L. Rev. 1121, 1131–1132 (1960); Harriss, Economic Aspects of Interstate Apportionment of Business Income, 37 Taxes 327, 362–363 (1959); Harriss, Interstate Apportionment of Business Income, 49 Am. Econ. Rev. 398, 400 (1959). If it were not for their age, these criticisms could have been taken almost verbatim from Trinova's brief:

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supra. Under the two-factor formula that Trinova now urges upon us, it is $360,213.

> "[S]ales-by-destination are not a proper allocation factor . . . . Taken by themselves, they do not necessarily represent the location of the company's productive income-creating effort. Only the location of the company's capital and labor, which may be wholly different from the destination of the sales, identifies the location of that effort and hence the situs for the imposition of a state income tax upon it." Studenski, *supra*, at 1131–1132.

Despite such criticism, the Uniform Division of Income for Tax Purposes Act decided upon an income apportionment formula that included sales, and the importance of sales in generating value has been acknowledged by this Court. *Container Corp.*, 463 U. S., at 183. Thus, as we responded to a similar argument in *Moorman Mfg. Co.*, whatever the merit of Trinova's argument that sales do not contribute to value added "from the standpoint of economic theory or legislative policy, it cannot support a claim in this litigation that [the State] in fact taxed profits not attributable to activities within the State during the yea[r 1980]." 437 U. S., at 272. Trinova gives no basis for distinguishing the same arguments that were pressed, and rejected, with regard to the apportionment of income. We could not accept Trinova's argument that the sales factor distorts Michigan's apportionment formula without rejecting our precedents which approve the use of the same formula to apportion income.

As we find no distortion caused by the three-factor formula, it follows that the Michigan SBT does not tax "value earned outside [Michigan's] borders." *ASARCO Inc.* v. *Idaho Tax Comm'n*, 458 U. S. 307, 315 (1982). The argument that the value was added in Ohio, by labor and capital, and that no value has been added in Michigan assumes that value added is subject to geographic ascertainment and assumes further the inappropriateness of a sales factor in apportionment. For the reasons we have given, we reject both arguments.

We need not say for certain which method—unadjusted apportionment by the three-factor formula ($19,838,700), apportionment by Trinova's alternative two-factor formula ($360,213), Trinova's *Jones & Laughlin* apportionment urged in state court (−$2,042,458), or the adjusted tax base as calculated in Trinova's original 1980 return ($12,492,671)—gives the most accurate calculation of Trinova's value added in Michigan. Trinova has not convincingly demonstrated which figure is most accurate. Trinova gives no estimate of the value added that would take account of both its Michigan sales activity and Michigan market demand for its products. Michigan, on the other hand, has consistently applied a formula, the elements of which appear to reflect a very large share of the activities by which value is generated, with further relief for labor-intensive taxpayers such as Trinova. Trinova has failed to meet its burden of proving "by 'clear and cogent evidence,'" *Moorman Mfg. Co.*, *supra*, at 274, that the State of Michigan's apportionment provides a distorted result.[10]

C

Trinova also urges that the Michigan SBT should be struck down because it discriminates against out-of-state businesses in violation of the Commerce Clause. Trinova cannot point to any treatment of in-state and out-of-state firms that is discriminatory on its face, as in the cases it cites. See, *e. g.*,

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[10] As an alternative ground for upholding the tax, Michigan reminds us that, instead of taxing value added, it could have taxed gross receipts of sales into Michigan. We have repeatedly upheld such taxes. *Standard Pressed Steel Co.* v. *Washington Revenue Dept.*, 419 U. S. 560, 564 (1975); *General Motors Corp.* v. *Washington*, 377 U. S. 436, 448 (1964); *McGoldrick* v. *Berwind-White Coal Mining Co.*, 309 U. S. 33, 58 (1940). While we accept the analogy Michigan has drawn between a VAT and an income tax, we recognize that the SBT also bears some similarities to a gross-receipts tax. Further, the SBT's alternative method of taxation (based upon gross receipts) might provide an additional limit on any distortion or possibility that out-of-state values might be taxed. See n. 6, *supra*. In light of our disposition, we need not address these arguments.

Westinghouse Electric Corp. v. *Tully*, 466 U. S. 388, 393 (1984) (tax credit was limited to gross receipts from export products shipped from a regular place of business of the taxpayer within New York); *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U. S. 318, 324–328 (1977) (tax facially discriminated against transactions on securities exchanges located outside of New York and had been enacted in an effort to discourage growth of such exchanges); *Halliburton Oil Well Cementing Co.* v. *Reily*, 373 U. S. 64 (1963) (sales tax exempted isolated sales within State, but use tax lacked a similar exemption for similar isolated sales outside of the State).

In the absence of any facial discrimination, Trinova recalls our statement in *American Trucking Assns., Inc.* v. *Scheiner*, 483 U. S. 266, 281 (1987), that "the Commerce Clause has a deeper meaning that may be implicated even though state provisions . . . do not allocate tax burdens between insiders and outsiders in a manner that is facially discriminatory." The Commerce Clause requires more than mere facial neutrality. The content of that requirement is fair apportionment. The "deeper meaning" to which *American Trucking* refers is embodied in the requirement of fair apportionment, as expressed in the tests of internal and external consistency. Other than the vague accusation of discrimination, Trinova presents no other standard by which we might consider the constitutionality of the Michigan SBT.

In further support of its discrimination argument, Trinova relies upon the 1987 statement of Michigan's Governor that the SBT was enacted "'to promote the development and investment of business within Michigan.'" Executive Message of Governor James J. Blanchard to the Michigan Supreme Court, Nov. 6, 1987, App. to Pet. for Cert. 73a. This statement helps Trinova not at all. It is a laudatory goal in the design of a tax system to promote investment that will provide jobs and prosperity to the citizens of the taxing State. States are free to "structur[e] their tax systems to

encourage the growth and development of intrastate commerce and industry." *Boston Stock Exchange*, *supra*, at 336. Although Trinova repeats the Governor's statement in an attempt to demonstrate an impermissible motive on the part of the State, all the contemporaneous evidence concerning passage of the SBT suggests a benign motivation, combined with a practical need to increase revenues.[11] Neither Trinova nor the secondary sources it relies upon present any evidence that the SBT was inspired as a way to export tax burdens or import tax revenues.

IV

In reviewing state taxation schemes under the Commerce Clause, we attempt "to ensure that each State taxes only its fair share of an interstate transaction." *Goldberg* v. *Sweet*, 488 U. S. 252, 260–261 (1989). We act as a defense against state taxes which, whether by design or inadvertence, either give rise to serious concerns of double taxation, or attempt to capture tax revenues that, under the theory of the tax, belong of right to other jurisdictions. We have always "declined to undertake the essentially legislative task of estab-

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[11] According to Kleine, proponents of the SBT argued as follows: (1) because of Michigan's volatile economy, the State's corporate income tax had proven unpredictably cyclical, and therefore a poor source of revenue. The SBT would provide a much broader tax base, and thus prove a more stable revenue source; (2) the SBT would lessen the tax burden on capital, thereby encouraging new investment; (3) the SBT would replace numerous taxes, resulting in less paperwork for both the taxpayer and the tax collector; (4) the SBT would not discriminate against businesses on the basis of their forms of organization; and (5) the SBT would tax inefficient and efficient firms equally for their use of government services, whereas an income tax would burden more heavily efficient, highly profitable firms. In addition, at the time of the SBT's enactment, Michigan faced a fiscal crisis. The legislature provided that the new SBT would overlap with the old corporate franchise tax, resulting in additional cash flow of $180 million. Kleine 20–23. The argument that a VAT would permit "exporting" the tax to taxpayers outside the State "was not used to any great extent by the proponents of the Michigan [SBT]." *Id.*, at 23.

lishing a 'single constitutionally mandated method of taxation.'" *Id.*, at 261, quoting *Container Corp.*, 463 U. S., at 171. We do not say today whether other States should adopt a VAT, or whether Michigan's three-factor formula is the only acceptable method of apportionment. We do hold that, as applied to Trinova during the tax year at issue, the Michigan SBT does not violate the Due Process or Commerce Clauses of the Constitution.

The judgment of the Supreme Court of Michigan is

Affirmed.

JUSTICE SOUTER took no part in the consideration or decision of this case.

JUSTICE SCALIA, concurring in the judgment.

As the Court notes, *ante*, at 384, the Michigan single business tax is not facially discriminatory. Since I am of the view that this suffices to comply with the requirements of the Commerce Clause, see *Amerada Hess Corp.* v. *Director, Div. of Taxation, N. J. Dept. of Treasury*, 490 U. S. 66, 80 (1989) (SCALIA, J., concurring in judgment); *Tyler Pipe Industries, Inc.* v. *Washington State Dept. of Revenue*, 483 U. S. 232, 265 (1987) (SCALIA, J., concurring in part and dissenting in part), I would forgo the additional Commerce Clause analysis articulated in *Complete Auto Transit, Inc.* v. *Brady*, 430 U. S. 274, 279 (1977). Some elements of that analysis, however, are relevant to the quite separate question whether the tax complies with the requirements of the Due Process Clause, see *Mobil Oil Corp.* v. *Commissioner of Taxes of Vt.*, 445 U. S. 425, 436–437 (1980); *Amerada Hess Corp.*, *supra*, at 80–81 (SCALIA, J., concurring in judgment).

Trinova concedes that there is a minimal connection between its interstate activities and the taxing State, see *Mobil*, *supra*; *ante*, at 373. The only issue, then, is whether the tax violates the Due Process Clause by taxing extraterritorial values. For the reasons stated in Parts III–A and III–B of the Court's opinion, I agree that it does not.

JUSTICE STEVENS, with whom JUSTICE BLACKMUN joins, dissenting.

Although the parties refer to Michigan's "Single Business Tax" (SBT) as a "Value Added Tax" (VAT), that term does not appear in the text of the statute. The text of the relevant Act describes the SBT as a tax on "certain commercial, business, and financial activities."[1] As a practical matter, Michigan's SBT is nothing more than an amalgam of three separate taxes: a tax on payroll, a tax on depreciable fixed assets, and a tax on income. Payroll and depreciation represent over 90 percent of the SBT base, and the productive activities that are measured by payroll and depreciation take place at geographic locations that are readily identifiable. Because Michigan's SBT uses an apportionment formula to tax a portion of those activities occurring outside Michigan, I depart from the Court's analysis and conclude that the state taxation scheme violates established principles of due process.

I

Petitioner Trinova's executive offices and manufacturing facilities are located in Ohio. Most of its employees live and work in Ohio. In fact, significantly less than one percent of

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[1] The preamble to the statute states, in part:

"AN ACT to provide for the imposition, levy, computation, collection, assessment and enforcement, by lien or otherwise, of taxes on certain commercial, business, and financial activities . . . ." See Mich. Comp. Laws § 208.1, p. 4 (1986).

The Michigan Supreme Court's explanation of the significance of the label "value added tax" describes it as a tax upon business activity. In its opinion below, the Michigan court explained:

"In short, a value added tax is a tax upon business activity. The act employs a value added measure of business activity, but its intended effect is to impose a tax upon the privilege of conducting business activity within Michigan. It is not a tax upon income. MCL 208.31(4); MSA 7.558(31)(4)." 433 Mich. 141, 149, 445 N. W. 2d 428, 431–432 (1989).

This Court today also states that "value added is a measure of actual business activity." *Ante*, at 364.

Trinova's capital assets and labor were employed in Michigan in 1980.[2] The company operated at a substantial loss in that year. The question presented is whether the fact that 26 percent of Trinova's unprofitable sales were made to Michigan customers provides a constitutionally sufficient justification for the State to attribute to Michigan (and thus to tax) approximately nine percent of Trinova's productive activities, almost all of which actually occurred in Ohio.

In upholding the constitutionality of the SBT against a Due Process Clause challenge, the Court today concludes that even though the bulk of Trinova's property and payroll are located outside Michigan, it does not follow that the bulk of its value-adding activities are located outside Michigan and thus are not attributable to or taxable by Michigan. Rather, the Court assumes that the value added to a product is largely contingent upon the revenue that the product generates when it is sold in the marketplace. Because the value added by Trinova's use of labor and capital in Ohio is not realized until Trinova's product is sold in Michigan and the product is given market value by consumers, the Court concludes that Michigan's sales contribute greatly to the value of Trinova's product, and thus that allowing a portion of the value added by Trinova's business activities in Ohio to be attributed to Michigan through use of an apportionment formula is justified.

The Court's assumption that value added from labor and capital is not realized until the product is sold, however, is simply wrong. Finished goods, even though stored in a warehouse and not yet sold, are more valuable than raw materials. Moreover, under the Michigan statute, the revenues generated by the sales of the finished product are reflected in the net income component of the tax base. Thus,

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[2] The Company's total payroll was $226,356,271; its Michigan payroll was only $511,774 or less than one-fourth of one percent. Its Michigan depreciation was only $2,152, representing less than one-tenth of one percent of its entire depreciation.

in this case, because Trinova operated at a loss, the value added by labor and capital is reduced, rather than enhanced, by the ultimate sales made in Michigan. It necessarily follows that allowing Michigan to apportion out-of-state expenses incurred for fixed assets and labor on the basis of Michigan sales in effect allows Michigan to tax extraterritorial business activity.

Under this Court's due process jurisprudence, a State may constitutionally tax only those interstate business activities or income to which it has a rational nexus. See *Container Corp. of America* v. *Franchise Tax Bd.*, 463 U. S. 159, 165–166 (1983). However, in the context of state income taxes on "unitary" interstate businesses, our cases allow States to deviate from the fixed rule of geographic accounting in favor of a more flexible system of formulary apportionment. In so doing, we have cautioned that "[t]he functional meaning of this requirement [of a rational nexus between the taxing State and the taxed activities] is that there be some sharing or exchange of value not capable of precise [geographic] identification or measurement . . . which renders formula apportionment a reasonable method of taxation." *Id.*, at 166.

The Court today extends its analysis upholding the constitutionality of income apportionment as an exception to the general rule of geographic accounting to situations in which the original justification for the use of an imprecise apportionment formula no longer holds. Unlike the income of a unitary business, which we before have recognized may not be precisely allocated, the two principal elements of Michigan's SBT—property and payroll—are subject to precise geographic identification and thus do not warrant being subject to an apportionment formula.

The Court concedes, as it must, that far less than one percent of Trinova's capital assets and labor were employed in Michigan in 1980, but rejects the logical result of such analysis by concluding that it does not necessarily follow that far less than one percent of Trinova's "value added" can be pre-

cisely identified as having been realized outside Michigan. Instead, the Court concludes that the value added by Trinova's factors of production located outside of Michigan cannot be precisely determined until the ultimate product is sold and the market value or revenue that the product commands is considered. As the Court states, "[t]he Michigan SBT . . . is not three separate and independent taxes, and Trinova cannot purport to identify the geographic source of value added by assuming that two elements can be located in a single State while the third cannot." *Ante*, at 375. Rather, "[i]n a unitary enterprise, compensation, depreciation, and profit are not independent variables to be adjusted without reference to each other. If Trinova had paid an additional $100 million in compensation during 1980, there is no way of knowing whether, or to what extent, value added would have increased. *In fact, value added would not have increased so long as revenues did not increase.*" *Ante*, at 376 (emphasis added).

Driving the Court's analysis is the recognition that Trinova in 1980 netted a loss of over $42 million. This, the Court concludes, means that the ultimate value added by Trinova's use of labor and capital resources was not equivalent to its actual payroll and capital expenses. Resisting the perceived awkwardness of finding "that Trinova added value at the factory through the consumption of capital and labor, but that its products somehow lost value outside of this process," *id.*, at 375, the Court holds that the value added by capital and labor should not be deemed to be realized and should not be geographically assigned until Trinova's product is sold, and that the measure of value added by payroll and capital expenses should be adjusted by the ultimate revenue the product generates.

II

The Court's assumption that value added by property and payroll is not realized and cannot be determined until the product is sold is belied by the rationale underlying the VAT.

The "concept of value added . . . is derived from the most basic of economic facts—the scarcity of resources—and hence consistently measures the amount of scarce labor and capital resources used up (and not available for use elsewhere) in every economic activity." See Haughey, The Economic Logic of the Single Business Tax, 22 Wayne L. Rev. 1017, 1018 (1976). That a product is ultimately unprofitable does not diminish the amount of resources a company utilized in manufacturing the product. Nor does the value added to the economy or gross national product by the company's purchase of labor and utilization of capital diminish when the product is not sold or is sold for a net loss.

Rather, value added is fully realized at each stage of the production process—at the stages where labor services are sold and paid for by the company in the form of payroll expenses and where capital is consumed. The amount of value added at these intermediate stages of production is the price paid for the labor services and for the capital expended. See *ibid.* (value added may be determined by "add[ing] up all of the payments paid internally to the owners of the labor and capital used"). Regardless of the profitability (or unprofitability) of the ultimate product, value added by labor and capital is not eliminated or diminished if the ultimate product is unable to command equivalent value or revenue in the marketplace.[3] As the Court itself concedes early in its opinion,

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[3] Unlike the tax bases under the VAT schemes that are found in European and South American countries, see *ante*, at 365–366, n. 3, the tax base under Michigan's SBT is affected by the revenues that the product brings in only insofar as such revenues are reflected in the company's net income, which is a component of the tax base under the additive method. In the foreign jurisdictions utilizing the VAT, however, the starting point for computing the tax base is the revenue received by the taxpayer from sales made in the taxing jurisdiction, with certain amounts exempted or subtracted from the in-state revenues. Although measuring value added with reference to revenues might therefore be warranted in traditional European models of the VAT, it is unjustified under Michigan's SBT, because the income component of the VAT base in Michigan already accounts for revenues.

"[e]ven if a business entity is unprofitable, under normal circumstances it adds value to its products and, as a consequence, will owe some VAT." *Ante*, at 364. This immunity of the VAT base from the vagaries of the marketplace is the basic justification for the SBT: "[B]ecause value added does not fluctuate as widely as net income, a VAT provides a more stable source of revenue than the corporate income tax." *Ibid.*

Concededly, under the Michigan statute, the task of calculating precisely Trinova's value added by its capital and labor resources without looking to its ultimate sales or profit is complicated by the unprofitability of Trinova's business during the tax year in question. Under Michigan's method for calculating the SBT base, the corporation's profit is added to the sum of labor costs and capital expenditures (consisting of depreciation and interest expenses) and represents the value added by the corporation's skill and entrepreneurial effort. Insofar as Trinova in 1980 netted a loss of over $42 million, Trinova's VAT base was actually reduced by "addition" of its profit to its labor and capital costs.

It is nevertheless clear that value added under the additive method is realized at each stage of the production process and is undiminished if the product suffers a net loss. That Michigan chooses to allow a company's VAT base to be reduced by the extent of its unprofitability does not in any way lead to the Court's conclusion that the value added by labor and capital is not realized when (and where) those resources are purchased, and that the amount of that value added to the economy is not equivalent to the price paid by the company for those resources.

Because the value added by the two principal components of Michigan's SBT—labor and capital—are fully realized and thus can be precisely quantified and geographically assigned when the actual purchase of labor services and use of capital occur, Michigan's apportionment of a company's entire payroll and capital expenses results in the unconstitutional tax-

ation by Michigan of a portion of the taxpayer's extraterritorial activities.[4] In fact, in Trinova's case, although less than one percent of Trinova's property and payroll expenses are incurred within its borders, Michigan, by applying the apportionment formula to payroll and capital, treats nine to ten percent of Trinova's labor and capital costs as if they were in-state expenses.[5] Because such extraterritorial taxation violates basic principles of due process, I respectfully dissent.

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[4] "The taxation of property not located in the taxing State is constitutionally invalid, both because it imposes an illegitimate restraint on interstate commerce and because it denies to the taxpayer the process that is his due. A State will not be permitted, under the shelter of an imprecise allocation formula or by ignoring the peculiarities of a given enterprise, to 'project the taxing power of the state plainly beyond its borders. . . .' Any formula used must bear a rational relationship, both on its face and in its application, to property values connected with the taxing State." *Norfolk & Western R. Co.* v. *Missouri State Tax Comm'n*, 390 U. S. 317, 325 (1968) (footnote omitted).

[5] The Court implies that it would be unjust to apportion Trinova's net income without also apportioning its company-wide labor and appreciation. *Ante*, at 381–382, n. 9. My reaction to the facts of this case is just the opposite. Because the apportioned share of the taxpayer's net loss far exceeds the actual use of labor and capital in Michigan, there is no more justification for imposing the SBT on Trinova than there would be to collect an income tax from a taxpayer whose company-wide operations, as well as its Michigan operations, produced a substantial net loss.

Appendix N

ation, which assessed valuation shall be fifty per centum of the true and fair value of such property in money: Provided, however, *That nothing herein shall prevent levies at the rates now provided by law by or for any port or public utility district. The term "taxing district" for the purposes of this section shall mean any political subdivision, municipal corporation, district, or other governmental agency authorized by law to levy, or have levied for it, ad valorem taxes on property, other than a port or public utility district. Such aggregate limitation or any specific limitation imposed by law in conformity therewith may be exceeded only*

(a) By any taxing district when specifically authorized so to do by a majority of at least three-fifths of the electors thereof voting on the proposition to levy such additional tax submitted not more than twelve months prior to the date on which the proposed levy is to be made and not oftener than twice in such twelve month period, either at a special election or at the regular election of such taxing district, at which election the number of persons voting on the proposition shall constitute not less than forty per centum of the total number of votes cast in such taxing district at the last preceding general election;

(b) By any taxing district otherwise authorized by law to issue general obligation bonds for capital purposes, for the sole purpose of making the required payments of principal and interest on general obligation bonds issued solely for capital purposes, other than the replacement of equipment, when authorized so to do by majority of at least three-fifths of the electors thereof voting on the proposition to issue such bonds and to pay the principal and interest thereon by an annual tax levy in excess of the limitation herein provided during the term of such bonds, submitted not oftener than twice in any calendar year, at an election held in the manner provided by law for bond elections in such taxing district, at which election the total number of persons voting on the proposition shall constitute not less than forty per centum of the total number of votes cast in such taxing district at the last preceding general election: Provided, *That any such taxing district shall have the right by vote of its governing body to refund any general obligation bonds of said district issued for capital purposes only, and to provide for the interest thereon and amortization thereof by annual levies in excess of the tax limitation provided for herein, and* Provided further, *That the provisions of this section shall also be subject to the limitations contained in Article VIII, Section 6, of this Constitution;*

(c) By the state or any taxing district for the purpose of paying the principal or interest on general obligation bonds outstanding on December 6, 1934; or for the purpose of preventing the impairment of the obligation of a contract when ordered so to do by a court of last resort. [AMENDMENT 17, 1943 House Joint Resolution No. 1, p 936. Approved November, 1944.]

Reviser's note: Original section 2, as amended by Amendment 3, was stricken by Amendment 14. The original section and Amendment 3, are set out following Art. 7, Section 1, above.

SECTION 3 TAXATION OF FEDERAL AGENCIES AND PROPERTY. The United States and its agencies and instrumentalities, and their property, may be taxed under any of the tax laws of this state, whenever and in such manner as such taxation may be authorized or permitted under the laws of the United States, notwithstanding anything to the contrary in the Constitution of this state. [**AMENDMENT 19,** 1945 House Joint Resolution No. 9, p 932. Approved November, 1946.]

Reviser's note: Original section 3 was stricken by Amendment 14. The original section is set out following Art. 7 Section 1, above.

SECTION 4 NO SURRENDER OF POWER OR SUSPENSION OF TAX ON CORPORATE PROPERTY.

Reviser's note: Original section 4 was stricken by Amendment 14. It is set out following Art. 7 Section 1, above.

SECTION 5 TAXES, HOW LEVIED. No tax shall be levied except in pursuance of law; and every law imposing a tax shall state distinctly the object of the same to which only it shall be applied.

SECTION 6 TAXES, HOW PAID. All taxes levied and collected for state purposes shall be paid in money only into the state treasury.

SECTION 7 ANNUAL STATEMENT. An accurate statement of the receipts and expenditures of the public moneys shall be published annually in such manner as the legislature may provide.

SECTION 8 TAX TO COVER DEFICIENCIES. Whenever the expenses of any fiscal year shall exceed the income, the legislature may provide for levying a tax for the ensuing fiscal year, sufficient, with other sources of income, to pay the deficiency, as well as the estimated expenses of the ensuing fiscal year.

SECTION 9 SPECIAL ASSESSMENTS OR TAXATION FOR LOCAL IMPROVEMENTS. The legislature may vest the corporate authorities of cities, towns and villages with power to make local improvements by special assessment, or by special taxation of property benefited. For all corporate purposes, all municipal corporations may be vested with authority to assess and collect taxes and such taxes shall be uniform in respect to persons and property within the jurisdiction of the body levying the same.

SECTION 10 RETIRED PERSONS PROPERTY TAX EXEMPTION. Notwithstanding the provisions of Article 7, section 1 (Amendment 14) and Article 7, section 2 (Amendment 17), the following tax exemption shall be allowed as to real property:

The legislature shall have the power, by appropriate legislation, to grant to retired property owners relief from the property tax on the real property occupied as a residence by those owners. The legislature may place such restrictions and conditions upon the granting of such relief as it shall deem proper. Such restrictions and conditions may include, but are not limited to, the limiting of the relief to those property owners below a specific level of income and those fulfilling certain minimum residential requirements. [**AMENDMENT 47,** 1965 ex.s. House Joint Resolution No. 7, p 2821. Approved November 8, 1966.]

SECTION 11 TAXATION BASED ON ACTUAL USE. Nothing in this Article VII as amended shall prevent the legislature from providing, subject to such conditions as it may enact, that the true and fair value in money (a) of farms, agricultural lands, standing timber and timberlands, and (b) of other open space lands which are used for recreation or for enjoyment of their scenic or natural beauty shall be based on the use to which such property is currently applied, and such values shall be used in computing the assessed valuation of such property in the same manner as the assessed valuation is computed for all property. [**AMENDMENT 53,** 1967 House Joint Resolution No. 1; see 1969 p 2976. Approved November 5, 1968.]

Appendix O

82.04.44525 Credit—New employment for international service activities in eligible areas—Designation of census tracts for eligibility—Records—Tax due upon ineligibility—Interest assessment—Information from employment security department.
82.04.4461 Credit—Preproduction development expenditures.
82.04.4463 Credit—Property and leasehold taxes paid on property used for manufacture of commercial airplanes.
82.04.447 Credit—Natural or manufactured gas purchased by direct service industrial customers—Reports.
82.04.448 Credit—Manufacturing semiconductor materials.
82.04.4481 Credit—Property taxes paid by aluminum smelter.
82.04.4482 Credit—Sales of electricity or gas to an aluminum smelter.
82.04.4483 Credit—Programming or manufacturing software in rural counties.
82.04.4484 Credit—Information technology help desk services in rural counties.
82.04.4485 Credit—Mechanical lifting devices purchased by hospitals.
82.04.4486 Credit—Syrup taxes paid by buyer.
82.04.4489 Credit—Motion picture competitiveness program.
82.04.449 Credit—Washington customized employment training program.
82.04.4491 Credit—Alternative power generation devices.
82.04.4492 Credit—Polysilicon manufacturers.
82.04.4493 Credit—Energy efficient commercial equipment.
82.04.450 Value of products, how determined.
82.04.460 Business within and without state—Apportionment.
82.04.470 Resale certificate—Burden of proof—Tax liability—Rules—Resale certificate defined.
82.04.480 Sales in own name—Sales as agent.
82.04.500 Tax part of operating overhead.
82.04.510 General administrative provisions invoked.
82.04.520 Administrative provisions for motor vehicle sales by courtesy dealers.
82.04.530 Telecommunications service providers—Calculation of gross proceeds.
82.04.535 Gross proceeds of sales calculation for mobile telecommunications service provider.
82.04.540 Professional employer organizations—Taxable under RCW 82.04.290(2)—Deduction.
82.04.600 Exemptions—Materials printed in county, city, town, school district, educational service district, library or library district.
82.04.601 Exemptions—Affixing stamp services for cigarette sales.
82.04.610 Exemptions—Import or export commerce.
82.04.615 Exemptions—Certain limited purpose public corporations, commissions, and authorities.
82.04.620 Exemptions—Certain prescription drugs.
82.04.625 Exemptions—Custom farming services.
82.04.627 Exemptions—Commercial airplane parts.
82.04.629 Exemptions—Honey bee products.
82.04.630 Exemptions—Bee pollination services.
82.04.900 Construction—1961 c 15.

Admission tax
cities: RCW 35.21.280.
counties: Chapter 36.38 RCW.

Commute trip reduction incentives: Chapter 82.70 RCW.

Housing authorities, tax exemption: Chapter 35.82 RCW.

Public utility districts, privilege taxes: Chapter 54.28 RCW.

82.04.010 Introductory. Unless the context clearly requires otherwise, the definitions set forth in the sections preceding RCW 82.04.220 apply throughout this chapter. [1996 c 93 § 4; 1961 c 15 § 82.04.010. Prior: 1955 c 389 § 2; prior: 1949 c 228 § 2, part; 1945 c 249 § 1, part; 1943 c 156 § 2, part; 1941 c 178 § 2, part; 1939 c 225 § 2, part; 1937 c 227 § 2, part; 1935 c 180 § 5, part; Rem. Supp. 1949 § 8370-5, part.]

82.04.020 "Tax year," "taxable year." "Tax year" or "taxable year" means either the calendar year, or the taxpayer's fiscal year when permission is obtained from the department of revenue to use a fiscal year in lieu of the calendar year. [1975 1st ex.s. c 278 § 39; 1961 c 15 § 82.04.020. Prior: 1955 c 389 § 3; prior: 1949 c 228 § 2, part; 1945 c 249 § 1, part; 1943 c 156 § 2, part; 1941 c 178 § 2, part; 1939 c 225 § 2, part; 1937 c 227 § 2, part; 1935 c 180 § 5; Rem. Supp. 1949 § 8370-5, part.]

Construction—Severability—1975 1st ex.s. c 278: See notes following RCW 11.08.160.

82.04.030 "Person," "company." "Person" or "company", herein used interchangeably, means any individual, receiver, administrator, executor, assignee, trustee in bankruptcy, trust, estate, firm, copartnership, joint venture, club, company, joint stock company, business trust, municipal corporation, political subdivision of the state of Washington, corporation, limited liability company, association, society, or any group of individuals acting as a unit, whether mutual, cooperative, fraternal, nonprofit, or otherwise and the United States or any instrumentality thereof. [1995 c 318 § 1; 1963 ex.s. c 28 § 1; 1961 c 15 § 82.04.030. Prior: 1955 c 389 § 4; prior: 1949 c 228 § 2, part; 1945 c 249 § 1, part; 1943 c 156 § 2, part; 1941 c 178 § 2, part; 1939 c 225 § 2, part; 1937 c 227 § 2, part; 1935 c 180 § 5, part; Rem. Supp. 1949 § 8370-5, part.]

Effective date—1995 c 318: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and shall take effect immediately [May 11, 1995]." [1995 c 318 § 12.]

Effective date—1963 ex.s. c 28: "This act shall take effect on July 1, 1963." [1963 ex.s. c 28 § 17.]

International companies investing in Washington—Eligibility for excise tax incentives: RCW 43.330.068.

82.04.035 "Plantation Christmas trees." "Plantation Christmas trees" means Christmas trees which are exempt from the timber excise tax under RCW 84.33.170. [1987 c 23 § 1.]

82.04.040 "Sale," "casual or isolated sale," "lease or rental." (1) "Sale" means any transfer of the ownership of, title to, or possession of property for a valuable consideration and includes any activity classified as a "sale at retail" or "retail sale" under RCW 82.04.050. It includes lease or rental, conditional sale contracts, and any contract under which possession of the property is given to the purchaser but title is retained by the vendor as security for the payment of the purchase price. It also includes the furnishing of food, drink, or meals for compensation whether consumed upon the premises or not.

(2) "Casual or isolated sale" means a sale made by a person who is not engaged in the business of selling the type of property involved.

(3)(a) "Lease or rental" means any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration. A lease or rental may include future options to purchase or extend. "Lease or rental" includes agreements covering motor vehicles and trailers where the amount of consideration may be increased or decreased by reference to the amount realized upon sale or disposition of the property as defined in 26 U.S.C. Sec. 7701(h)(1), as amended or renumbered as of January 1, 2003. The definition in this subsection (3) shall be used for sales and use tax purposes regardless if a transaction is characterized as a lease or rental under generally accepted accounting

principles, the United States internal revenue code, Washington state's commercial code, or other provisions of federal, state, or local law.

(b) "Lease or rental" does not include:

(i) A transfer of possession or control of property under a security agreement or deferred payment plan that requires the transfer of title upon completion of the required payments;

(ii) A transfer of possession or control of property under an agreement that requires the transfer of title upon completion of required payments, and payment of an option price does not exceed the greater of one hundred dollars or one percent of the total required payments; or

(iii) Providing tangible personal property along with an operator for a fixed or indeterminate period of time. A condition of this exclusion is that the operator is necessary for the tangible personal property to perform as designed. For the purpose of this subsection (3)(b)(iii), an operator must do more than maintain, inspect, or set up the tangible personal property. [2004 c 153 § 402; 2003 c 168 § 103; 1961 c 15 § 82.04.040. Prior: 1959 ex.s. c 5 § 1; 1959 ex.s. c 3 § 1; 1955 c 389 § 5; prior: 1949 c 228 § 2, part; 1945 c 249 § 1, part; 1943 c 156 § 2, part; 1941 c 178 § 2, part; 1939 c 225 § 2, part; 1937 c 227 § 2, part; 1935 c 180 § 5, part; Rem. Supp. 1949 § 8370-5, part.]

Retroactive effective date—Effective date—2004 c 153: See note following RCW 82.08.0293.

Effective dates—Part headings not law—2003 c 168: See notes following RCW 82.08.010.

82.04.050 "Sale at retail," "retail sale." (1) "Sale at retail" or "retail sale" means every sale of tangible personal property (including articles produced, fabricated, or imprinted) to all persons irrespective of the nature of their business and including, among others, without limiting the scope hereof, persons who install, repair, clean, alter, improve, construct, or decorate real or personal property of or for consumers other than a sale to a person who presents a resale certificate under RCW 82.04.470 and who:

(a) Purchases for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person, but a purchase for the purpose of resale by a regional transit authority under RCW 81.112.300 is not a sale for resale; or

(b) Installs, repairs, cleans, alters, imprints, improves, constructs, or decorates real or personal property of or for consumers, if such tangible personal property becomes an ingredient or component of such real or personal property without intervening use by such person; or

(c) Purchases for the purpose of consuming the property purchased in producing for sale a new article of tangible personal property or substance, of which such property becomes an ingredient or component or is a chemical used in processing, when the primary purpose of such chemical is to create a chemical reaction directly through contact with an ingredient of a new article being produced for sale; or

(d) Purchases for the purpose of consuming the property purchased in producing ferrosilicon which is subsequently used in producing magnesium for sale, if the primary purpose of such property is to create a chemical reaction directly through contact with an ingredient of ferrosilicon; or

(e) Purchases for the purpose of providing the property to consumers as part of competitive telephone service, as defined in RCW 82.04.065. The term shall include every sale of tangible personal property which is used or consumed or to be used or consumed in the performance of any activity classified as a "sale at retail" or "retail sale" even though such property is resold or utilized as provided in (a), (b), (c), (d), or (e) of this subsection following such use. The term also means every sale of tangible personal property to persons engaged in any business which is taxable under RCW 82.04.280 (2) and (7), 82.04.290, and 82.04.2908; or

(f) Purchases for the purpose of satisfying the person's obligations under an extended warranty as defined in subsection (7) of this section, if such tangible personal property replaces or becomes an ingredient or component of property covered by the extended warranty without intervening use by such person.

(2) The term "sale at retail" or "retail sale" shall include the sale of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to the following:

(a) The installing, repairing, cleaning, altering, imprinting, or improving of tangible personal property of or for consumers, including charges made for the mere use of facilities in respect thereto, but excluding charges made for the use of self-service laundry facilities, and also excluding sales of laundry service to nonprofit health care facilities, and excluding services rendered in respect to live animals, birds and insects;

(b) The constructing, repairing, decorating, or improving of new or existing buildings or other structures under, upon, or above real property of or for consumers, including the installing or attaching of any article of tangible personal property therein or thereto, whether or not such personal property becomes a part of the realty by virtue of installation, and shall also include the sale of services or charges made for the clearing of land and the moving of earth excepting the mere leveling of land used in commercial farming or agriculture;

(c) The constructing, repairing, or improving of any structure upon, above, or under any real property owned by an owner who conveys the property by title, possession, or any other means to the person performing such construction, repair, or improvement for the purpose of performing such construction, repair, or improvement and the property is then reconveyed by title, possession, or any other means to the original owner;

(d) The cleaning, fumigating, razing, or moving of existing buildings or structures, but shall not include the charge made for janitorial services; and for purposes of this section the term "janitorial services" shall mean those cleaning and caretaking services ordinarily performed by commercial janitor service businesses including, but not limited to, wall and window washing, floor cleaning and waxing, and the cleaning in place of rugs, drapes and upholstery. The term "janitorial services" does not include painting, papering, repairing, furnace or septic tank cleaning, snow removal or sandblasting;

(e) Automobile towing and similar automotive transportation services, but not in respect to those required to report and pay taxes under chapter 82.16 RCW;

Appendix P

equal to the gross income of the business derived from contests of chance multiplied by the rate of 1.5 percent.

(2) An additional tax is imposed on those persons subject to tax in subsection (1) of this section. The amount of the additional tax with respect to the business of operating contests of chance is equal to the gross income of the business derived from contests of chance multiplied by the rate of 0.1 percent through June 30, 2006, and 0.13 percent thereafter. The money collected under this subsection (2) shall be deposited in the problem gambling account created in RCW 43.20A.892. This subsection does not apply to businesses operating contests of chance when the gross income from the operation of contests of chance is less than fifty thousand dollars per year.

(3) For the purpose of this section, "contests of chance" means any contests, games, gaming schemes, or gaming devices, other than the state lottery as defined in RCW 67.70.010, in which the outcome depends in a material degree upon an element of chance, notwithstanding that skill of the contestants may also be a factor in the outcome. The term includes social card games, bingo, raffle, and punchboard games, and pull-tabs as defined in chapter 9.46 RCW. The term does not include race meets for the conduct of which a license must be secured from the Washington horse racing commission, or "amusement game" as defined in RCW 9.46.0201.

(4) "Gross income of the business" does not include the monetary value or actual cost of any prizes that are awarded, amounts paid to players for winning wagers, accrual of prizes for progressive jackpot contests, or repayment of amounts used to seed guaranteed progressive jackpot prizes. [2005 c 369 § 5.]

Findings—Intent—Severability—Effective date—2005 c 369: See notes following RCW 43.20A.890.

82.04.286 Tax on horse races. (1) Upon every person engaging within this state in the business of conducting race meets for the conduct of which a license must be secured from the Washington horse racing commission; as to such persons, the amount of tax with respect to the business of parimutuel wagering is equal to the gross income of the business derived from parimutuel wagering multiplied by the rate of 0.1 percent through June 30, 2006, and 0.13 percent thereafter. The money collected under this section shall be deposited in the problem gambling account created in RCW 43.20A.892.

(2) For purposes of this section, "gross income of the business" does not include amounts paid to players for winning wagers, or taxes imposed or other distributions required under chapter 67.16 RCW.

(3) The tax imposed under this section is in addition to any tax imposed under chapter 67.16 RCW. [2005 c 369 § 6.]

Findings—Intent—Severability—Effective date—2005 c 369: See notes following RCW 43.20A.890.

82.04.290 Tax on international investment management services or other business or service activities. (1) Upon every person engaging within this state in the business of providing international investment management services, as to such persons, the amount of tax with respect to such business shall be equal to the gross income or gross proceeds of sales of the business multiplied by a rate of 0.275 percent.

(2)(a) Upon every person engaging within this state in any business activity other than or in addition to an activity taxed explicitly under another section in this chapter or subsection (3) of this section; as to such persons the amount of tax on account of such activities shall be equal to the gross income of the business multiplied by the rate of 1.5 percent.

(b) This subsection (2) includes, among others, and without limiting the scope hereof (whether or not title to materials used in the performance of such business passes to another by accession, confusion or other than by outright sale), persons engaged in the business of rendering any type of service which does not constitute a "sale at retail" or a "sale at wholesale." The value of advertising, demonstration, and promotional supplies and materials furnished to an agent by his principal or supplier to be used for informational, educational and promotional purposes shall not be considered a part of the agent's remuneration or commission and shall not be subject to taxation under this section.

(3)(a) Until July 1, 2024, upon every person engaging within this state in the business of performing aerospace product development for others, as to such persons, the amount of tax with respect to such business shall be equal to the gross income of the business multiplied by a rate of 0.9 percent.

(b) "Aerospace product development" has the meaning as provided in RCW 82.04.4461. [2008 c 81 § 6; 2005 c 369 § 8; 2004 c 174 § 2; 2003 c 343 § 2; 2001 1st sp.s. c 9 § 6; (2001 1st sp.s. c 9 § 4 expired July 1, 2001). Prior: 1998 c 343 § 4; 1998 c 331 § 2; 1998 c 312 § 8; 1998 c 308 § 5; 1998 c 308 § 4; 1997 c 7 § 2; 1996 c 1 § 2; 1995 c 229 § 3; 1993 sp.s. c 25 § 203; 1985 c 32 § 3; 1983 2nd ex.s. c 3 § 2; 1983 c 9 § 2; 1983 c 3 § 212; 1971 ex.s. c 281 § 8; 1970 ex.s. c 65 § 4; 1969 ex.s. c 262 § 39; 1967 ex.s. c 149 § 14; 1963 ex.s. c 28 § 2; 1961 c 15 § 82.04.290; prior: 1959 ex.s. c 5 § 5; 1955 c 389 § 49; prior: 1953 c 195 § 2; 1950 ex.s. c 5 § 1, part; 1949 c 228 § 1, part; 1943 c 156 § 1, part; 1941 c 178 § 1, part; 1939 c 225 § 1, part; 1937 c 227 § 1, part; 1935 c 180 § 4, part; Rem. Supp. 1949 § 8370-4, part.]

Findings—Savings—Effective date—2008 c 81: See notes following RCW 82.08.975.

Findings—Intent—Severability—Effective date—2005 c 369: See notes following RCW 43.20A.890.

Effective date—2004 c 174: See note following RCW 82.04.2908.

Expiration dates—2001 1st sp.s. c 9: "(1) Sections 2 and 4 of this act expire July 1, 2001.

(2) Section 5 of this act expires July 1, 2003.

(3) Section 8 of this act expires July 22, 2001." [2001 1st sp.s. c 9 § 10.]

Effective dates—2001 1st sp.s. c 9: See note following RCW 82.04.298.

Effective date—1998 c 343: See note following RCW 82.04.272.

Effective date—1998 c 331: See note following RCW 82.04.2907.

Effective date—Savings—1998 c 312: See notes following RCW 82.04.332.

Effective dates—1998 c 308: See note following RCW 82.04.050.

Savings—Effective date—1997 c 7: See notes following RCW 82.04.255.

Effective date—1996 c 1: See note following RCW 82.04.255.

Effective date—1995 c 229: See note following RCW 82.04.293.

Appendix Q

RAP 13.4
DISCRETIONARY REVIEW OF DECISION TERMINATING REVIEW

(a) How to Seek Review. A party seeking discretionary review by the Supreme Court of a Court of Appeals decision terminating review must serve on all other parties and file a petition for review or an answer to the petition that raises new issues. A petition for review should be filed in the Court of Appeals. If no motion to publish or motion to reconsider all or part of the Court of Appeals decision is timely made, a petition for review must be filed within 30 days after the decision is filed. If such a motion is made, the petition for review must be filed within 30 days after an order is filed denying a timely motion for reconsideration or determining a timely motion to publish. If the petition for review is filed prior to the Court of Appeals determination on the motion to reconsider or on a motion to publish, the petition will not be forwarded to the Supreme Court until the Court of Appeals files an order on all such motions. The first party to file a petition for review must, at the time the petition is filed, pay the statutory filing fee to the clerk of the Court of Appeals in which the petition is filed. Failure to serve a party with the petition for review or file proof of service does not prejudice the rights of the party seeking review, but may subject the party to a motion by the Clerk of the Supreme Court to dismiss the petition for review if not cured in a timely manner. A party prejudiced by the failure to serve the petition for review or to file proof of service may move in the Supreme Court for appropriate relief.

(b) Considerations Governing Acceptance of Review. A petition for review will be accepted by the Supreme Court only: (1) If the decision of the Court of Appeals is in conflict with a decision of the Supreme Court; or (2) If the decision of the Court of Appeals is in conflict with a published decision of the Court of Appeals; or (3) If a significant question of law under the Constitution of the State of Washington or of the United States is involved; or (4) If the petition involves an issue of substantial public interest that should be determined by the Supreme Court.

(c) Content and Style of Petition. The petition for review should contain under appropriate headings and in the order here indicated:

(1) *Cover*. A title page, which is the cover.

(2) *Tables*. A table of contents, with page references, and a table of cases (alphabetically arranged), statutes, and other authorities cited, with reference to the pages of the brief where cited.

(3) *Identity of Petitioner*. A statement of the name and designation of the person filing the petition.

(4) *Citation to Court of Appeals Decision*. A reference to the Court of Appeals decision which petitioner wants reviewed, the date of filing the decision, and the date of any order granting or denying a motion for reconsideration.

(5) *Issues Presented for Review*. A concise statement of the issues presented for review.

(6) *Statement of the Case*. A statement of the facts and procedures relevant to the issues presented for review, with appropriate references to the record.

(7) *Argument*. A direct and concise statement of the reason why review should be accepted under one or more of the tests established in section (b), with argument.

(8) *Conclusion*. A short conclusion stating the precise relief sought.

(9) *Appendix*. An appendix containing a copy of the Court of Appeals decision, any order granting or denying a motion for reconsideration of the decision, and copies of statutes and constitutional provisions relevant to the issues presented for review.

(d) Answer and Reply. A party may file an answer to a petition for review. A party filing an answer to a petition for review must serve the answer on all other parties. If the party wants to seek review of any issue that is not raised in the petition for review, including any issues that were raised but not decided in the Court of Appeals, the party must raise those new issues in an answer. Any answer should be filed within 30 days after the service on the party of the petition. A party may file a reply to an answer only if the answering party seeks review of issues not raised in the petition for review. A reply to an answer should be limited to addressing only the new issues raised in the answer. A party filing any reply to an answer must serve the reply to the answer on all other parties. A reply to an answer should be filed within 15 days after the service on the party of the answer. An answer or reply should be filed in the Supreme Court. The Supreme Court may call for an answer or a reply to an answer.

(e) Form of Petition, Answer, and Reply. The petition, answer, and reply should comply with the requirements as to form for a brief as provided in rules 10.3, 10.4, and 18.17, except as otherwise provided in this rule.

(f) Length. The petition for review, answer, or reply should comply with the length limitations of RAP 18.17.

(g) Reproduction of Petition, Answer, and Reply. The clerk will arrange for the reproduction of copies of a petition for review, an answer, or a reply, and bill the appropriate party for the copies as provided in rule 10.5.

(h) Amicus Curiae Memoranda. The Supreme Court may grant permission to file an amicus curiae memorandum in support of or opposition to a pending petition for review. Absent a showing of particular justification, an amicus curiae memorandum should be received by the court and counsel of record for the parties and other amicus curiae not later than 60 days from the date the petition for review is filed. Rules 10.4 and 10.6 should govern generally disposition of a motion to file an amicus curiae memorandum. An amicus curiae memorandum or answer thereto should comply with the length limitations of RAP 18.17.

(i) No Oral Argument. The Supreme Court will decide the petition without oral argument.

References

Form 9, Petition for review.

[Adopted effective July 1, 1976; Amended effective September 1, 1983; September 1, 1990; September 18, 1992; September 1, 1994; September 1, 1998; September 1, 1999; December 24, 2002; September 1, 2006; September 1, 2009; September 1, 2010; December 8, 2015; September 1, 2016; September 1, 2021.]

Appendix R

SENATE BILL REPORT
2ESSB 6143

As Amended by House, March 20, 2010

Title: An act relating to modifying excise tax laws to preserve funding for public schools, colleges, and universities, as well as other public systems essential for the safety, health, and security of all Washingtonians.

Brief Description: Modifying excise tax laws to preserve funding for public schools, colleges, and universities, as well as other public systems essential for the safety, health, and security of all Washingtonians.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senator Prentice).

Brief History:
Committee Activity: Ways & Means: 3/05/10 [DPS, DNP].
Passed Senate: 3/07/10, 25-23.
Passed House: 3/09/10, 52-45.
First Special Session: Passed Senate: 3/19/10, 25-18.
Passed House: 3/20/10, 53-42.

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: That Substitute Senate Bill No. 6143 be substituted therefor, and the substitute bill do pass.
Signed by Senators Prentice, Chair; Fraser, Vice Chair, Capital Budget Chair; Fairley, Keiser, Kline, Kohl-Welles, McDermott, Murray, Oemig, Pridemore, Regala and Rockefeller.

Minority Report: Do not pass.
Signed by Senators Zarelli, Ranking Minority Member; Brandland, Carrell, Hewitt, Honeyford, Parlette, Pflug and Schoesler.

Staff: Dean Carlson (786-7305)

Background: <u>The Sales and Use Tax.</u> The sales tax is imposed by the state, counties, and cities on retail sales of most items of tangible personal property and some services, including construction and repair services. If retail sales taxes were not collected when the property or services were acquired by the user, then use taxes are applied to the value of most tangible personal property and some services when used in this state. Use tax rates are the same as

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

retail sales tax rates. The combined state/local rate is between 7 and 9.5 percent, depending on location.

The Federal Earned Income Tax Credit. The earned income tax credit (EITC), established in the federal tax code in 1975, is a refundable tax credit available to eligible workers earning relatively low wages. Because the credit is refundable, an EITC recipient need not owe taxes to receive the benefits. The amount of the credit varies but it is generally determined by income and family size. Some states with an income tax provide an EITC. For purposes of the EITC, earned income includes wages, salaries, tips, and other taxable employee pay. The following types of income are not considered earned income: retired persons' disability benefits, pensions and annuities, social security, child support, welfare benefits, workers' compensation benefits, and veterans' benefits. The EITC cannot be claimed unless investment income is less than $3,100 for the 2009 tax year. Generally, a taxpayer may be able to take the credit for tax year 2009 if the taxpayer:

- has three or more qualifying children and earns less than $43,279 ($48,279 married filing jointly);
- has two qualifying children and earns less than $40,295 ($45,295 married filing jointly);
- has one qualifying child and earns less than $35,463 ($40,463 married filing jointly); or
- has no qualifying children and earns less than $13,440 ($18,440 married filing jointly).

For the 2009 tax year, the maximum credit is:

- $5,657 with three or more qualifying children;
- $5,028 with two qualifying children;
- $3,043 with one qualifying child; and
- $457 with no qualifying children.

Working Families' Tax Exemption. In 2008 the Legislature enacted a working families' tax exemption in the form of a state sales tax remittance, equal to a percentage of the EITC. Persons eligible for the credit must file a federal income tax return, receive an EITC, and have resided in Washington for more than 180 days in the year which the exemption is claimed. Eligible persons must pay the sales tax in the year for which the exemption is claimed. For remittances in 2009 and 2010, the exemption for the prior year is $25 or equal to 5 percent of the EITC for which data is available, whichever is greater. For 2011 and thereafter, the exemption for the prior year is $50 or equal to 10 percent of the EITC for which data is available, whichever is greater. For any fiscal period, the working families' tax exemption must be approved in the state omnibus appropriations act. The Department of Revenue (DOR) determines eligibility based on information provided by the applicant, and through audit, administrative records, and verification of Internal Revenue Service records. DOR may use the best data available to process the remittance. DOR may, in conjunction with other agencies or organizations, design a public information campaign to inform potentially eligible persons of the exemption. DOR may contact persons who appear to be eligible. The administrative provisions of chapter 82.32 RCW apply and DOR is granted rulemaking authority. DOR must limit its costs to the initial start-up costs to implement the program. The state omnibus appropriations act must specify funding to be used for the ongoing administrative costs of the program.

Nexus. Nexus is the level of connection with a state necessary under the U.S. Commerce Clause to permit a state to impose a tax or a sales tax collection duty on out-of-state businesses doing business in the state. A state tax is constitutional under the Commerce Clause if it is assessed against a taxpayer with whom the state has a substantial nexus, is fairly apportioned, is nondiscriminatory, and is fairly related to the services provided by the state. Of these requirements, the substantial nexus requirement is often the most difficult to determine. In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the Court held that out-of-state businesses must have a physical presence in the state for there to be substantial nexus sufficient under the Commerce Clause to impose a sales tax collection duty. However, the Court was less clear in indicating whether the physical presence standard extends to other taxes. The proper nexus standard for state taxation of out-of-state businesses has been a contentious issue since the *Quill* decision. Numerous state courts have since affirmed economic presence standards, holding that a state may tax businesses with no physical presence within its borders.

The state of Washington uses a physical presence standard to determine whether a business has nexus with Washington. A physical presence standard requires a business to own or use real or personal property in this state, employ employees in this state, or engage, directly or through an agent, in activities in this state significantly associated with the business' ability to establish or maintain a market for its products or services in this state. A few examples of nexus-creating activities include: soliciting sales in this state through employees or other representatives; installing or assembling goods in this state, either by employees or other representatives; maintaining a stock of goods in this state; renting or leasing tangible personal property in this state; or making repairs or providing maintenance or service to property sold in this state.

Apportionment. Generally, a business performing service-taxable activities inside and outside the state must apportion to Washington the gross income derived from Washington activities as determined by a separate accounting method. However, if a separate accounting is impractical or inaccurate, Washington law provides an apportionment formula based on the cost of doing business in Washington versus the cost of doing business everywhere. More specifically, the apportionment formula is a fraction, the numerator of which is the cost of doing business in Washington, and the denominator is the total cost of doing business everywhere. A business' total income, earned inside and outside of Washington, is multiplied by the resulting fraction/percentage to determine the amount of service income subject to Washington's B&O tax. Under Washington law, only service-taxable activities are subject to the apportionment formula.

Financial institutions are subject to a different formula for apportionment. State law requires that the rules for financial institutions be consistent with uniform rules for apportionment developed throughout the nation. The DOR has issued a rule that provides a standard three-factor formula for financial institutions. The apportionment percentage is the average of a receipts factor, payroll factor, and property factor. The financial institutions total gross income, earned inside and outside of Washington, is multiplied by the resulting percentage to determine the amount of income subject to Washington's B&O tax.

Royalty income is not apportioned in this state. Instead, royalties are allocated to the domicile of the business.

Economic Substance Doctrine. The economic substance doctrine states that a transaction's tax benefits will not be allowed if the transaction does not have economic substance. This common law doctrine is an effort by the courts to enforce legislative intent in situations in which a literal reading of statutory code would allow a taxpayer to circumvent this intent. The doctrine is used frequently at the federal level to determine whether tax shelters or strategies used to reduce tax liability are considered abusive by the Internal Revenue Service. Washington courts have not used the economic substance doctrine to interpret tax statutes, but instead have relied on traditional methods of statutory construction that include: (1) looking to the plain language of a statute to determine whether the language is ambiguous; (2) giving words their common and ordinary meaning if the words are not ambiguous; (3) evaluating other evidence if language is determined to be ambiguous to ascertain legislative intent; and (4) construing tax exemptions, credits, and deductions narrowly.

Nonresident Sales Tax Exemption. The sales tax is imposed by the state, counties, and cities on retail sales of most items of tangible personal property and some services, including construction and repair services. The state sales rate is 6.5 percent and the local rates vary by location. If retail sales taxes were not collected when the property or services were acquired by the user, then use taxes are applied to the value of most tangible personal property and some services when used in this state. Use tax rates are the same as retail sales tax rates. The combined state/local rate is between 7.0 and 9.5 percent, depending on location.

Persons who reside in a state, possession or Canadian province that imposes a sales tax of less than 3.0 percent are exempt from Washington retail sales tax on tangible personal property purchased for use outside of Washington (i.e., the exemption does not apply to lodging or meals). Sales to residents of other states may also be exempt if their state of residence allows similar exemption for Washington residents; however, no state currently qualifies under this provision of reciprocity.

Direct Seller B&O Tax Exemption. A B&O tax exemption is provided for certain out-of-state sellers that sell consumer products exclusively to or through a direct seller's representative (DSR). Broadly, a DSR is defined to mean a person who buys consumer products for resale in either the home or some other forum that does not constitute a permanent retail establishment. There is no explicit requirement in the statute that the seller make sales of only consumer products through the DSR nor an explicit requirement that prohibits downstream sales of consumer products from being sold at retail from a permanent retail establishment. Traditionally, the exemption has been used by out-of-state sellers engaged in sales of consumer products exclusively through in-home parties or door-to-door selling. A seller qualifying for the exemption does not owe B&O tax on wholesaling or retailing of the consumer products. (The representative owes B&O tax on the commission.) In *Dot Foods, Inc. v. Dep't of Revenue*, 166 Wn.2d 912 (2009), the Washington Supreme Court held that the exemption also applies to out-of-state businesses selling non consumer products through its representative in addition to consumer products and to out-of-state businesses for consumer products ultimately sold at retail in permanent retail establishments. Many out-of-state businesses selling consumer products in this state could be eligible for the

exemption under this expanded interpretation or could easily restructure their business operations to qualify for the exemption.

Tax Preferences for Manufacturers of Certain Agricultural Products. Washington law provides a preferential tax rate for the business of slaughtering, breaking, or processing of perishable meat products and the wholesaling of such perishable meat products. In *Agrilink Foods, Inc. v. Dep't of Revenue*, 153 Wn.2d 392 (2005), the Supreme Court held that the preferential B&O tax rate applies to the processing of perishable meat products into nonperishable finished products, such as canned food. There had been a question as to whether the finished product had to also be a perishable meat product.

A B&O tax exemption is provided for manufacturing by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables, and selling such products at wholesale by the manufacturer to purchasers who transport the goods out-of-state in the ordinary course of business. This exemption expires July 1, 2012, and is replaced by a preferential B&O tax rate.

Preferential B&O Tax Rate for Board of Director Income. The wages of employees is exempt from the B&O tax. Members of corporate boards of directors receive fees for their services. Corporate directors are not employees of the corporation when they engage in their roles as corporate directors.

Foreclosure Real Estate Excise Tax Exemption. The sale of real estate is subject to the state real estate excise tax (REET). The tax is measured by the full selling price, including the amount of any liens, mortgages, or other debts multiplied by the rate of 1.28 percent. State law also authorizes several local REETs.

The REET also applies to transfers of controlling interests in entities that own property in the state. In order for the REET to apply to the sale of a controlling interest in an entity that owns real property, the following must have occurred: (1) the transfer or acquisition of the controlling interest occurred within a 12-month period; (2) the controlling interest was transferred in a single transaction or series of transactions by a single person or acquired by a single person or a group of persons acting in concert; (3) the entity has an interest in real property located in this state; (4) the transfer is not otherwise exempt from tax under state law; and (5) the transfer was made for valuable consideration. A program established in 2005 requires transfers of controlling interests in an entity that owns real property to be reported to the Secretary of State. Failure to report a transfer of a controlling interest to the Secretary of State can result in interest and penalties, including a 50 percent tax evasion penalty.

The REET is a legal obligation of the seller. Additionally, a statutory lien is placed on the property until the tax is paid. If REET is not properly paid, the DOR may enforce the obligation in an action of debt against the seller, enforce the lien in the same manner as a mortgage foreclosure, or some combination of the two. A buyer may also be liable for the REET unless the buyer notifies the DOR in writing within 30 days following the sale.

The real estate excise tax does not apply to a non judicial foreclosure sale of real property by a trustee under the terms of a deed of trust or a judicial foreclosure sale order by a court on

any mortgage, lien, or deed of trust. This exemption applies regardless of whether the sale is to the lender or a third party.

Tax Debts - Corporate Officer Liability. Currently, business owners can be held personally liable for uncollected but unremitted sales tax only when a corporation or limited liability company goes out of business.

B&O Tax Credit for New Employment for International Service Activities. Firms engaged in certain international services are entitled to a B&O tax credit of $3,000 for each new job a firm creates. Eligible activities are defined in the statute, which include services such as computer, legal, accounting, engineering, architectural, advertising, and financial services. To qualify, the firm must be located in a community empowerment zone or in a city or group of contiguous cities with a population of at least 80,000.

Rural Job Credit and Deferral Program. A credit against the state B&O tax is provided for manufacturing, research and development, or computer service firms that create new jobs in rural counties or community empowerment zones (CEZs).

Rural counties are defined as those with an average population density of less than 100 persons per square mile. Currently, of the state's 39 counties, only seven (Clark, King, Kitsap, Pierce, Snohomish, Spokane and Thurston) do not meet this definition. CEZs have been established in King, Kitsap, Pierce, and Spokane Counties.

The amount of the credit is $2,000 for each new job created, unless the new position is paid wages (including benefits) of more than $40,000 annually, in which case the credit is $4,000. To qualify, a firm must increase its total employment in rural counties or community empowerment zones by at least 15 percent. The amount of credit is capped at $7.5 million annually for all firms. The 15 percent job increase percentage is calculated by comparing employment in the four full calendar quarters after employees are hired to employment in the four full calendar quarters before employees were hired.

The Rural County Sales/Use Tax Deferral Program grants a deferral of sales/use tax for manufacturing, and computer-related businesses, research and development laboratories, and commercial testing facilities (excluding light and power businesses) locating in rural counties, CEZ, or a county containing a CEZ. The sales and/or use taxes on qualified construction and equipment costs for such businesses located in these specific geographic areas are waived when all program requirements have been met and verified.

B&O Deduction for Dues and Fees. B&O tax deduction is allowed for amounts received by a business for which no goods or services are received and only give the payee the right to be a member (aka bona fide initiation fees and dues).

B&O Deduction for Bad Debts. A credit or refund against current sales tax liability is allowed for retail sales taxes previously remitted to the state on debts that are deductible as worthless for federal income tax purposes.

Taxation of Brokered Natural Gas. Washington imposes a separate and distinct use tax on the use of natural gas or manufactured gas, referred to as the brokered natural gas (BNG) use

tax. Cities may impose a local version of the BNG use tax. The purpose of BNG use taxes is to eliminate differential tax treatment for natural gas purchased from gas companies, which is subject to state and local utility taxes, and gas purchased directly from producers by large, commercial users, which is not subject to utility taxes. The BNG use tax rates are identical to state and local utility tax rates.

Community Solar Incentives. In 2009 the Legislature enacted ESSB 6170, which provided additional incentives for renewable energy systems cost recovery program, extending the cost-recovery incentive program for renewable energy systems to include community solar projects. As a result, community solar projects are now eligible to receive cost recovery incentive payments from participating light and power businesses at a base incentive rate of $0.30 for each economic development kilowatt-hour of energy produced. Incentive payments for all other renewable energy systems remain at a base rate of $0.15 for each economic development kilowatt-hour of energy produced.

Sales and Use Tax Exemption for Livestock Nutrient Management Equipment and Facilities. In 2001 the Legislature provided an exemption from sales and use taxes for dairy nutrient management equipment, facilities, and related services. To be eligible the person had to have a certified dairy nutrient management plan. In 2006 the sales and use tax exemption was broadened beyond dairy to other sectors of the livestock industry that had approved nutrient management plans. A sales and use tax exemption applies to the materials, machinery, equipment, and labor and services purchased or used in relation to the operation, repair, cleaning, alteration, or improvement of livestock nutrient management facilities and equipment. Livestock nutrient management facilities and equipment are machinery, equipment, and structures used in the handling and treatment of livestock manure, such as aerators, agitators, alley scrapers, and augers. The exemption includes repair and replacement parts. The exemption requires facilities and equipment to be used exclusively for activities necessary to maintain a livestock nutrient management plan.

B&O Exemption for Property Management Salaries. B&O tax exemption is allowed for amounts received by a property management company, if the payments are received from a property management trust account for payment of wages and benefits to on-site personnel.

PUD Privilege Tax. Public Utility Districts (PUDs) were created to provide water and electricity, and to conserve water and power resources. Currently, there are 28 PUDs: 23 provide electricity services; 14 provide water or water and wastewater service; and 13 offer wholesale broadband telecommunications service.

The PUDs that generate, transmit, or distribute electricity are subject to the PUD privilege tax. The tax is intended to be in lieu of property tax, since public utility districts are governmental entities and do not pay property taxes.

The tax is based on the amount received from the sale of electricity. A recent lower court case has upheld the request for refund of tax by two PUDs that separate their kilowatt-hour charges from the charge to recoup the costs of providing service regardless of whether any electricity is used (e.g. meter reading, billing, and fixed facilities). These PUDs argue that tax should be paid only on the kilowatt-hour charge. It has been the department's interpretation that the tax applies to the entire amount received.

Sales Tax Exemption for Coal. Purchases of coal used at a thermal electric generating facility placed in operation after 1969 and before July 1, 1997, are exempt from retail sales/ use tax. The exemption is contingent upon owners of the plant demonstrating to the Department of Ecology that progress is being made to install the necessary air pollution control devices and that the facility has emitted no more than 10,000 tons of sulfur dioxide during the previous 12 months.

Exemption for Machinery Used to Generate Electricity from Wind. Effective July 1, 2009, through June 30, 2013, purchases and installation of machinery and equipment that will be used directly in a facility that generates no more than ten kilowatts of electricity using solar energy are exempt from sales/use tax. In addition, purchases and installation of machinery and equipment used directly in generating electricity using fuel cells, sun, wind, biomass energy, tidal and wave energy, geothermal resources, anaerobic digestion, technology that converts otherwise lost energy from exhaust, or landfill gas in a facility that generates no less than one kilowatt of electricity are exempt from sales/use tax subject to the following: (1) from July 1, 2009, through June 30, 2011, the exemption is 100 percent of the sales or use tax paid; and (2) July 1, 2011, through June 30, 2013, the exemption is in the form of a refund from the DOR of 75 percent of sales or use tax paid.

Summary of Second Engrossed Substitute Bill: Sales Tax and Working Families Tax Exemption. From June 1, 2010 until June 30, 2013, an additional sales and use tax of 0.2 percent is imposed.

The Working Families' Tax Exemption is provided to eligible low-income persons for sales tax paid after January 1, 2011. For remittances made in 2012 (for taxes paid in 2011), the exemption is the greater of $25 or a 5 percent of the EITC granted. For remittances made in 2013 and thereafter, the exemption is the greater of $50 or 10 percent of the EITC granted. For remittances provided in the Fiscal Year 2015 and thereafter, DOR must limit its ongoing costs to administer the program to 5 percent of the total exemptions provided each year.

An exception from the requirement that a sales and use tax change take effect no sooner than 75 days after its enactment and only on the first day of January, April, July, or October is provided.

Economic Nexus and Apportionment. For purposes of imposing the B&O tax on service activities and the activity of receiving royalty income, a business or individual will have substantial nexus with the state if the individual or business meets one of the following requirements: (1) an individual is a resident or domiciled in the state; (2) a business entity is organized or commercially domiciled in this state; or (3) the individual or business is organized or domiciled outside the state but has more than $50,000 of property in the state, more than $50,000 of payroll in the state, more than $250,000 of receipts from this state, or at least 25 percent of the individual's or business's total property, total payroll, or total receipts in this state. This nexus standard only applies to service activities and the activity of receiving royalty income. A business or individual with substantial nexus in any tax year is deemed to have substantial nexus with the state for the following tax year.

Income derived from service activities and royalties is apportioned to Washington based on a receipts factor. The receipts factor is a fraction of which the numerator is the total gross income of the business attributable to this state for the activity, and the denominator is the worldwide gross income of the business for the activity. The total worldwide gross income from the activity is multiplied by the receipts factor to determine the amount of income apportioned to Washington for purposes of the B&O tax. Apportionment using the receipts factor would replace the three-factor apportionment formula for financial institutions and the cost apportionment formula for other businesses providing services.

Except for financial institutions, gross income is attributable to this state based on the following series of hierarchical rules:

1. income is attributable to this state if the customer received the benefit of the service in this state or used the business's intangible property in this state;
2. if the customer received the benefit of the service or used the intangible property in more than one state, income is attributable to the state where the service was primarily received or where the intangible property is primarily used;
3. if income cannot be attributed under the foregoing, then the income is attributable to the state where the customer ordered the service or where the royalty agreement was negotiated;
4. if income cannot be attributed under the foregoing, then the income is attributable to the state to which the billing statements or invoices are sent to the customer;
5. if income cannot be attributed under the foregoing, then the income is attributable to the state from which the customer sends payment to the business;
6. if income cannot be attributed under the foregoing, then the income is attributable to the state where the customer is located; and
7. if income cannot be attributed under the foregoing, then the income is attributable to the state where the business is domiciled.

For financial institutions the Department must adopt their apportionment methods by rule.

Economic Substance and Tax Avoidance. The economic substance doctrine is adopted. Accordingly, DOR may disregard abusive tax avoidance transactions for tax periods on or after January 1, 2006. An abusive tax avoidance transaction is defined to mean a transaction, plan, or arrangement that lacks economic substance. A transaction is deemed to have economic substance only if: (1) the transaction changes the taxpayer's economic position in a meaningful way, apart from the transaction's tax effects; (2) the taxpayer has a substantial nontax purpose for entering into the transaction; and (3) the transaction is an objectively reasonable means of accomplishing the substantial nontax purpose. DOR has the burden of establishing that a transaction does not have economic substance.

If DOR determines that a transaction lacks economic substance, DOR may take reasonable steps necessary to deny the tax benefit resulting from the abusive tax avoidance transaction. These steps may include: re-characterizing the nature of income; disregarding the form of a corporate or other business entity; treating a transaction according to its underlying economic substance rather than form; treating a series of formally separate steps as a single transaction; and imputing income to a taxpayer who provides services to a related person and the consideration does not reflect the fair market value of the service.

If a tax deficiency is deemed to be a result of an abusive tax avoidance transaction, DOR may assess a 35 percent penalty; however, DOR may not assess the penalty if the taxpayer discloses its participation in an abusive tax avoidance transaction before DOR discovers it.

The statutory language describing how the acquisition of tangible personal property (TPP) occurs (lease, gift, bailment, etc.) is eliminated. Therefore, the acquisition of TPP in any manner is subject to use tax unless some other provision specifically exempts the transaction.

For the purpose of determining whether the sale of a controlling interest has occurred within a 12-month period, an option to purchase real estate is also included in the determination. The date the option agreement is executed is used as the relevant date.

DOR may, at its option, enforce the collection of REET for the sale of a controlling interest in a business by pursuing the buyer of a controlling interest, seller of a controlling interest, or the business entity itself of which a controlling interest is transferred.

The law is clarified that a lien for payment of REET attaches to each parcel of property owned by an entity in which a controlling interest has been transferred.

A parent corporation of a wholly owned subsidiary is responsible for REET if the subsidiary transfers real property to a third party and then dissolves before payment of the tax.

Buyers are no longer absolved from REET liability by simply providing notice of a real estate sale to DOR.

Direct Seller B&O Exemption. The B&O exemption for firms that sell into Washington using direct seller's representatives is eliminated. For periods prior to April 1, 2010, the exemption is retroactively limited to consumer products.

Preferential B&O Tax Rate for Manufacturing Certain Agricultural Products. The B&O preferential tax rate (0.138 percent) for meat processing to the manufacturing of perishable meat products, dehydrated, cured, or smoked meat products, and hides, tallow, and other meat by-products is expressly limited to those activities creating a final product which is at least 50 percent fruit and vegetables to qualify for the preferential tax rate.

The preferential rate for slaughtering, breaking, or processing perishable meat products or selling these perishable meat products at wholesale is modified by requiring that the end product be: a perishable meat product; a nonperishable meat product that is comprised primarily of animal carcass by weight or volume, other than a canned meat product; or a meat by-product. The tax preference for fruit and vegetable manufacturers is modified by requiring that the end product be comprised either exclusively of fruits or vegetables, or any combination of fruits, vegetables, and certain other substances that, cumulatively, may not exceed the amount of fruits and vegetables contained in the product measured by weight or volume.

B&O Tax on Amounts Paid to Corporate Directors. The fees paid to members of corporate boards of directors are explicitly subject to tax under the service and other classification at

the 1.5 percent tax rate. After July 1, 2010, fees paid to members of corporate boards of directors would not be exempt under the exemption for wages and salaries for employees.

Foreclosure Exemption from REET. The REET exemption for transfers made pursuant to foreclosure is narrowed. Sales of the property to a third party would be subject to tax. When a transfer or conveyance pursuant to a judicial or non judicial foreclosure or enforcement of a judgment is a sale the tax levied under this chapter is the obligation of the buyer.

Tax Debts - Corporate Officer Liability. DOR is allowed to pursue uncollected taxes of a terminated or insolvent limited liability business from the chief executive or chief financial officer, or other persons responsible for paying the taxes.

The B&O Tax Job Credit for International Service Activities. The B&O tax credit for international service activities is repealed.

Eligibility for the Rural County Programs. A business claiming the sales and use tax deferral under chapter 82.60 RCW and B&O credits under chapter 82.62 RCW in the Rural County Job Credit and Deferral Programs are eligible for the incentives for computer programming, but only when it is used to create a new item for sale.

Limiting the B&O Deduction for Dues and Fees. The B&O tax deduction for dues and initiation fees is allowed certain nonprofit organizations exempt under certain federal income tax provisions in U.S.C. section 501(c).

Limiting the Bad Debt Deduction. The deduction is expressly limited to the seller.

Limiting Community Solar Incentives. For community solar projects, the renewable cost recovery program is limited to those community solar projects generating no more than 75 kilowatts of electricity.

Sales Tax Exemption for Livestock Nutrient Equipment and Facilities. The sales and use tax exemption for equipment and facilities used for handling livestock nutrients at dairies and livestock feeding operations is suspended for three years.

PUD Privilege Tax. Gross revenue for purpose of the PUD privilege tax applies to all charges for electricity including recurring charges as a condition of receiving the electricity.

Repealing the Sales Tax Exemption for Coal. The sales and use tax exemption for coal used at a coal-fired thermal electric generation facility is repealed.

Machinery Used to Create Electricity from Wind. In order to qualify for the exemption for machinery and equipment used to create energy from wind, a producer must either be a local utility or someone contracting with a local utility for the sale of power.

Repeal of B&O Exemption for Property Management Salaries. The B&O exemption for amounts received by a property management company from the owner of a property for gross wages and benefits paid to on-site personnel is repealed.

Business and Occupation Tax Increase on Service Activities. Businesses who pay the B&O tax at the rate of 1.5 percent will have an increase of .25 percent for three years. In addition, the small business tax credit for these businesses is double to be worth a maximum of $70 a month from $35 a month. The small business tax credit is a permanent change.

Sales Tax on Bottled Water. The sales tax is extended to bottled water and takes effect May 1, 2010. In addition an exemption is added for persons who purchase bottle water with a prescription, and for persons who don't house potable water. The sales tax on bottled water and the accompanying exemptions expire June 1, 2013.

Appropriation: Appropriates $313,307,000 from the state General Fund to the Education Legacy Trust Account for Fiscal Year 2011.

Fiscal Note: Requested on March 5, 2010.
[OFM requested ten-year cost projection pursuant to I-960.]

Committee/Commission/Task Force Created: No.

Effective Date: The bill contains an emergency clause and takes effect on June 1, 2010.

Staff Summary of Public Testimony on SB 6873 and SB 6875: SB 6873
PRO: Economic nexus will level the playing field for in-state businesses. Furthermore, the apportionment changes will encourage fairness. Businesses which set up structures for the sole purpose of avoiding taxes raises concerns. Tax avoidance changes interacts with economic nexus provisions of this bill to encourage businesses not to restructure in-state businesses out-of-state for the sole purpose of tax avoidance. The tax avoidance provision addresses the disappearing taxpayer scenario or the subsidiary set up out of state for the sole purpose of avoiding tax. This package is a better option than a sales tax increase. We are glad to see a proposal to raise revenue, but we would still like to see additional revenue to support programs for homecare programs and services. An all-cuts budget takes away necessary services. Corporations and businesses should pay their fair share. Looking at the public value of tax preferences is good public policy. State spending has a multiplier effect, as does private sector spending; thus, the 2009 reductions in state spending has impacted our economy. While increasing taxes may impact jobs, the factor is smaller than cutting state spending; raising revenue to support state programs saves jobs. Washington's tax structure is outdated, as it was developed in the 1930s. The tax base should be broadened. The federal government deregulated this industry in the 1980s; the Washington Legislature put in a use tax to address this. If the utility tax is paid, the use tax is not. The brokered natural gas change is equitable, and it is prospective. The use tax on brokered natural gas is constitutional, is fair by treating all consumers of natural gas the same, and reasserts the existing practice of local taxes on natural gas. This is good policy and also helps local governments, which are also struggling to fund essential government services, which is why this proposal fits under the title. The two-year budget contemplates $4 billion in reductions to $1 billion in new revenues; those reductions have hit some populations harder than others, such as children, the poor, the elderly, and the disabled. This proposal helps share the burden and some of us would support a tax increase. Despite the clean-up efforts, the coal plant in Centralia continues to pollute. The exemption for coal is in contrast with other pollution control and reduction efforts. The agreement with Trans Alta is complicated, but was not

contingent upon clean air standards. Revenues resulting from the repeal of the coal exemption should be redirected into related programs.

CON: Part 1: Economic Nexus and Apportionment.This proposal is overbroad and a significant change to Washington's tax system. This change would create a lack of certainty. This will create litigation costs to the state. This should be a study (economic nexus and apportionment). This is on a fast-track and should be slowed down for stakeholder work. We are concerned that the local governments will impose economic nexus, which will be impossible. This is a big change. Apportionment changes could help some in-state businesses in the high tech sector. The financial services industry would be impacted. This could make capital less available; this could impact economic recovery. This could make credit less available, and could hurt consumers and businesses. Community banks will also be impacted; they work with national banks. Out-of-state credit card companies will be impacted, and these costs will impact Washington consumers and businesses. This could also disincentivize securitizing loans. For the national banks, this will lead to pyramiding taxation on their affiliates as funds are transferred, per federal regulation. This could discourage small business lending. Economic nexus will increase Alaska Airline's costs.
Part 2: Tax Avoidance. This creates an unreasonable expansion of authority to DOR (Part 2 – Tax Avoidance). This takes the Legislature's authority away. These powers are not needed. DOR allowed this treatment for years, and these changes may be applied retroactively. Recharacterizing bank contracts by DOR is a concern. This change creates uncertainty for businesses; they will not know what their tax liability would be until an audit was over. There may be reasons why property is maintained and owned outside of Washington. There is authority under current law to pursue some of these schemes. This should be studied, rather than adopted outright.
Part 3: Mortgage Deduction. Any origination fees will now be treated differently. Residential mortgages are narrow-margin loans; this deduction encourages such mortgages. Servicing loans keeps banks, jobs, and connections to the customer in Washington.
Part 4: Nonresident Sales Tax Exemption.A lot of sales of yachts are for nonresidents, and this refund mechanism will drive sales out of Washington.
Part 5: Direct Sellers. There are direct sellers who qualified under the exemption as it was intended when it was enacted; narrow the preference to its intended beneficiaries. There is a high-turnover industry, and complicating these transactions is going to make this a lot more difficult for the direct sellers, many of whom are women making a supplemental income for themselves and families.
Part 6: Ag Products Manufacturing.We have concerns about the fiscal estimates; we believe the benefit to agricultural producers is small.
Part 7: Corporate fees.This will affect banks'actions to get qualified persons on the boards; banks are required to have boards.
Part 8: Aircraft Excise Tax.This could lead to aircraft being sold, because of the increased tax burden. We would like to work with the Legislature on other proposals, because restructuring the aircraft excise tax would harm this industry. There are many small airfields and airports that will be impacted, because the high-value aircraft will move out of state. Further, this increase will impact border areas in Washington, because it would be very easy to move aircraft to another state. The aviation industry has been hit hard; this proposal will hurt this sector's recovery. This industry supports family-wage jobs and has invested a lot in the sector. This restructuring is an excessive increase. There may be other approaches which make more sense.

Part 9: REET Foreclosure. This will disadvantage banks which have already lost revenue on foreclosed property.
Part 10: Corporate Officer Liability.We should not make corporate officers liable for unpaid excise taxes; this removes personal liability when a business fails which may be outside the control of corporate officers. This proposal is overbroad, because some corporate officers have no part of the financial operations. There is a distinct difference between the sales tax held in trust and other excise taxes. Businesses retaining sales taxes are stealing from the state; a business'excise tax liability is different.
Part 12: Prescription Drug.Prescription drug resellers operate on a low margin. The industry stayed in Washington and brought family wage jobs after the preferential rate was enacted.
Part 14: Urban PUT. The increase of the urban PUT would be a blow to the state's economy. The trucking industry has been impacted by the poor economy. This is not a loophole. This would do more harm than good. Cargo shipped through our ports is trucked to warehouses in the area. Washington ports are in competition with other ports in the U.S. and Canada. This will not only impact jobs on the waterfront, but jobs throughout the state, including farmers. Ports should be part of the solution; we are the most trade dependent state. We will lose business and cargo if this tax is increased, as have other ports in the U.S. This will affect exports as well, including agricultural products. This will fundamentally increase the cost of moving goods in Washington.
Part 15: Sprays and Fertilizers.We provide healthy food, jobs, and tax revenues. This will jeopardize our competitiveness. This is also a policy debate about organic inputs. Agricultural producers are price takers, not price makers; we have little control over inputs, markets, and prices. Eliminating these exemptions will affect businesses'viability. This is a cyclical industry; market forces could change quickly. The organics input regulation is very complicated, changing this exemption should be carefully considered before we make any changes. Agricultural producers have little control over growing conditions and the inputs related to these conditions; any inputs come out of the producer's bottom line.
Part 16: Dues and Fees.While club membership is discretionary, clubs do support jobs and revenue. This sector is already impacted, because membership is discretionary. An additional tax could be counterproductive. AAA services or community service programs are funded, in part, through these membership fees. DOR reviews this preference every four years (in its Tax Exemption Study) and has concluded that any savings are unlikely.
Part 18: BNG. Brokered natural gas use for local tax is going to cost the state money and is unconstitutional. Shifting the tax incidence from first use to consumption is going to complicate the taxing of brokered natural gas. Having different tax incidence for the same product is poor tax policy. Concern about whether this fits in the title.
Part 13: Rural County.This is currently in litigation, so any proposals should wait. Yahoo has invested in these areas and is entitled to the tax preferences.
Part 21: Bullion. Bullion is a small margin business, the markup is only 2 to 5 percent. These businesses will have to close, due to the tax increase proposed, and jobs and tax revenue will be lost. Bullion is recognized in Washington and under the federal IRS code as an investment. Bullion businesses are paying our fair share, similar to other investment professionals. We cannot pass this on to our customers, because bullion is for investment.
Part 22: PUD Privilege. This provision should be prospective only.
Part 23: Coal Exemption.Repealing the exemption for coal will impact jobs at Trans Alta. Washington will lose more than it gains from this repeal. The exemption was part of a bargain to clean up this industry's environmental impact, and to pull them back now is unfair. Trans Alta has invested a large amount of money in the plant and pollution control

devices, and supports jobs in the Centralia area. The Centralia area needs the family-wage jobs and revenues which Trans Alta brings. Trans Alta has a commitment to a cleaner Washington, and will continue to reduce emissions. Energy provision is essential, but often taken for granted.
Part 24: Trade-in.Trade-in exemption is important to the agricultural producer and rural communities. This would hurt boat sales and impact revenues. This will greatly increase the amount of tax the customer will pay and will increase debt. Vehicle sales are essential to economic recovery. Luxury tax proposals are a problem, when this is a consumer led recovery. Boat owners are already paying a vehicle excise tax and other taxes and fees; they are paying their fair share.
Part 25: Wind Energy Narrowing. This incentive should be retained to encourage wind generated electricity. Wind energy should not be treated any differently than other renewable energy generators in Washington. This is an economic investment in our state, creating jobs and revenues. Members of the environmental community support the current law and its encouragement of renewable generators. Other tax preferences should be narrowed or eliminated; this incentive should be retained.
Part 26: Property Management.This change will increase taxes and will lead to job cuts at property management companies, which is a low-margin business. In this marketplace, the commercial real estate market is very weak; property management is likewise affected. The cost of this increase will be passed on, either to property owners or by reducing jobs. We are not employment agencies, we are a pass through.
General. We should look to more cuts, not tax increases.

SB 6875
PRO: This is an important proposal to support higher education funding. This provides the revenue necessary to fund state needs grants. This will help preserve access to higher education institutions. Helps students achieve the American dream. Low-income persons are paying more than their fair share of the tax burden, relative to their incomes. The rebate will ease the burden. The investment in higher education is an investment in the future.

CON: Any increase to the sales tax reduces sales in retail stores. In the current economic environment, consumers are price conscious. The number one concern of independent business members is an increase in the sales tax. This will undermine consumer confidence. Tax increase proposals should be approved by voters. Funding for newer educational programs should be reviewed, and possibly eliminated, rather than tax increases. Sales tax increases impact day-to-day operations of businesses, which must recalibrate accounting and other systems. We should look to more cuts, not tax increases. We support the programs that this tax would fund; but, we believe that levy equalization and all day kindergarten is essential. You cannot fund such essential programs with a temporary source of revenue. Also, any new sources of revenue should add education programs, rather than replacing existing funding.

OTHER: The sales tax is regressive. We appreciate that the Working Families'tax credit ameliorates that regressivity. However, the unemployed cannot get the EITC, and thus can't get this new credit.

Persons Testifying: **SB 6873**
Contact committee staff for list of names. There were 14 pro; 60 con.

SB 6875

PRO: Lonnie Johns-Brown, NOW; Terry Teale, Council of Presidents; Sam Shaddox, John Hanks, ASUW and WSU; Fatima Morales, Washington Community Action Network; Marsha Riddle Buly, WWU.

CON: Mark Johnson, Washington Retail Association; Patrick Conner, National Federation of Independent Business; Amber Carter, Association of Washington Business; John Worthington, citizen; Jan Gee, Washington Food Industry; George Scarola, League of Education Voters; Steve Lindstrom; George Harris, Northwest Marine Trade In; Kurt Kingman, Robert Berglund, Northwest Yachtnet; Tom Cooper, Seacraft Yacht Sales.

OTHER: Randy Parr, Washington Education Association.

House Amendment(s): Most provisions start in April 2010 instead of June 2010.

Adds a provision which makes the sale of custom software subject to sales tax.

Moves the B&O surtax on service business effective in May instead of July.

Removes the B&O tax deduction for interest on first mortgages over $120 million.

Eliminates the sales tax exemption for certain nonresidents.

For the tax avoidance legislation, removes the express tax avoidance doctrines. Requires DOR to do a study.

Eliminates the credit against the state sales tax for lodging in Seattle that goes to the convention center. Allows it to be an add-on tax.

Adds a 3-tiered aircraft excise tax; fee by type for aircraft manufactured before 1970; fee by type for aircraft manufactured after 1970; and fee by gross weight for turbojet multi-engine aircraft.

Removes the provisions regarding the real estate excise tax on certain foreclosed properties.

Does not include the B&O exemption on international service activities and rural county activities.

Removes the elimination of the B&O deduction on initiation fees and dues from certain organizations.

Removes the limitation of the bad debt deduction.

Removes the repeal of the sales tax exemption on coal.

Removes the limitation of the sales tax exemption for wind machinery and equipment.

Removes the sales tax increase of 0.2 percent and the working families tax exemption.

Appendix S

SENATE BILL REPORT
SB 6143

As of March 5, 2010

Title: An act relating to revenue and taxation.

Brief Description: Relating to revenue and taxation.

Sponsors: Senator Prentice.

Brief History:
Committee Activity: Ways & Means: 3/05/10.

SENATE COMMITTEE ON WAYS & MEANS

Staff: Dean Carlson (786-7305)

Background: The Sales and Use Tax. The sales tax is imposed by the state, counties, and cities on retail sales of most items of tangible personal property and some services, including construction and repair services. If retail sales taxes were not collected when the property or services were acquired by the user, then use taxes are applied to the value of most tangible personal property and some services when used in this state. Use tax rates are the same as retail sales tax rates. The combined state/local rate is between 7 and 9.5 percent, depending on location.

The Federal Earned Income Tax Credit. The earned income tax credit (EITC), established in the federal tax code in 1975, is a refundable tax credit available to eligible workers earning relatively low wages. Because the credit is refundable, an EITC recipient need not owe taxes to receive the benefits. The amount of the credit varies but it is generally determined by income and family size. Some states with an income tax provide an EITC. For purposes of the EITC, earned income includes wages, salaries, tips, and other taxable employee pay. The following types of income are not considered earned income: retired persons' disability benefits, pensions and annuities, social security, child support, welfare benefits, workers' compensation benefits, and veterans' benefits. The EITC cannot be claimed unless investment income is less than $3,100 for the 2009 tax year. Generally, a taxpayer may be able to take the credit for tax year 2009 if the taxpayer:

- has three or more qualifying children and earns less than $43,279 ($48,279 married filing jointly);
- has two qualifying children and earns less than $40,295 ($45,295 married filing jointly);

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

- has one qualifying child and earns less than $35,463 ($40,463 married filing jointly); or
- has no qualifying children and earns less than $13,440 ($18,440 married filing jointly).

For the 2009 tax year, the maximum credit is:
- $5,657 with three or more qualifying children;
- $5,028 with two qualifying children;
- $3,043 with one qualifying child; and
- $457 with no qualifying children.

Working Families' Tax Exemption. In 2008 the Legislature enacted a working families' tax exemption in the form of a state sales tax remittance, equal to a percentage of the EITC. Persons eligible for the credit must file a federal income tax return, receive an EITC, and have resided in Washington for more than 180 days in the year which the exemption is claimed. Eligible persons must pay the sales tax in the year for which the exemption is claimed. For remittances in 2009 and 2010, the exemption for the prior year is $25 or equal to 5 percent of the EITC for which data is available, whichever is greater. For 2011 and thereafter, the exemption for the prior year is $50 or equal to 10 percent of the EITC for which data is available, whichever is greater. For any fiscal period, the working families' tax exemption must be approved in the state omnibus appropriations act. The Department of Revenue (DOR) determines eligibility based on information provided by the applicant, and through audit, administrative records, and verification of Internal Revenue Service records. DOR may use the best data available to process the remittance. DOR may, in conjunction with other agencies or organizations, design a public information campaign to inform potentially eligible persons of the exemption. DOR may contact persons who appear to be eligible. The administrative provisions of chapter 82.32 RCW apply and DOR is granted rulemaking authority. DOR must limit its costs to the initial start-up costs to implement the program. The state omnibus appropriations act must specify funding to be used for the ongoing administrative costs of the program.

Nexus. Nexus is the level of connection with a state necessary under the U.S. Commerce Clause to permit a state to impose a tax or a sales tax collection duty on out-of-state businesses doing business in the state. A state tax is constitutional under the Commerce Clause if it is assessed against a taxpayer with whom the state has a substantial nexus, is fairly apportioned, is nondiscriminatory, and is fairly related to the services provided by the state. Of these requirements, the substantial nexus requirement is often the most difficult to determine. In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the Court held that out-of-state businesses must have a physical presence in the state for there to be substantial nexus sufficient under the Commerce Clause to impose a sales tax collection duty. However, the Court was less clear in indicating whether the physical presence standard extends to other taxes. The proper nexus standard for state taxation of out-of-state businesses has been a contentious issue since the *Quill* decision. Numerous state courts have since affirmed economic presence standards, holding that a state may tax businesses with no physical presence within its borders.

The state of Washington uses a physical presence standard to determine whether a business has nexus with Washington. A physical presence standard requires a business to own or use

real or personal property in this state, employ employees in this state, or engage, directly or through an agent, in activities in this state significantly associated with the business' ability to establish or maintain a market for its products or services in this state. A few examples of nexus-creating activities include: soliciting sales in this state through employees or other representatives; installing or assembling goods in this state, either by employees or other representatives; maintaining a stock of goods in this state; renting or leasing tangible personal property in this state; or making repairs or providing maintenance or service to property sold in this state.

Apportionment. Generally, a business performing service-taxable activities inside and outside the state must apportion to Washington the gross income derived from Washington activities as determined by a separate accounting method. However, if a separate accounting is impractical or inaccurate, Washington law provides an apportionment formula based on the cost of doing business in Washington versus the cost of doing business everywhere. More specifically, the apportionment formula is a fraction, the numerator of which is the cost of doing business in Washington, and the denominator is the total cost of doing business everywhere. A business' total income, earned inside and outside of Washington, is multiplied by the resulting fraction/percentage to determine the amount of service income subject to Washington's B&O tax. Under Washington law, only service-taxable activities are subject to the apportionment formula.

Financial institutions are subject to a different formula for apportionment. State law requires that the rules for financial institutions be consistent with uniform rules for apportionment developed throughout the nation. The DOR has issued a rule that provides a standard three-factor formula for financial institutions. The apportionment percentage is the average of a receipts factor, payroll factor, and property factor. The financial institutions total gross income, earned inside and outside of Washington, is multiplied by the resulting percentage to determine the amount of income subject to Washington's B&O tax.

Royalty income is not apportioned in this state. Instead, royalties are allocated to the domicile of the business.

Economic Substance Doctrine. The economic substance doctrine states that a transaction's tax benefits will not be allowed if the transaction does not have economic substance. This common law doctrine is an effort by the courts to enforce legislative intent in situations in which a literal reading of statutory code would allow a taxpayer to circumvent this intent. The doctrine is used frequently at the federal level to determine whether tax shelters or strategies used to reduce tax liability are considered abusive by the Internal Revenue Service. Washington courts have not used the economic substance doctrine to interpret tax statutes, but instead have relied on traditional methods of statutory construction that include: (1) looking to the plain language of a statute to determine whether the language is ambiguous; (2) giving words their common and ordinary meaning if the words are not ambiguous; (3) evaluating other evidence if language is determined to be ambiguous to ascertain legislative intent; and (4) construing tax exemptions, credits, and deductions narrowly.

Nonresident Sales Tax Exemption. The sales tax is imposed by the state, counties, and cities on retail sales of most items of tangible personal property and some services, including construction and repair services. The state sales rate is 6.5 percent and the local rates vary by

location. If retail sales taxes were not collected when the property or services were acquired by the user, then use taxes are applied to the value of most tangible personal property and some services when used in this state. Use tax rates are the same as retail sales tax rates. The combined state/local rate is between 7.0 and 9.5 percent, depending on location.

Persons who reside in a state, possession or Canadian province that imposes a sales tax of less than 3.0 percent are exempt from Washington retail sales tax on tangible personal property purchased for use outside of Washington (i.e., the exemption does not apply to lodging or meals). Sales to residents of other states may also be exempt if their state of residence allows similar exemption for Washington residents; however, no state currently qualifies under this provision of reciprocity.

Direct Seller B&O Tax Exemption. A B&O tax exemption is provided for certain out-of-state sellers that sell consumer products exclusively to or through a direct seller's representative (DSR). Broadly, a DSR is defined to mean a person who buys consumer products for resale in either the home or some other forum that does not constitute a permanent retail establishment. There is no explicit requirement in the statute that the seller make sales of only consumer products through the DSR nor an explicit requirement that prohibits downstream sales of consumer products from being sold at retail from a permanent retail establishment. Traditionally, the exemption has been used by out-of-state sellers engaged in sales of consumer products exclusively through in-home parties or door-to-door selling. A seller qualifying for the exemption does not owe B&O tax on wholesaling or retailing of the consumer products. (The representative owes B&O tax on the commission.) In *Dot Foods, Inc. v. Dep't of Revenue*, 166 Wn.2d 912 (2009), the Washington Supreme Court held that the exemption also applies to out-of-state businesses selling non consumer products through its representative in addition to consumer products and to out-of-state businesses for consumer products ultimately sold at retail in permanent retail establishments. Many out-of-state businesses selling consumer products in this state could be eligible for the exemption under this expanded interpretation or could easily restructure their business operations to qualify for the exemption.

Tax Preferences for Manufacturers of Certain Agricultural Products. Washington law provides a preferential tax rate for the business of slaughtering, breaking, or processing of perishable meat products and the wholesaling of such perishable meat products. In *Agrilink Foods, Inc. v. Dep't of Revenue*, 153 Wn.2d 392 (2005), the Supreme Court held that the preferential B&O tax rate applies to the processing of perishable meat products into nonperishable finished products, such as canned food. There had been a question as to whether the finished product had to also be a perishable meat product.

A B&O tax exemption is provided for manufacturing by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables, and selling such products at wholesale by the manufacturer to purchasers who transport the goods out-of-state in the ordinary course of business. This exemption expires July 1, 2012, and is replaced by a preferential B&O tax rate.

Preferential B&O Tax Rate for Board of Director Income. The wages of employees is exempt from the B&O tax. Members of corporate boards of directors receive fees for their

services. Corporate directors are not employees of the corporation when they engage in their roles as corporate directors.

Foreclosure Real Estate Excise Tax Exemption. The sale of real estate is subject to the state real estate excise tax (REET). The tax is measured by the full selling price, including the amount of any liens, mortgages, or other debts multiplied by the rate of 1.28 percent. State law also authorizes several local REETs.

The REET also applies to transfers of controlling interests in entities that own property in the state. In order for the REET to apply to the sale of a controlling interest in an entity that owns real property, the following must have occurred: (1) the transfer or acquisition of the controlling interest occurred within a 12-month period; (2) the controlling interest was transferred in a single transaction or series of transactions by a single person or acquired by a single person or a group of persons acting in concert; (3) the entity has an interest in real property located in this state; (4) the transfer is not otherwise exempt from tax under state law; and (5) the transfer was made for valuable consideration. A program established in 2005 requires transfers of controlling interests in an entity that owns real property to be reported to the Secretary of State. Failure to report a transfer of a controlling interest to the Secretary of State can result in interest and penalties, including a 50 percent tax evasion penalty.

The REET is a legal obligation of the seller. Additionally, a statutory lien is placed on the property until the tax is paid. If REET is not properly paid, the DOR may enforce the obligation in an action of debt against the seller, enforce the lien in the same manner as a mortgage foreclosure, or some combination of the two. A buyer may also be liable for the REET unless the buyer notifies the DOR in writing within 30 days following the sale.

The real estate excise tax does not apply to a non judicial foreclosure sale of real property by a trustee under the terms of a deed of trust or a judicial foreclosure sale order by a court on any mortgage, lien, or deed of trust. This exemption applies regardless of whether the sale is to the lender or a third party.

Tax Debts - Corporate Officer Liability. Currently, business owners can be held personally liable for uncollected but unremitted sales tax only when a corporation or limited liability company goes out of business.

B&O Tax Credit for New Employment for International Service Activities. Firms engaged in certain international services are entitled to a B&O tax credit of $3,000 for each new job a firm creates. Eligible activities are defined in the statute, which include services such as computer, legal, accounting, engineering, architectural, advertising, and financial services. To qualify, the firm must be located in a community empowerment zone or in a city or group of contiguous cities with a population of at least 80,000.

Rural Job Credit and Deferral Program. A credit against the state B&O tax is provided for manufacturing, research and development, or computer service firms that create new jobs in rural counties or community empowerment zones (CEZs).

Rural counties are defined as those with an average population density of less than 100 persons per square mile. Currently, of the state's 39 counties, only seven (Clark, King, Kitsap, Pierce, Snohomish, Spokane and Thurston) do not meet this definition. CEZs have been established in King, Kitsap, Pierce, and Spokane Counties.

The amount of the credit is $2,000 for each new job created, unless the new position is paid wages (including benefits) of more than $40,000 annually, in which case the credit is $4,000. To qualify, a firm must increase its total employment in rural counties or community empowerment zones by at least 15 percent. The amount of credit is capped at $7.5 million annually for all firms. The 15 percent job increase percentage is calculated by comparing employment in the four full calendar quarters after employees are hired to employment in the four full calendar quarters before employees were hired.

The Rural County Sales/Use Tax Deferral Program grants a deferral of sales/use tax for manufacturing, and computer-related businesses, research and development laboratories, and commercial testing facilities (excluding light and power businesses) locating in rural counties, CEZ, or a county containing a CEZ. The sales and/or use taxes on qualified construction and equipment costs for such businesses located in these specific geographic areas are waived when all program requirements have been met and verified.

B&O Deduction for Dues and Fees. B&O tax deduction is allowed for amounts received by a business for which no goods or services are received and only give the payee the right to be a member (aka bona fide initiation fees and dues).

B&O Deduction for Bad Debts. A credit or refund against current sales tax liability is allowed for retail sales taxes previously remitted to the state on debts that are deductible as worthless for federal income tax purposes.

Taxation of Brokered Natural Gas. Washington imposes a separate and distinct use tax on the use of natural gas or manufactured gas, referred to as the brokered natural gas (BNG) use tax. Cities may impose a local version of the BNG use tax. The purpose of BNG use taxes is to eliminate differential tax treatment for natural gas purchased from gas companies, which is subject to state and local utility taxes, and gas purchased directly from producers by large, commercial users, which is not subject to utility taxes. The BNG use tax rates are identical to state and local utility tax rates.

Community Solar Incentives. In 2009 the Legislature enacted ESSB 6170, which provided additional incentives for renewable energy systems cost recovery program, extending the cost-recovery incentive program for renewable energy systems to include community solar projects. As a result, community solar projects are now eligible to receive cost recovery incentive payments from participating light and power businesses at a base incentive rate of $0.30 for each economic development kilowatt-hour of energy produced. Incentive payments for all other renewable energy systems remain at a base rate of $0.15 for each economic development kilowatt-hour of energy produced.

Sales and Use Tax Exemption for Livestock Nutrient Management Equipment and Facilities. In 2001 the Legislature provided an exemption from sales and use taxes for dairy nutrient management equipment, facilities, and related services. To be eligible the person had to have

a certified dairy nutrient management plan. In 2006 the sales and use tax exemption was broadened beyond dairy to other sectors of the livestock industry that had approved nutrient management plans. A sales and use tax exemption applies to the materials, machinery, equipment, and labor and services purchased or used in relation to the operation, repair, cleaning, alteration, or improvement of livestock nutrient management facilities and equipment. Livestock nutrient management facilities and equipment are machinery, equipment, and structures used in the handling and treatment of livestock manure, such as aerators, agitators, alley scrapers, and augers. The exemption includes repair and replacement parts. The exemption requires facilities and equipment to be used exclusively for activities necessary to maintain a livestock nutrient management plan.

B&O Exemption for Property Management Salaries. B&O tax exemption is allowed for amounts received by a property management company, if the payments are received from a property management trust account for payment of wages and benefits to on-site personnel.

PUD Privilege Tax. Public Utility Districts (PUDs) were created to provide water and electricity, and to conserve water and power resources. Currently, there are 28 PUDs: 23 provide electricity services; 14 provide water or water and wastewater service; and 13 offer wholesale broadband telecommunications service.

The PUDs that generate, transmit, or distribute electricity are subject to the PUD privilege tax. The tax is intended to be in lieu of property tax, since public utility districts are governmental entities and do not pay property taxes.

The tax is based on the amount received from the sale of electricity. A recent lower court case has upheld the request for refund of tax by two PUDs that separate their kilowatt-hour charges from the charge to recoup the costs of providing service regardless of whether any electricity is used (e.g. meter reading, billing, and fixed facilities). These PUDs argue that tax should be paid only on the kilowatt-hour charge. It has been the department's interpretation that the tax applies to the entire amount received.

Sales Tax Exemption for Coal. Purchases of coal used at a thermal electric generating facility placed in operation after 1969 and before July 1, 1997, are exempt from retail sales/ use tax. The exemption is contingent upon owners of the plant demonstrating to the Department of Ecology that progress is being made to install the necessary air pollution control devices and that the facility has emitted no more than 10,000 tons of sulfur dioxide during the previous 12 months.

Exemption for Machinery Used to Generate Electricity from Wind. Effective July 1, 2009, through June 30, 2013, purchases and installation of machinery and equipment that will be used directly in a facility that generates no more than ten kilowatts of electricity using solar energy are exempt from sales/use tax. In addition, purchases and installation of machinery and equipment used directly in generating electricity using fuel cells, sun, wind, biomass energy, tidal and wave energy, geothermal resources, anaerobic digestion, technology that converts otherwise lost energy from exhaust, or landfill gas in a facility that generates no less than one kilowatt of electricity are exempt from sales/use tax subject to the following: (1) from July 1, 2009, through June 30, 2011, the exemption is 100 percent of the sales or use tax

paid; and (2) July 1, 2011, through June 30, 2013, the exemption is in the form of a refund from the DOR of 75 percent of sales or use tax paid.

Summary of Bill: Sales Tax and Working Families Tax Exemption. From June 1, 2010 until June 30, 2013, an additional sales and use tax of 0.3 percent is imposed.

An amount of $313,307,000 reflecting the increased revenue receipts, is appropriated for Fiscal Year 2011 from the state General Fund to the Education Legacy Trust Account to maintain support for property-poor school districts through the state's levy equalization program, provide funding for approximately 16,000 students to continue to receive state-funded all-day kindergarten, and allow approximately 34,000 students to attend institutions of higher education with the assistance of the state need grant.

The Working Families' Tax Exemption is provided to eligible low-income persons for sales tax paid after June 1, 2010. For remittances made in 2011 (for taxes paid in 2010), the exemption is the greater of $25 or a 5 percent of the EITC granted, prorated for the seven calendar months of 2010 in which the additional tax is imposed. For remittances made in 2012, the exemption is the greater of $25 or 5 percent of the EITC granted. For remittances made in 2013 and thereafter, the exemption is the greater of $50 or 10 percent of the EITC granted. For remittances provided in the Fiscal Year 2015 and thereafter, DOR must limit its ongoing costs to administer the program to 5 percent of the total exemptions provided each year.

An exception from the requirement that a sales and use tax change take effect no sooner than 75 days after its enactment and only on the first day of January, April, July, or October is provided.

An exception is provided from lowering the state expenditure limit from the monies deposited into or appropriated from the Education Legacy Trust Account.

Economic Nexus and Apportionment. For purposes of imposing the B&O tax on service activities and the activity of receiving royalty income, a business or individual will have substantial nexus with the state if the individual or business meets one of the following requirements: (1) an individual is a resident or domiciled in the state; (2) a business entity is organized or commercially domiciled in this state; or (3) the individual or business is organized or domiciled outside the state but has more than $50,000 of property in the state, more than $50,000 of payroll in the state, more than $250,000 of receipts from this state, or at least 25 percent of the individual's or business's total property, total payroll, or total receipts in this state. This nexus standard only applies to service activities and the activity of receiving royalty income. A business or individual with substantial nexus in any tax year is deemed to have substantial nexus with the state for the following tax year.

Income derived from service activities and royalties is apportioned to Washington based on a receipts factor. The receipts factor is a fraction of which the numerator is the total gross income of the business attributable to this state for the activity, and the denominator is the worldwide gross income of the business for the activity. The total worldwide gross income from the activity is multiplied by the receipts factor to determine the amount of income apportioned to Washington for purposes of the B&O tax. Apportionment using the receipts

factor would replace the three-factor apportionment formula for financial institutions and the cost apportionment formula for other businesses providing services.

Except for financial institutions, gross income is attributable to this state based on the following series of hierarchical rules:

1. income is attributable to this state if the customer received the benefit of the service in this state or used the business's intangible property in this state;
2. if the customer received the benefit of the service or used the intangible property in more than one state, income is attributable to the state where the service was primarily received or where the intangible property is primarily used;
3. if income cannot be attributed under the foregoing, then the income is attributable to the state where the customer ordered the service or where the royalty agreement was negotiated;
4. if income cannot be attributed under the foregoing, then the income is attributable to the state to which the billing statements or invoices are sent to the customer;
5. if income cannot be attributed under the foregoing, then the income is attributable to the state from which the customer sends payment to the business;
6. if income cannot be attributed under the foregoing, then the income is attributable to the state where the customer is located; and
7. if income cannot be attributed under the foregoing, then the income is attributable to the state where the business is domiciled.

For financial institutions the Department must adopt their apportionment methods by rule.

Economic Substance and Tax Avoidance. The economic substance doctrine is adopted. Accordingly, DOR may disregard abusive tax avoidance transactions for tax periods on or after January 1, 2006. An abusive tax avoidance transaction is defined to mean a transaction, plan, or arrangement that lacks economic substance. A transaction is deemed to have economic substance only if: (1) the transaction changes the taxpayer's economic position in a meaningful way, apart from the transaction's tax effects; (2) the taxpayer has a substantial nontax purpose for entering into the transaction; and (3) the transaction is an objectively reasonable means of accomplishing the substantial nontax purpose. DOR has the burden of establishing that a transaction does not have economic substance.

If DOR determines that a transaction lacks economic substance, DOR may take reasonable steps necessary to deny the tax benefit resulting from the abusive tax avoidance transaction. These steps may include: re-characterizing the nature of income; disregarding the form of a corporate or other business entity; treating a transaction according to its underlying economic substance rather than form; treating a series of formally separate steps as a single transaction; and imputing income to a taxpayer who provides services to a related person and the consideration does not reflect the fair market value of the service.

If a tax deficiency is deemed to be a result of an abusive tax avoidance transaction, DOR may assess a 35 percent penalty; however, DOR may not assess the penalty if the taxpayer discloses its participation in an abusive tax avoidance transaction before DOR discovers it.

The statutory language describing how the acquisition of tangible personal property (TPP) occurs (lease, gift, bailment, etc.) is eliminated. Therefore, the acquisition of TPP in any manner is subject to use tax unless some other provision specifically exempts the transaction.

For the purpose of determining whether the sale of a controlling interest has occurred within a 12-month period, an option to purchase real estate is also included in the determination. The date the option agreement is executed is used as the relevant date.

DOR may, at its option, enforce the collection of REET for the sale of a controlling interest in a business by pursuing the buyer of a controlling interest, seller of a controlling interest, or the business entity itself of which a controlling interest is transferred.

The law is clarified that a lien for payment of REET attaches to each parcel of property owned by an entity in which a controlling interest has been transferred.

A parent corporation of a wholly owned subsidiary is responsible for REET if the subsidiary transfers real property to a third party and then dissolves before payment of the tax.

Buyers are no longer absolved from REET liability by simply providing notice of a real estate sale to DOR.

Direct Seller B&O Exemption. The B&O exemption for firms that sell into Washington using direct seller's representatives is eliminated. For periods prior to April 1, 2010, the exemption is retroactively limited to consumer products.

Preferential B&O Tax Rate for Manufacturing Certain Agricultural Products. The B&O preferential tax rate (0.138 percent) for meat processing to the manufacturing of perishable meat products, dehydrated, cured, or smoked meat products, and hides, tallow, and other meat by-products is expressly limited to those activities creating a final product which is at least 50 percent fruit and vegetables to qualify for the preferential tax rate.

The preferential rate for slaughtering, breaking, or processing perishable meat products or selling these perishable meat products at wholesale is modified by requiring that the end product be: a perishable meat product; a nonperishable meat product that is comprised primarily of animal carcass by weight or volume, other than a canned meat product; or a meat by-product. The tax preference for fruit and vegetable manufacturers is modified by requiring that the end product be comprised either exclusively of fruits or vegetables, or any combination of fruits, vegetables, and certain other substances that, cumulatively, may not exceed the amount of fruits and vegetables contained in the product measured by weight or volume.

B&O Tax on Amounts Paid to Corporate Directors. The fees paid to members of corporate boards of directors are explicitly subject to tax under the service and other classification at the 1.5 percent tax rate. After July 1, 2010, fees paid to members of corporate boards of directors would not be exempt under the exemption for wages and salaries for employees.

Foreclosure Exemption from REET. The REET exemption for transfers made pursuant to foreclosure is narrowed. Sales of the property to a third party would be subject to tax. When

a transfer or conveyance pursuant to a judicial or non judicial foreclosure or enforcement of a judgment is a sale the tax levied under this chapter is the obligation of the buyer.

Tax Debts - Corporate Officer Liability. DOR is allowed to pursue uncollected taxes of a terminated or insolvent limited liability business from the chief executive or chief financial officer, or other persons responsible for paying the taxes.

The B&O Tax Job Credit for International Service Activities. The B&O tax credit for international service activities is repealed.

Eligibility for the Rural County Programs. A business claiming the sales and use tax deferral under chapter 82.60 RCW and B&O credits under chapter 82.62 RCW in the Rural County Job Credit and Deferral Programs are eligible for the incentives for computer programming, but only when it is used to create a new item for sale.

Limiting the B&O Deduction for Dues and Fees. The B&O tax deduction for dues and initiation fees is allowed certain nonprofit organizations exempt under certain federal income tax provisions in U.S.C. section 501(c).

Limiting the Bad Debt Deduction. The deduction is expressly limited to the seller.

Brokered Natural Gas. The brokered natural gas use tax is imposed at the location where the gas is burned by the taxpayer or stored in a facility of the taxpayer for later consumption. This change does not affect the state, but increases revenues to local governments imposing the tax.

Limiting Community Solar Incentives. For community solar projects, the renewable cost recovery program is limited to those community solar projects generating no more than 75 kilowatts of electricity.

Sales Tax Exemption for Livestock Nutrient Equipment and Facilities. The sales and use tax exemption for equipment and facilities used for handling livestock nutrients at dairies and livestock feeding operations is suspended for three years.

PUD Privilege Tax. Gross revenue for purpose of the PUD privilege tax applies to all charges for electricity including recurring charges as a condition of receiving the electricity.

Repealing the Sales Tax Exemption for Coal. The sales and use tax exemption for coal used at a coal-fired thermal electric generation facility is repealed.

Machinery Used to Create Electricity from Wind. In order to qualify for the exemption for machinery and equipment used to create energy from wind, a producer must either be a local utility or someone contracting with a local utility for the sale of power.

Repeal of B&O Exemption for Property Management Salaries. The B&O exemption for amounts received by a property management company from the owner of a property for gross wages and benefits paid to on-site personnel is repealed.

Business and Occupation Tax Increase on Service Activities. Businesses who pay the B&O tax at the rate of 1.5 percent will have an increase of .25 percent for three years. In addition, the small business tax credit for these businesses is double to be worth a maximum of $70 a month from $35 a month.

Sales Tax on Bottled Water. The sales tax is extended to bottled water. In addition an exemption is added for persons who purchase bottle water with a prescription.

Appropriation: Appropriates $313,307,000 from the state General Fund to the Education Legacy Trust Account for Fiscal Year 2011.

Fiscal Note: Requested on March 5, 2010.

Committee/Commission/Task Force Created: No.

Effective Date: The bill contains an emergency clause and takes effect on June 1, 2010.

Appendix T

Special Notice

WASHINGTON STATE DEPARTMENT OF REVENUE MAY 28, 2010

New “Economic Nexus” in Washington State May Impact Financial Institutions Including Out-of-state Banks and Credit Card Issuers

Background

Effective June 1, 2010, Washington State’s new economic nexus standard goes into effect. The economic nexus standard may be met without a physical presence in Washington. Under the new economic nexus standard, income of financial institutions, including banks and credit card issuers located outside of Washington, could become subject to Washington’s business and occupation (B&O) tax on an apportioned basis.

Please forward this information to any of your affiliates that also may be affected by this new legislation.

New legislation

Second Engrossed Substitute Senate Bill 6143, Chapter 23 Laws of 2010 (Section 101) establishes that businesses are no longer required to have a physical presence in Washington to have nexus. Businesses meeting any of the thresholds outlined below have nexus with Washington.

Economic nexus taxable thresholds

Under this new standard, a financial institution, including a bank or card issuer, has nexus with Washington State if in a tax year it has at least one of the following in Washington State:

- It is commercially domiciled in Washington;
- Property – average value exceeding $50,000,
- Payroll exceeding $50,000 (including certain third party costs),
- Sales exceeding $250,000, or
- At least 25% of its worldwide property, payroll, or sales.

Note: For purposes of calculating the property, payroll, and sales thresholds for the 2010 tax year, the entire 2010 calendar year is to be used. Starting June 1, 2010, a business will incur B&O tax only if it establishes nexus with Washington under the new economic nexus standards in 2ESSB 6143. For example, Taxpayer X is an out-of-state business with no physical presence in Washington. In 2010, Taxpayer X has $100,000 of Washington sales in May, $100,000 in June, and $100,000 in July. Taxpayer X establishes nexus with Washington by exceeding the $250,000 sales threshold and will owe B&O tax only on its Washington sales after June 1, 2010.

continued on the next page

"Trailing" nexus

Once nexus has been established, it will continue:

- As long as the taxpayer continues to meet at least one of the thresholds; and
- For one year after the year in which the taxpayer no longer meets one of the thresholds.

Registering in Washington

Businesses that have nexus under the new standard can obtain a Washington tax registration number and begin reporting B&O tax by visiting our website at **dor.wa.gov/EconomicNexus**.

Affiliates

Each affiliate (legal entity) must determine for itself whether it has nexus with Washington under this new standard. The state of Washington does not allow for determining nexus or tax reporting on a combined entity or unified basis.

Definitions

Property - real property, personal property, loan and credit card receivables, rented property, intangible property, and receivables. It does not include computer software, digital goods, or digital codes. The average value of property is determined by averaging the value of property on January 1 and on December 31.

Payroll - compensation paid to employees and third party representatives providing services in Washington.

Sales - interest, fees, gains from trading securities, dividends, commissions, royalties, and other income. The determination of where a financial institution earns income is done consistent with the Model Multistate Tax Commission's model rule for financial institutions.

New apportionment methodology

This legislation also provides a new single factor apportionment methodology based on sales. The new apportionment calculation will be discussed in detail in upcoming Department rules and/or other publications which will be issued no later than June 1, 2010 and will be available on the Department's website at **dor.wa.gov/EconomicNexus**.

For more information

Visit the Department's website at **dor.wa.gov/EconomicNexus** or contact the Department's Telephone Information Center at 1-800-647-7706.

To inquire about the availability of this document in an alternate format for the visually impaired, please call (360)705-6715. Teletype (TTY) users please call 1-800-451-7985.

Appendix U

CERTIFICATION OF ENROLLMENT

SECOND ENGROSSED SUBSTITUTE SENATE BILL 6143

Chapter 23, Laws of 2010

61st Legislature
2010 1st Special Session

TAXES

EFFECTIVE DATE: Various

Passed by the Senate April 12, 2010
YEAS 25 NAYS 21

BRAD OWEN

President of the Senate

Passed by the House April 10, 2010
YEAS 52 NAYS 44

FRANK CHOPP

Speaker of the House of Representatives

CERTIFICATE

I, Thomas Hoemann, Secretary of the Senate of the State of Washington, do hereby certify that the attached is **SECOND ENGROSSED SUBSTITUTE SENATE BILL 6143** as passed by the Senate and the House of Representatives on the dates hereon set forth.

THOMAS HOEMANN

Secretary

Approved April 23, 2010, 1:44 p.m.

FILED

April 23, 2010

CHRISTINE GREGOIRE

Governor of the State of Washington

Secretary of State
State of Washington

SECOND ENGROSSED SUBSTITUTE SENATE BILL 6143

AS RECOMMENDED BY THE CONFERENCE COMMITTEE

Passed Legislature - 2010 1st Special Session

State of Washington **61st Legislature** **2010 Regular Session**

By Senate Ways & Means (originally sponsored by Senator Prentice)

READ FIRST TIME 03/06/10.

1 AN ACT Relating to modifying excise tax laws to preserve funding
2 for public schools, colleges, and universities, as well as other public
3 systems essential for the safety, health, and security of all
4 Washingtonians; amending RCW 82.04.220, 82.04.2907, 82.04.2907,
5 82.04.460, 82.04.080, 82.32.090, 82.12.020, 82.45.033, 82.45.070,
6 82.45.080, 82.45.100, 82.45.220, 43.07.390, 82.04.4292, 82.04.423,
7 82.04.4266, 82.04.4266, 82.04.260, 82.04.250, 82.04.250, 82.04.250,
8 82.04.298, 82.04.334, 82.04.4463, 82.04.4463, 82.08.806, 82.32.550,
9 82.45.195, 35.102.150, 48.14.080, 82.08.890, 82.12.890, 82.04.360,
10 82.32.145, 82.08.0293, 82.08.0293, 82.12.0293, 54.28.011, 82.04.4451,
11 82.32.045, 82.04.394, 82.04.394, 66.24.290, 82.08.037, 82.12.037,
12 82.08.---, and 82.12.---; reenacting and amending RCW 82.45.010,
13 82.04.260, 82.04.261, and 82.04.440; adding new sections to chapter
14 82.04 RCW; adding new sections to chapter 82.32 RCW; adding new
15 sections to chapter 82.08 RCW; adding new sections to chapter 82.12
16 RCW; creating new sections; providing effective dates; providing
17 expiration dates; and declaring an emergency.

18 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

NEW SECTION. **Sec. 1.** In order to preserve funding for education, public safety, health care, environmental protection, and safety net services for children, elderly, disabled, and vulnerable people, it is the intent of the legislature to close obsolete tax preferences, clarify the legislature's intent regarding existing tax policy, and to ensure balanced tax policy while bolstering emerging industries.

PART I
Minimum Nexus Standards

NEW SECTION. **Sec. 101.** (1) The legislature finds that out-of-state businesses that do not have a physical presence in Washington earn significant income from Washington residents from providing services or collecting royalties on the use of intangible property in this state. The legislature further finds that these businesses receive significant benefits and opportunities provided by the state, such as: Laws providing protection of business interests or regulating consumer credit; access to courts and judicial process to enforce business rights, including debt collection and intellectual property rights; an orderly and regulated marketplace; and police and fire protection and a transportation system benefiting in-state agents and other representatives of out-of-state businesses. Therefore, the legislature intends to extend the state's business and occupation tax to these companies to ensure that they pay their fair share of the cost of services that this state renders and the infrastructure it provides.

(2)(a) The legislature also finds that the current cost apportionment method in RCW 82.04.460(1) for apportioning most service income has been difficult for both taxpayers and the department to apply due in large part (i) to the difficulty in assigning certain costs of doing business inside or outside of this state, and (ii) to its dissimilarity with the apportionment methods used in other states for their business activity taxes.

(b) The legislature further finds that there is a trend among states to adopt a single factor apportionment formula based on sales. The legislature recognizes that adoption of a sales factor only apportionment method has the advantages of simplifying apportionment and making Washington a more attractive place for businesses to expand their property and payroll. For these reasons, the legislature adopts

1 single factor sales apportionment for purposes of apportioning royalty
2 income and certain service income for state business and occupation tax
3 purposes.

4 (c) Nothing in this act may be construed, however, to authorize
5 apportionment of the gross income or value of products taxable under
6 the following business and occupation tax classifications: Retailing,
7 wholesaling, manufacturing, processing for hire, extracting, extracting
8 for hire, printing, government contracting, public road construction,
9 the classifications in RCW 82.04.280 (2), (4), (6), and (7), and any
10 other activity not specifically included in the definition of
11 apportionable activities in RCW 82.04.460.

12 (d) Nothing in this part is intended to modify the nexus and
13 apportionment requirements for local gross receipts business and
14 occupation taxes.

15 **Sec. 102.** RCW 82.04.220 and 1961 c 15 s 82.04.220 are each amended
16 to read as follows:

17 (1) There is levied and ((~~shall be~~)) collected from every person
18 that has a substantial nexus with this state a tax for the act or
19 privilege of engaging in business activities. ((~~Such~~)) The tax ((~~shall~~
20 ~~be~~)) is measured by the application of rates against value of products,
21 gross proceeds of sales, or gross income of the business, as the case
22 may be.

23 (2) A person who has a substantial nexus with this state in any tax
24 year will be deemed to have a substantial nexus with this state for the
25 following tax year.

26 NEW SECTION. **Sec. 103.** A new section is added to chapter 82.04
27 RCW to read as follows:

28 "Engaging within this state" and "engaging within the state," when
29 used in connection with any apportionable activity as defined in RCW
30 82.04.460, means that a person generates gross income of the business
31 from sources within this state, such as customers or intangible
32 property located in this state, regardless of whether the person is
33 physically present in this state.

34 NEW SECTION. **Sec. 104.** A new section is added to chapter 82.04
35 RCW to read as follows:

(1) A person engaging in business is deemed to have substantial nexus with this state if the person is:

(a) An individual and is a resident or domiciliary of this state;

(b) A business entity and is organized or commercially domiciled in this state; or

(c) A nonresident individual or a business entity that is organized or commercially domiciled outside this state, and in any tax year the person has:

(i) More than fifty thousand dollars of property in this state;

(ii) More than fifty thousand dollars of payroll in this state;

(iii) More than two hundred fifty thousand dollars of receipts from this state; or

(iv) At least twenty-five percent of the person's total property, total payroll, or total receipts in this state.

(2)(a) Property counting toward the thresholds in subsection (1)(c)(i) and (iv) of this section is the average value of the taxpayer's property, including intangible property, owned or rented and used in this state during the tax year.

(b)(i) Property owned by the taxpayer, other than loans and credit card receivables owned by the taxpayer, is valued at its original cost basis. Loans and credit card receivables owned by the taxpayer are valued at their outstanding principal balance, without regard to any reserve for bad debts. However, if a loan or credit card receivable is charged off in whole or in part for federal income tax purposes, the portion of the loan or credit card receivable charged off is deducted from the outstanding principal balance.

(ii) Property rented by the taxpayer is valued at eight times the net annual rental rate. For purposes of this subsection, "net annual rental rate" means the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

(c) The average value of property must be determined by averaging the values at the beginning and ending of the tax year; but the department may require the averaging of monthly values during the tax year if reasonably required to properly reflect the average value of the taxpayer's property.

(d)(i) For purposes of this subsection (2), loans and credit card receivables are deemed owned and used in this state as follows:

(A) Loans secured by real property, personal property, or both real and personal property, are deemed owned and used in the state if the real property or personal property securing the loan is located within this state. If the property securing the loan is located both within this state and one or more other states, the loan is deemed owned and used in this state if more than fifty percent of the fair market value of the real or personal property is located within this state. If more than fifty percent of the fair market value of the real or personal property is not located within any one state, then the loan is deemed owned and used in this state if the borrower is located in this state. The determination of whether the real or personal property securing a loan is located within this state must be made, as of the time the original agreement was made, and any and all subsequent substitutions of collateral must be disregarded.

(B) Loans not secured by real or personal property are deemed owned and used in this state if the borrower is located in this state.

(C) Credit card receivables are deemed owned and used in this state if the billing address of the cardholder is in this state.

(ii)(A) Except as otherwise provided in (d)(ii)(B) of this subsection (2), the definitions in the multistate tax commission's recommended formula for the apportionment and allocation of net income of financial institutions as existing on the effective date of this section or such subsequent date as may be provided by the department by rule, consistent with the purposes of this section, apply to this section.

(B) "Credit card" means a card or device existing for the purpose of obtaining money, property, labor, or services on credit.

(e) Notwithstanding anything else to the contrary in this subsection, property counting toward the thresholds in subsection (1)(c)(i) and (iv) of this section does not include a person's ownership of, or rights in, computer software as defined in RCW 82.04.215, including computer software used in providing a digital automated service; master copies of software; and digital goods and digital codes residing on servers located in this state.

(3)(a) Payroll counting toward the thresholds in subsection (1)(c)(ii) and (iv) of this section is the total amount paid by the taxpayer for compensation in this state during the tax year plus nonemployee compensation paid to representative third parties in this

state. Nonemployee compensation paid to representative third parties includes the gross amount paid to nonemployees who represent the taxpayer in interactions with the taxpayer's clients and includes sales commissions.

(b) Employee compensation is paid in this state if the compensation is properly reportable to this state for unemployment compensation tax purposes, regardless of whether the compensation was actually reported to this state.

(c) Nonemployee compensation is paid in this state if the service performed by the representative third party occurs entirely or primarily within this state.

(d) For purposes of this subsection, "compensation" means wages, salaries, commissions, and any other form of remuneration paid to employees or nonemployees and defined as gross income under 26 U.S.C. Sec. 61 of the federal internal revenue code of 1986, as existing on the effective date of this section.

(4) Receipts counting toward the thresholds in subsection (1)(c)(iii) and (iv) of this section are those amounts included in the numerator of the receipts factor under section 105 of this act and, for financial institutions, those amounts included in the numerator of the receipts factor under the rule adopted by the department as authorized in RCW 82.04.460(2).

(5)(a) Each December, the department must review the cumulative percentage change in the consumer price index. The department must adjust the thresholds in subsection (1)(c)(i) through (iii) of this section if the consumer price index has changed by five percent or more since the later of the effective date of this section, or the date that the thresholds were last adjusted under this subsection. For purposes of determining the cumulative percentage change in the consumer price index, the department must compare the consumer price index available as of December 1st of the current year with the consumer price index as of the later of the effective date of this section, or the date that the thresholds were last adjusted under this subsection. The thresholds must be adjusted to reflect that cumulative percentage change in the consumer price index. The adjusted thresholds must be rounded to the nearest one thousand dollars. Any adjustment will apply to tax periods that begin after the adjustment is made.

(b) As used in this subsection, "consumer price index" means the consumer price index for all urban consumers (CPI-U) available from the bureau of labor statistics of the United States department of labor.

(6) Subsections (1) through (5) of this section only apply with respect to the taxes imposed under this chapter on apportionable activities as defined in RCW 82.04.460. For purposes of the taxes imposed under this chapter on any activity not included in the definition of apportionable activities in RCW 82.04.460, a person is deemed to have a substantial nexus with this state if the person has a physical presence in this state, which need only be demonstrably more than a slightest presence. For purposes of this subsection, a person is physically present in this state if the person has property or employees in this state. A person is also physically present in this state if the person, either directly or through an agent or other representative, engages in activities in this state that are significantly associated with the person's ability to establish or maintain a market for its products in this state.

NEW SECTION. **Sec. 105.** A new section is added to chapter 82.04 RCW to read as follows:

(1) The apportionable income of a person within the scope of RCW 82.04.460(1) is apportioned to Washington by multiplying its apportionable income by the receipts factor. Persons who are subject to tax under more than one of the tax classifications enumerated in RCW 82.04.460(4)(a) (i) through (x) must calculate a separate receipts factor for each tax classification that the person is taxable under.

(2) For purposes of subsection (1) of this section, the receipts factor is a fraction and is calculated as provided in subsections (3) and (4) of this section and, for financial institutions, as provided in the rule adopted by the department under the authority of RCW 82.04.460(2).

(3)(a) The numerator of the receipts factor is the total gross income of the business of the taxpayer attributable to this state during the tax year from engaging in an apportionable activity. The denominator of the receipts factor is the total gross income of the business of the taxpayer from engaging in an apportionable activity everywhere in the world during the tax year.

(b) Except as otherwise provided in this section, for 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.

(ii) If the customer received the benefit of the service or used the intangible property in more than one state, 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.

(iii) If the taxpayer is unable to attribute gross income of the business under the provisions of (b)(i) or (ii) of this subsection (3), gross income of the business must be attributed to the state from which the customer ordered the service or, in the case of royalties, the office of the customer from which the royalty agreement with the taxpayer was negotiated.

(iv) If the taxpayer is unable to attribute gross income of the business under the provisions of (b)(i), (ii), or (iii) of this subsection (3), gross income of the business must be attributed to the state to which the billing statements or invoices are sent to the customer by the taxpayer.

(v) If the taxpayer is unable to attribute gross income of the business under the provisions of (b)(i), (ii), (iii), or (iv) of this subsection (3), gross income of the business must be attributed to the state from which the customer sends payment to the taxpayer.

(vi) If the taxpayer is unable to attribute gross income of the business under the provisions of (b)(i), (ii), (iii), (iv), or (v) of this subsection (3), gross income of the business must be attributed to the state where the customer is located as indicated by the customer's address: (A) Shown in the taxpayer's business records maintained in the regular course of business; or (B) obtained during consummation of the sale or the negotiation of the contract for services or for the use of the taxpayer's intangible property, including any address of a customer's payment instrument when readily available to the taxpayer and no other address is available.

(vii) If the taxpayer is unable to attribute gross income of the

1 business under the provisions of (b)(i), (ii), (iii), (iv), (v), or
2 (vi) of this subsection (3), gross income of the business must be
3 attributed to the commercial domicile of the taxpayer.

4 (viii) For purposes of this subsection (3)(b), "customer" means a
5 person or entity to whom the taxpayer makes a sale or renders services
6 or from whom the taxpayer otherwise receives gross income of the
7 business. "Customer" includes anyone who pays royalties or charges in
8 the nature of royalties for the use of the taxpayer's intangible
9 property.

10 (c) Gross income of the business from engaging in an apportionable
11 activity must be excluded from the denominator of the receipts factor
12 if, in respect to such activity, at least some of the activity is
13 performed in this state, and the gross income is attributable under (b)
14 of this subsection (3) to a state in which the taxpayer is not taxable.
15 For purposes of this subsection (3)(c), "not taxable" means that the
16 taxpayer is not subject to a business activities tax by that state,
17 except that a taxpayer is taxable in a state in which it would be
18 deemed to have a substantial nexus with that state under the standards
19 in section 104(1) of this act regardless of whether that state imposes
20 such a tax. "Business activities tax" means a tax measured by the
21 amount of, or economic results of, business activity conducted in a
22 state. The term includes taxes measured in whole or in part on net
23 income or gross income or receipts. "Business activities tax" does not
24 include a sales tax, use tax, or a similar transaction tax, imposed on
25 the sale or acquisition of goods or services, whether or not
26 denominated a gross receipts tax or a tax imposed on the privilege of
27 doing business.

28 (d) This subsection (3) does not apply to financial institutions
29 with respect to apportionable income taxable under RCW 82.04.290.
30 Financial institutions must calculate the receipts factor as provided
31 in subsection (4) of this section and the rule adopted by the
32 department under the authority of RCW 82.04.460(2) with respect to
33 apportionable income taxable under RCW 82.04.290. Financial
34 institutions that are subject to tax under any other tax classification
35 enumerated in RCW 82.04.460(4)(a) (i) through (v) and (vii) through (x)
36 must calculate a separate receipts factor, as provided in this section,
37 for each of the other tax classifications that the financial
38 institution is taxable under.

(4) A taxpayer may calculate the receipts factor for the current tax year based on the most recent calendar year for which information is available for the full calendar year. If a taxpayer does not calculate the receipts factor for the current tax year based on previous calendar year information as authorized in this subsection, the business must use current year information to calculate the receipts factor for the current tax year. In either case, a taxpayer must correct the reporting for the current tax year when complete information is available to calculate the receipts factor for that year, but not later than October 31st of the following tax year. Interest will apply to any additional tax due on a corrected tax return. Interest must be assessed at the rate provided for delinquent excise taxes under chapter 82.32 RCW, retroactively to the date the original return was due, and will accrue until the additional taxes are paid. Penalties as provided in RCW 82.32.090 will apply to any such additional tax due only if the current tax year reporting is not corrected and the additional tax is not paid by October 31st of the following tax year. Interest as provided in RCW 82.32.060 will apply to any tax paid in excess of that properly due on a return as a result of a taxpayer using previous calendar year data or incomplete current-year data to calculate the receipts factor.

(5) Unless the context clearly requires otherwise, the definitions in this subsection apply throughout this section.

(a) "Apportionable activities" and "apportionable income" have the same meaning as in RCW 82.04.460.

(b) "State" means a state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any foreign country or political subdivision of a foreign country.

Sec. 106. RCW 82.04.2907 and 2009 c 535 s 407 are each amended to read as follows:

(1) Upon every person engaging within this state in the business of receiving income from royalties ((~~or charges in the nature of royalties for the granting of intangible rights, such as copyrights, licenses, patents, or franchise fees~~)), the amount of tax with respect to ((~~such~~)) the business ((~~shall be~~)) is equal to the gross income from

royalties ((~~or charges in the nature of royalties from the business~~)) multiplied by the rate of 0.484 percent.

(2) For the purposes of this section, "gross income from royalties" means compensation for the use of intangible property, ((~~such as~~)) including charges in the nature of royalties, regardless of where the intangible property will be used. For purposes of this subsection, "intangible property" includes copyrights, patents, licenses, franchises, trademarks, trade names, and similar items. ((~~It~~)) "Gross income from royalties" does not include compensation for any natural resource, the licensing of prewritten computer software to the end user, or the licensing ((~~or use~~)) of digital goods, digital codes, or digital automated services to the end user as defined in RCW 82.04.190(11).

Sec. 107. RCW 82.04.2907 and 2010 c 111 (SHB 2620) s 302 are each amended to read as follows:

(1) Upon every person engaging within this state in the business of receiving income from royalties ((~~or charges in the nature of royalties for the granting of intangible rights, such as copyrights, licenses, patents, or franchise fees~~)), the amount of tax with respect to the business is equal to the gross income from royalties ((~~or charges in the nature of royalties from the business~~)) multiplied by the rate of 0.484 percent.

(2) For the purposes of this section, "gross income from royalties" means compensation for the use of intangible property, ((~~such as~~)) including charges in the nature of royalties, regardless of where the intangible property will be used. For purposes of this subsection, "intangible property" includes copyrights, patents, licenses, franchises, trademarks, trade names, and similar items. ((~~It~~)) "Gross income from royalties" does not include compensation for any natural resource, the licensing of prewritten computer software to the end user, or the licensing of digital goods, digital codes, or digital automated services to the end user as defined in RCW 82.04.190(11).

Sec. 108. RCW 82.04.460 and 2004 c 174 s 6 are each amended to read as follows:

(1) Except as otherwise provided in this section, any person ((~~rendering services~~)) earning apportionable income taxable under ((~~RCW~~

~~82.04.290 or 82.04.2908~~)) this chapter and ((~~maintaining places of business both within and without this state which contribute to the rendition of such services shall~~)) also taxable in another state, must, for the purpose of computing tax liability under ((~~RCW 82.04.290 or 82.04.2908~~)) this chapter, apportion to this state, in accordance with section 105 of this act, that portion of the person's ((~~gross~~)) apportionable income ((~~which is~~)) derived from ((~~services rendered~~)) business activities performed within this state. ((~~Where such apportionment cannot be accurately made by separate accounting methods, the taxpayer shall apportion to this state that proportion of the taxpayer's total income which the cost of doing business within the state bears to the total cost of doing business both within and without the state.~~))

(2) ((~~Notwithstanding the provision of subsection (1) of this section, persons doing business both within and without the state who receive gross income from service charges, as defined in RCW 63.14.010 (relating to amounts charged for granting the right or privilege to make deferred or installment payments) or who receive gross income from engaging in business as financial institutions within the scope of chapter 82.14A RCW (relating to city taxes on financial institutions) shall apportion or allocate gross income taxable under RCW 82.04.290 to this state pursuant to rules promulgated by the department consistent with uniform rules for apportionment or allocation developed by the states.~~)) The department must by rule provide a method of apportioning the apportionable income of financial institutions, where such apportionable income is taxable under RCW 82.04.290. The rule adopted by the department must, to the extent feasible, be consistent with the multistate tax commission's recommended formula for the apportionment and allocation of net income of financial institutions as existing on the effective date of this section or such subsequent date as may be provided by the department by rule, consistent with the purposes of this section, except that:

(a) The department's rule must provide for a single factor apportionment method based on the receipts factor; and

(b) The definition of "financial institution" contained in appendix A to the multistate tax commission's recommended formula for the apportionment and allocation of net income of financial institutions is advisory only.

(3) The department ((~~shall~~)) may by rule provide a method or methods of apportioning or allocating gross income derived from sales of telecommunications service and competitive telephone service((~~s~~)) taxed under this chapter, if the gross proceeds of sales subject to tax under this chapter do not fairly represent the extent of the taxpayer's income attributable to this state. ((~~The rules shall be, so far as feasible, consistent with the methods of apportionment contained in this section and shall require the consideration of those facts, circumstances, and apportionment factors as will result in an equitable and constitutionally permissible division of the services.~~)) The rule must provide for an equitable and constitutionally permissible division of the tax base.

(4) For purposes of this section, the following definitions apply unless the context clearly requires otherwise:

(a) "Apportionable income" means gross income of the business generated from engaging in apportionable activities, including income received from apportionable activities performed outside this state if the income would be taxable under this chapter if received from activities in this state, less the exemptions and deductions allowable under this chapter. For purposes of this subsection, "apportionable activities" means only those activities taxed under:

(i) RCW 82.04.255;

(ii) RCW 82.04.260 (3), (4), (5), (6), (7), (8), (9), and (12);

(iii) RCW 82.04.280(5);

(iv) RCW 82.04.285;

(v) RCW 82.04.286;

(vi) RCW 82.04.290;

(vii) RCW 82.04.2907;

(viii) RCW 82.04.2908;

(ix) RCW 82.04.263, but only to the extent of any activity that would be taxable under any of the provisions enumerated under (a)(i) through (viii) of this subsection (4) if the tax classification in RCW 82.04.263 did not exist; and

(x) RCW 82.04.260(13) and 82.04.280(1), but only with respect to advertising.

(b)(i) "Taxable in another state" means that the taxpayer is subject to a business activities tax by another state on its income received from engaging in apportionable activities; or the taxpayer is

not subject to a business activities tax by another state on its income received from engaging in apportionable activities, but any other state has jurisdiction to subject the taxpayer to a business activities tax on such income under the substantial nexus standards in section 104(1) of this act.

(ii) For purposes of this subsection (4)(b), "business activities tax" and "state" have the same meaning as in section 105 of this act.

Sec. 109. RCW 82.04.080 and 1961 c 15 s 82.04.080 are each amended to read as follows:

(1) "Gross income of the business" means the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

(2) Financial institutions must determine gains realized from trading in stocks, bonds, and other evidences of indebtedness on a net annualized basis. For purposes of this subsection, a financial institution means a person within the scope of the rule adopted by the department under the authority of RCW 82.04.460(2).

NEW SECTION. **Sec. 110.** A new section is added to chapter 82.04 RCW to read as follows:

(1) This chapter does not apply to amounts received by a financial institution from an affiliated person if the amounts are received from transactions that are required to be at arm's length under sections 23A or 23B of the federal reserve act as existing on the effective date of this section or such subsequent date as may be provided by the department by rule, consistent with the purposes of this section. For purposes of this subsection, "financial institution" has the same meaning as in RCW 82.04.080.

(2) As used in this section, "affiliated" means under common control. "Common control" means the possession, directly or

indirectly, of more than fifty percent of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting shares, by contract, or otherwise.

<u>NEW SECTION.</u> **Sec. 111.** A new section is added to chapter 82.04 RCW to read as follows:

(1) This chapter does not apply to amounts received by investment conduits or securitization entities from cash and securities.

(2) For purposes of this section, the following definitions apply:

(a) "Investment conduit" means an entity formed by a financial institution as defined in RCW 82.04.080 for the express purpose of holding or owning cash or securities if the entity formed:

(i) Has no employees;

(ii) Has no direct profit-making motive;

(iii) Owns no tangible assets, other than cash or securities;

(iv) Holds or owns cash or securities solely as a conduit, allocating its income to holders of its ownership interests; and

(v) Has, within twelve months of its organization or initial capitalization date, issued ownership interests to other than affiliated persons, equal to or greater than twenty-five percent of its total issued ownership interests.

(b) "Securities" has the same meaning as in section 2 of the securities act of 1933 and includes eligible assets as defined by Rule 3a-7 of the investment company act, as the law and rule exist on the effective date of this section or such subsequent date as may be provided by the department by rule, consistent with the purposes of this section.

(c) "Securitization entity" means an entity created by a bank holding company if the entity created:

(i) Has no employees;

(ii) Has no direct profit-making motive;

(iii) Owns no tangible assets, other than cash, fixed or revolving discrete pools of credit or charge card receivables originated by a financial institution, or securities;

(iv) Acts solely as a conduit, allocating its income to holders of its ownership interests; and

(v) Has as its sole business activities the:

(A) Acquisition of such discrete pools of credit or charge card receivables; and

(B) Issuance or causing the issuance of securities primarily to persons not affiliated with the entity.

(d) "Bank holding company" has the same meaning as provided in the bank holding company act of 1956, as existing on the effective date of this section or such subsequent date as may be provided by the department by rule, consistent with the purposes of this section.

(e) "No direct profit-making motive" means that all of an entity's income, less a reasonable servicing fee, is paid to holders of its ownership interests.

(f) "Ownership interest" means interests categorized as debt or equity for purposes of federal tax or generally accepted accounting principles.

(g) "Affiliated" has the same meaning as in section 110 of this act.

NEW SECTION. **Sec. 112.** A new section is added to chapter 82.04 RCW to read as follows:

(1) In computing tax there may be deducted from the measure of tax interest and fees on loans secured by commercial aircraft primarily used to provide routine air service and owned by:

(a) An air carrier, as defined in RCW 82.42.030, which is primarily engaged in the business of providing passenger air service;

(b) An affiliate of such air carrier; or

(c) A parent entity for which such air carrier is an affiliate.

(2) The deduction authorized under this section is not available to any person who is physically present in this state as determined under section 104(6) of this act.

(3) For purposes of this section, the following definitions apply:

(a) "Affiliate" means a person is "affiliated," as defined in section 110 of this act, with another person; and

(b) "Commercial aircraft" means a commercial airplane as defined in RCW 82.32.550.

PART II
Tax Avoidance Transactions

1 <u>NEW SECTION.</u> **Sec. 201.** A new section is added to chapter 82.32
2 RCW to read as follows:
3 (1) It is the legislature's intent to require all taxpayers to pay
4 their fair share of taxes. To accomplish this purpose, it is the
5 legislature's intent to stop transactions or arrangements that are
6 designed to unfairly avoid taxes.
7 (2) The department must disregard, for tax purposes, the tax
8 avoidance transactions or arrangements that are described in subsection
9 (3) of this section. The department must deny the tax benefit that
10 would otherwise result from the tax avoidance transaction or
11 arrangement. In determining whether the department must disregard a
12 transaction or arrangement described under subsection (3) of this
13 section, the department may consider:
14 (a) Whether an arrangement or transaction changes in a meaningful
15 way, apart from its tax effects, the economic positions of the
16 participants in the arrangement when considered as a whole;
17 (b) Whether substantial nontax reasons exist for entering into an
18 arrangement or transaction;
19 (c) Whether an arrangement or transaction is a reasonable means of
20 accomplishing a substantial nontax purpose;
21 (d) An entities' relative contributions to the work that generates
22 income;
23 (e) The location where work is performed; and
24 (f) Other relevant factors.
25 (3) This section applies only to the following transactions or
26 arrangements:
27 (a) Arrangements that are, in form, a joint venture or similar
28 arrangement between a construction contractor and the owner or
29 developer of a construction project but that are, in substance,
30 substantially guaranteed payments for the purchase of construction
31 services characterized by a failure of the parties' agreement to
32 provide for the contractor to share substantial profits and bear
33 significant risk of loss in the venture;
34 (b) Arrangements through which a taxpayer attempts to avoid tax
35 under chapter 82.04 RCW by disguising income received, or otherwise
36 avoiding tax on income, from a person that is not affiliated with the
37 taxpayer from business activities that would be taxable in Washington

by moving that income to another entity that would not be taxable in Washington; and

(c) Arrangements through which a taxpayer attempts to avoid tax under chapter 82.08 or 82.12 RCW by engaging in a transaction to disguise its purchase or use of tangible personal property by vesting legal title or other ownership interest in another entity over which the taxpayer exercises control in such a manner as to effectively retain control of the tangible personal property.

(4) In determining whether a transaction or arrangement comes within the scope of subsection (3) of this section, the department is not required to prove a taxpayer's subjective intent in engaging in the transaction or arrangement.

(5) The department must adopt rules to assist in determining whether a transaction or arrangement is within the scope of subsection (3) of this section. The adoption of a rule as required under this subsection is not a condition precedent for the department's exercise of the authority provided in this section. Any rules adopted under this section must include examples of transactions that the department will disregard for tax purposes.

(6) This section does not affect the department's authority to apply any other remedies available under statutory or common law.

(7) For purposes of this section, "affiliated" means under common control. "Control" means the possession, directly or indirectly, of more than fifty percent of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting shares, by contract, or otherwise.

NEW SECTION. **Sec. 202.** A new section is added to chapter 82.32 RCW to read as follows:

(1)(a) The department may not use section 201 of this act to disregard any transaction or arrangement initiated before the effective date of this section, if, in respect to such transaction or arrangement, the taxpayer had reported its tax liability in conformance with either specific written instructions provided by the department to the taxpayer, a determination published under the authority of RCW 82.32.410, or other document made available by the department to the general public.

(b) This section does not apply if the transaction or arrangement engaged in by the taxpayer differs materially from the transaction or arrangement that was addressed in the specific written instructions, published determination, or other document made available by the department to the general public.

(2) Section 201 of this act does not apply to any tax periods ending before May 1, 2010, that were included in a completed field audit conducted by the department.

(3) For purposes of this section, "specific written instructions" means tax reporting instructions provided to a taxpayer and which specifically identify the taxpayer to whom the instructions apply. Specific written instructions may be provided as part of an audit, tax assessment, determination, closing agreement, or in response to a binding ruling request.

Sec. 203. RCW 82.32.090 and 2006 c 256 s 6 are each amended to read as follows:

(1) 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 ((~~shall be~~)) is assessed a penalty of five 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 ((~~shall be~~)) is assessed a total penalty of fifteen 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 ((~~shall be~~)) is assessed a total penalty of twenty-five percent of the amount of the tax under this subsection. No penalty so added shall be less than five dollars.

(2) If the department of revenue determines that any tax has been substantially underpaid, there ((~~shall be~~)) is assessed a penalty of five percent of the amount of the tax determined by the department to be due. If payment of any tax determined by the department to be due is not received by the department by the due date specified in the notice, or any extension thereof, there ((~~shall be~~)) is assessed a total penalty of fifteen percent of the amount of the tax under this subsection; and if payment of any tax determined by the department to be due is not received on or before the thirtieth day following the due date specified in the notice of tax due, or any extension thereof, there ((~~shall be~~)) is assessed a total penalty of twenty-five percent

of the amount of the tax under this subsection. No penalty so added ((~~shall~~)) 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.

(3) If a warrant ((~~be~~)) is issued by the department of revenue for the collection of taxes, increases, and penalties, there ((~~shall be~~)) is added thereto a penalty of ten percent of the amount of the tax, but not less than ten dollars.

(4) 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 as required by RCW 82.32.030, the department ((~~shall~~)) 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 as required by RCW 82.32.030. The department ((~~shall~~)) may not impose the penalty under this subsection (4) if a person who has engaged in business taxable under this title without first having registered as required by RCW 82.32.030, prior to any notification by the department of the need to register, obtains a registration certificate from the department.

(5) If the department finds that all or any part of a deficiency resulted from the disregard of specific written instructions as to reporting or tax liabilities, the department ((~~shall~~)) must add a penalty of ten percent of the amount of the additional tax found due because of the failure to follow the instructions. A taxpayer disregards specific written instructions when the department ((~~of revenue~~)) has informed the taxpayer in writing of the taxpayer's tax obligations and the taxpayer fails to act in accordance with those instructions unless the department has not issued final instructions because the matter is under appeal pursuant to this chapter or departmental regulations. The department ((~~shall~~)) may not assess the penalty under this section upon any taxpayer who has made a good faith effort to comply with the specific written instructions provided by the department to that taxpayer. Specific written instructions may be given as a part of a tax assessment, audit, determination, or closing

agreement, provided that such specific written instructions ((~~shall~~)) apply only to the taxpayer addressed or referenced on such documents. Any specific written instructions by the department ((~~of revenue shall~~)) must be clearly identified as such and ((~~shall~~)) must inform the taxpayer that failure to follow the instructions may subject the taxpayer to the penalties imposed by this subsection.

(6) If the department finds that all or any part of a deficiency resulted from engaging in a disregarded transaction, as described in section 201(3) of this act, the department must assess a penalty of thirty-five percent of the additional tax found to be due as a result of engaging in a transaction disregarded by the department under section 201(2) of this act. The penalty provided in this subsection may be assessed together with any other applicable penalties provided in this section on the same tax found to be due, except for the evasion penalty provided in subsection (7) of this section. The department may not assess the penalty under this subsection if, before the department discovers the taxpayer's use of a transaction described under section 201(3) of this act, the taxpayer discloses its participation in the transaction to the department.

(7) If the department finds that all or any part of the deficiency resulted from an intent to evade the tax payable hereunder, a further penalty of fifty percent of the additional tax found to be due ((~~shall~~)) must be added.

((~~(7)~~)) (8) The penalties imposed under subsections (1) through (4) of this section can each be imposed on the same tax found to be due. This subsection does not prohibit or restrict the application of other penalties authorized by law.

((~~(8)~~)) (9) The department ((~~of revenue~~)) may not impose ((~~both~~)) the evasion penalty ((~~and~~)) in combination with the penalty for disregarding specific written instructions or the penalty provided in subsection (6) of this section on the same tax found to be due.

((~~(9)~~)) (10) For the purposes of this section, "return" means any document a person is required by the state of Washington to file to satisfy or establish a tax or fee obligation that is administered or collected by the department ((~~of revenue~~)), and that has a statutorily defined due date.

NEW SECTION. **Sec. 204.** A new section is added to chapter 82.32 RCW to read as follows:

There is hereby created a joint tax avoidance review committee which is a bipartisan committee consisting of three members of the senate, two from the majority caucus and one from the minority caucus, and three members of the house of representatives, two from the majority caucus and one from the minority caucus. The senate members of the committee must be appointed by the majority leader of the senate, and the house members of the committee must be appointed by the speaker of the house. The appointing authorities must also appoint one alternate member from each of the two largest caucuses of each legislative chamber.

(1)(a) Members and alternates must be appointed as soon as possible after the effective date of this section, and their terms continue until such persons no longer wish to serve on the committee or no longer serve in the legislature, whichever occurs first.

(b) A vacancy must be filled by the appointment of a legislator from the same legislative chamber and caucus as the original appointment. The appropriate appointing authority must make the appointment within thirty days of the vacancy occurring. Former committee members and alternates may be reappointed to the committee.

(2) The committee must choose its chair and vice-chair from among its membership. The committee meets at the call of the chair. The chair of the committee must cause all meeting notices and committee documents to be sent to the committee members and alternates.

(3) Staff support for the committee must be provided by the senate committee services and the house of representatives office of program research.

(4) The committee must:

(a) Generally monitor the department's implementation of Part II of this act, providing timely advice to the department in any rule making undertaken pursuant to the authority granted under section 201 of this act;

(b) Seek input from stakeholders and other legislators as the committee may determine is desirable and useful in the furtherance of its mission herein described;

(c) Review other cases, identified by the department, of tax

avoidance transactions not described in section 201 of this act that may represent examples of arrangements that circumvent the policies of this state and thus unfairly avoid taxes;

(d) Consider the need for an explicit statutory construction standard to provide direction to the courts on the interpretation of Part II of this act; and

(e) Provide a report to the fiscal committees of the house of representatives and senate by December 31, 2010, which must include:

(i) Recommended legislation on any matters that the committee deems advisable, including amendments to sections 201, 202, and 203 of this act; and

(ii) Recommendations for future legislative oversight of the department's implementation of sections 201, 202, and 203 of this act.

(5) For the purposes of this section, the disclosure of otherwise confidential tax information to the members of the committee is deemed to fall within the exception provided by RCW 82.32.330(3)(d).

(6) This section expires July 1, 2011.

NEW SECTION. **Sec. 205.** (1) The legislature finds that this state's tax policy with respect to the taxation of transactions between affiliated entities and the income derived from such transactions (intercompany transactions) has motivated some taxpayers to engage in transactions designed solely or primarily to minimize the tax effects of intercompany transactions. The legislature further finds that some intercompany transactions result from taxpayers that are required to establish affiliated entities to comply with regulatory mandates and that transactions between such affiliates effectively increases the tax burden in this state on the affiliated group of entities.

(2) Therefore, as existing resources allow, the department of revenue is directed to conduct a review of the state's tax policy with respect to the taxation of intercompany transactions. The review must include the impacts of such transactions under the state's business and occupation tax and state and local sales and use taxes. The department may include other taxes in the review as it deems appropriate.

(3) In conducting the review, the department must examine how this state's tax policy compares to the tax policy of other states with respect to the taxation of intercompany transactions. The department's

review must include an analysis of potential alternatives to the current policy of taxing intercompany transactions, including their estimated revenue impacts if practicable.

(4) In conducting this review, the department may seek input from members of the business community and others as it deems appropriate.

(5) The department must report its findings to the fiscal committees of the house of representatives and senate by December 1, 2010. However, if the department has not completed its review by December 1, 2010, the department must provide the fiscal committees of the legislature with a brief status report by December 1, 2010, and the final report by December 1, 2011.

Sec. 206. RCW 82.12.020 and 2009 c 535 s 305 are each amended to read as follows:

(1) There is ((~~hereby~~)) levied and ((~~there shall be~~)) collected from every person in this state a tax or excise for the privilege of using within this state as a consumer any:

(a) Article of tangible personal property ((~~purchased at retail, or~~)) acquired by ((~~lease, gift, repossession, or bailment, or extracted or produced or manufactured by the person so using the same, or otherwise furnished to a person engaged in any business taxable under RCW 82.04.280 (2) or (7)~~)) the user in any manner, including tangible personal property acquired at a casual or isolated sale, and including by-products used by the manufacturer thereof, except as otherwise provided in this chapter, irrespective of whether the article or similar articles are manufactured or are available for purchase within this state;

(b) Prewritten computer software, regardless of the method of delivery, but excluding prewritten computer software that is either provided free of charge or is provided for temporary use in viewing information, or both;

(c) Services defined as a retail sale in RCW 82.04.050 (2)(a) or (g), (3)(a), or (6)(b), excluding services defined as a retail sale in RCW 82.04.050(6)(b) that are provided free of charge;

(d) Extended warranty; or

(e)(i) Digital good, digital code, or digital automated service, including the use of any services provided by a seller exclusively in

connection with digital goods, digital codes, or digital automated services, whether or not a separate charge is made for such services.

(ii) With respect to the use of digital goods, digital automated services, and digital codes acquired by purchase, the tax imposed in this subsection (1)(e) applies in respect to:

(A) Sales in which the seller has granted the purchaser the right of permanent use;

(B) Sales in which the seller has granted the purchaser a right of use that is less than permanent;

(C) Sales in which the purchaser is not obligated to make continued payment as a condition of the sale; and

(D) Sales in which the purchaser is obligated to make continued payment as a condition of the sale.

(iii) With respect to digital goods, digital automated services, and digital codes acquired other than by purchase, the tax imposed in this subsection (1)(e) applies regardless of whether or not the consumer has a right of permanent use or is obligated to make continued payment as a condition of use.

(2) The provisions of this chapter do not apply in respect to the use of any article of tangible personal property, extended warranty, digital good, digital code, digital automated service, or service taxable under RCW 82.04.050 (2)(a) or (g), (3)(a), or (6)(b), if the sale to, or the use by, the present user or the present user's bailor or donor has already been subjected to the tax under chapter 82.08 RCW or this chapter and the tax has been paid by the present user or by the present user's bailor or donor.

(3)(a) Except as provided in this section, payment of the tax imposed by this chapter or chapter 82.08 RCW by one purchaser or user of tangible personal property, extended warranty, digital good, digital code, digital automated service, or other service does not have the effect of exempting any other purchaser or user of the same property, extended warranty, digital good, digital code, digital automated service, or other service from the taxes imposed by such chapters.

(b) The tax imposed by this chapter does not apply:

(i) If the sale to, or the use by, the present user or his or her bailor or donor has already been subjected to the tax under chapter 82.08 RCW or this chapter and the tax has been paid by the present user or by his or her bailor or donor;

(ii) In respect to the use of any article of tangible personal property acquired by bailment and the tax has once been paid based on reasonable rental as determined by RCW 82.12.060 measured by the value of the article at time of first use multiplied by the tax rate imposed by chapter 82.08 RCW or this chapter as of the time of first use;

(iii) In respect to the use of any article of tangible personal property acquired by bailment, if the property was acquired by a previous bailee from the same bailor for use in the same general activity and the original bailment was prior to June 9, 1961; or

(iv) To the use of digital goods or digital automated services, which were obtained through the use of a digital code, if the sale of the digital code to, or the use of the digital code by, the present user or the present user's bailor or donor has already been subjected to the tax under chapter 82.08 RCW or this chapter and the tax has been paid by the present user or by the present user's bailor or donor.

(4)(a) Except as provided in (b) of this subsection (4), the tax is levied and must be collected in an amount equal to the value of the article used, value of the digital good or digital code used, value of the extended warranty used, or value of the service used by the taxpayer, multiplied by the applicable rates in effect for the retail sales tax under RCW 82.08.020.

(b) In the case of a seller required to collect use tax from the purchaser, the tax must be collected in an amount equal to the purchase price multiplied by the applicable rate in effect for the retail sales tax under RCW 82.08.020.

(5) For purposes of the tax imposed in this section, "person" includes anyone within the definition of "buyer," "purchaser," and "consumer" in RCW 82.08.010.

Sec. 207. RCW 82.45.010 and 2008 c 116 s 3 and 2008 c 6 s 701 are each reenacted and amended to read as follows:

(1) As used in this chapter, the term "sale" ((~~shall have~~)) has its ordinary meaning and ((~~shall~~)) includes any conveyance, grant, assignment, quitclaim, or transfer of the ownership of or title to real property, including standing timber, or any estate or interest therein for a valuable consideration, and any contract for such conveyance, grant, assignment, quitclaim, or transfer, and any lease with an option to purchase real property, including standing timber, or any estate or

interest therein or other contract under which possession of the property is given to the purchaser, or any other person at the purchaser's direction, and title to the property is retained by the vendor as security for the payment of the purchase price. The term also includes the grant, assignment, quitclaim, sale, or transfer of improvements constructed upon leased land.

(2)(a) The term "sale" also includes the transfer or acquisition within any twelve-month period of a controlling interest in any entity with an interest in real property located in this state for a valuable consideration.

(b) For the sole purpose of determining whether, pursuant to the exercise of an option, a controlling interest was transferred or acquired within a twelve-month period, the date that the option agreement was executed is the date on which the transfer or acquisition of the controlling interest is deemed to occur. For all other purposes under this chapter, the date upon which the option is exercised is the date of the transfer or acquisition of the controlling interest.

(c) For purposes of this subsection, all acquisitions of persons acting in concert ((~~shall~~)) must be aggregated for purposes of determining whether a transfer or acquisition of a controlling interest has taken place. The department ((~~of revenue shall~~)) must adopt standards by rule to determine when persons are acting in concert. In adopting a rule for this purpose, the department ((~~shall~~)) must consider the following:

((~~(a)~~)) (i) Persons ((~~shall~~)) must be treated as acting in concert when they have a relationship with each other such that one person influences or controls the actions of another through common ownership; and

((~~(b)~~)) (ii) When persons are not commonly owned or controlled, they ((~~shall~~)) must be treated as acting in concert only when the unity with which the purchasers have negotiated and will consummate the transfer of ownership interests supports a finding that they are acting as a single entity. If the acquisitions are completely independent, with each purchaser buying without regard to the identity of the other purchasers, then the acquisitions ((~~shall be~~)) are considered separate acquisitions.

(3) The term "sale" ((~~shall~~)) does not include:

(a) A transfer by gift, devise, or inheritance.

(b) A transfer of any leasehold interest other than of the type mentioned above.

(c) A cancellation or forfeiture of a vendee's interest in a contract for the sale of real property, whether or not such contract contains a forfeiture clause, or deed in lieu of foreclosure of a mortgage.

(d) The partition of property by tenants in common by agreement or as the result of a court decree.

(e) The assignment of property or interest in property from one spouse or one domestic partner to the other spouse or other domestic partner in accordance with the terms of a decree of dissolution of marriage or state registered domestic partnership or in fulfillment of a property settlement agreement.

(f) The assignment or other transfer of a vendor's interest in a contract for the sale of real property, even though accompanied by a conveyance of the vendor's interest in the real property involved.

(g) Transfers by appropriation or decree in condemnation proceedings brought by the United States, the state or any political subdivision thereof, or a municipal corporation.

(h) A mortgage or other transfer of an interest in real property merely to secure a debt, or the assignment thereof.

(i) Any transfer or conveyance made pursuant to a deed of trust or an order of sale by the court in any mortgage, deed of trust, or lien foreclosure proceeding or upon execution of a judgment, or deed in lieu of foreclosure to satisfy a mortgage or deed of trust.

(j) A conveyance to the federal housing administration or veterans administration by an authorized mortgagee made pursuant to a contract of insurance or guaranty with the federal housing administration or veterans administration.

(k) A transfer in compliance with the terms of any lease or contract upon which the tax as imposed by this chapter has been paid or where the lease or contract was entered into prior to the date this tax was first imposed.

(l) The sale of any grave or lot in an established cemetery.

(m) A sale by the United States, this state or any political subdivision thereof, or a municipal corporation of this state.

(n) A sale to a regional transit authority or public corporation

under RCW 81.112.320 under a sale/leaseback agreement under RCW 81.112.300.

(o) A transfer of real property, however effected, if it consists of a mere change in identity or form of ownership of an entity where there is no change in the beneficial ownership. These include transfers to a corporation or partnership which is wholly owned by the transferor and/or the transferor's spouse or domestic partner or children of the transferor or the transferor's spouse or domestic partner((~~: PROVIDED, That~~)). However, if thereafter such transferee corporation or partnership voluntarily transfers such real property, or such transferor, spouse or domestic partner, or children of the transferor or the transferor's spouse or domestic partner voluntarily transfer stock in the transferee corporation or interest in the transferee partnership capital, as the case may be, to other than ((~~(1)~~)) (i) the transferor and/or the transferor's spouse or domestic partner or children of the transferor or the transferor's spouse or domestic partner, ((~~(2)~~)) (ii) a trust having the transferor and/or the transferor's spouse or domestic partner or children of the transferor or the transferor's spouse or domestic partner as the only beneficiaries at the time of the transfer to the trust, or ((~~(3)~~)) (iii) a corporation or partnership wholly owned by the original transferor and/or the transferor's spouse or domestic partner or children of the transferor or the transferor's spouse or domestic partner, within three years of the original transfer to which this exemption applies, and the tax on the subsequent transfer has not been paid within sixty days of becoming due, excise taxes ((~~shall~~)) become due and payable on the original transfer as otherwise provided by law.

(p)(i) A transfer that for federal income tax purposes does not involve the recognition of gain or loss for entity formation, liquidation or dissolution, and reorganization, including but not limited to nonrecognition of gain or loss because of application of ((~~section~~)) 26 U.S.C. Sec. 332, 337, 351, 368(a)(1), 721, or 731 of the internal revenue code of 1986, as amended.

(ii) However, the transfer described in (p)(i) of this subsection cannot be preceded or followed within a twelve-month period by another transfer or series of transfers, that, when combined with the otherwise exempt transfer or transfers described in (p)(i) of this subsection, results in the transfer of a controlling interest in the entity for

valuable consideration, and in which one or more persons previously holding a controlling interest in the entity receive cash or property in exchange for any interest the person or persons acting in concert hold in the entity. This subsection (3)(p)(ii) does not apply to that part of the transfer involving property received that is the real property interest that the person or persons originally contributed to the entity or when one or more persons who did not contribute real property or belong to the entity at a time when real property was purchased receive cash or personal property in exchange for that person or persons' interest in the entity. The real estate excise tax under this subsection (3)(p)(ii) is imposed upon the person or persons who previously held a controlling interest in the entity.

(q) A qualified sale of a manufactured/mobile home community, as defined in RCW 59.20.030, that takes place on or after June 12, 2008, but before December 31, 2018.

Sec. 208. RCW 82.45.033 and 1993 sp.s. c 25 s 505 are each amended to read as follows:

(1) As used in this chapter, the term "controlling interest" has the following meaning:

((~~(1)~~)) (a) In the case of a corporation, either fifty percent or more of the total combined voting power of all classes of stock of the corporation entitled to vote, or fifty percent of the capital, profits, or beneficial interest in the voting stock of the corporation; and

((~~(2)~~)) (b) In the case of a partnership, association, trust, or other entity, fifty percent or more of the capital, profits, or beneficial interest in such partnership, association, trust, or other entity.

(2) The department may, at the department's option, enforce the obligation of the seller under this chapter as provided in this subsection (2):

(a) In the transfer or acquisition of a controlling interest as defined in subsection (1)(a) of this section, either against the corporation in which a controlling interest is transferred or acquired, against the person or persons who acquired the controlling interest in the corporation or, when the corporation is not a publicly traded company, against the person or persons who transferred the controlling interest in the corporation; and

(b) In the transfer or acquisition of a controlling interest as defined in subsection (1)(b) of this section, either against the entity in which a controlling interest is transferred or acquired or against the person or persons who transferred or acquired the controlling interest in the entity.

Sec. 209. RCW 82.45.070 and 1969 ex.s. c 223 s 28A.45.070 are each amended to read as follows:

The tax ((~~herein~~)) provided for in this chapter and any interest or penalties thereon ((~~shall be~~)) is a specific lien upon each ((~~piece~~)) parcel of real property located in this state that is either sold or that is owned by an entity in which a controlling interest has been transferred or acquired. The lien attaches from the time of sale until the tax ((~~shall have been~~)) is paid, which lien may be enforced in the manner prescribed for the foreclosure of mortgages.

Sec. 210. RCW 82.45.080 and 1980 c 154 s 3 are each amended to read as follows:

(1) The tax levied under this chapter ((~~shall be~~)) is the obligation of the seller and the department ((~~of revenue~~)) may, at the department's option, enforce the obligation through an action of debt against the seller or the department may proceed in the manner prescribed for the foreclosure of mortgages ((~~and resort to~~)). The department's use of one course of enforcement ((~~shall~~)) is not ((~~be~~)) an election not to pursue the other.

(2) For purposes of this section and notwithstanding any other provisions of law, the seller is the parent corporation of a wholly owned subsidiary, when such subsidiary is the transferor to a third-party transferee and the subsidiary is dissolved before paying the tax imposed under this chapter.

Sec. 211. RCW 82.45.100 and 2007 c 111 s 112 are each amended to read as follows:

(1) Payment of the tax imposed under this chapter is due and payable immediately at the time of sale, and if not paid within one month thereafter ((~~shall~~)) will bear interest from the time of sale until the date of payment.

(a) Interest imposed before January 1, 1999, ((~~shall be~~)) is computed at the rate of one percent per month.

(b) Interest imposed after December 31, 1998, ((~~shall be~~)) is computed on a monthly basis at the rate as computed under RCW 82.32.050(2). The rate so computed ((~~shall~~)) must be adjusted on the first day of January of each year for use in computing interest for that calendar year. The department ((~~of revenue shall~~)) must provide written notification to the county treasurers of the variable rate on or before December 1st of the year preceding the calendar year in which the rate applies.

(2) In addition to the interest described in subsection (1) of this section, if the payment of any tax is not received by the county treasurer or the department of revenue, as the case may be, within one month of the date due, there ((~~shall be~~)) is assessed a penalty of five percent of the amount of the tax; if the tax is not received within two months of the date due, there ((~~shall~~)) will be assessed a total penalty of ten percent of the amount of the tax; and if the tax is not received within three months of the date due, there ((~~shall~~)) will be assessed a total penalty of twenty percent of the amount of the tax. The payment of the penalty described in this subsection ((~~shall be~~)) is collectible from the seller only, and RCW 82.45.070 does not apply to the penalties described in this subsection.

(3) If the tax imposed under this chapter is not received by the due date, the transferee ((~~shall be~~)) is personally liable for the tax, along with any interest as provided in subsection (1) of this section, unless((~~:~~

~~(a)~~)) an instrument evidencing the sale is recorded in the official real property records of the county in which the property conveyed is located((~~; or~~

~~(b) Either the transferor or transferee notifies the department of revenue in writing of the occurrence of the sale within thirty days following the date of the sale~~)).

(4) If upon examination of any affidavits or from other information obtained by the department or its agents it appears that all or a portion of the tax is unpaid, the department ((~~shall~~)) must assess against the taxpayer the additional amount found to be due plus interest and penalties as provided in subsections (1) and (2) of this section. The department ((~~shall~~)) must notify the taxpayer by mail, or

electronically as provided in RCW 82.32.135, of the additional amount and the same ((~~shall~~)) becomes due and ((~~shall~~)) must be paid within thirty days from the date of the notice, or within such further time as the department may provide.

(5) No assessment or refund may be made by the department more than four years after the date of sale except upon a showing of:

(a) Fraud or misrepresentation of a material fact by the taxpayer;

(b) A failure by the taxpayer to record documentation of a sale or otherwise report the sale to the county treasurer; or

(c) A failure of the transferor or transferee to report the sale under RCW 82.45.090(2).

(6) Penalties collected on taxes due under this chapter under subsection (2) of this section and RCW 82.32.090 (2) through ((~~(7)~~)) (8) ((~~shall~~)) must be deposited in the housing trust fund as described in chapter 43.185 RCW.

Sec. 212. RCW 82.45.220 and 2005 c 326 s 3 are each amended to read as follows:

(1) An organization that fails to report a transfer of the controlling interest in the organization under RCW 43.07.390 to the secretary of state and is later determined to be subject to real estate excise taxes due to the transfer, ((~~shall be~~)) is subject to the provisions of RCW 82.45.100 as well as the evasion penalty in RCW 82.32.090((~~(6)~~)) (7).

(2) Subsection (1) of this section also applies to the failure to report to the secretary of state the granting of an option to acquire an interest in the organization if the exercise of the option would result in a sale as defined in RCW 82.45.010(2).

Sec. 213. RCW 43.07.390 and 2005 c 326 s 2 are each amended to read as follows:

(1)(a) The secretary of state ((~~shall~~)) must adopt rules requiring any entity that is required to file an annual report with the secretary of state, including entities under Titles 23, 23B, 24, and 25 RCW, to disclose: (i) Any transfer ((~~in~~)) of the controlling interest ((~~of~~)) in the entity ((~~and any interest in real property~~)); and (ii) the granting of any option to acquire an interest in the entity if the

1 exercise of the option would result in a sale as defined in RCW
2 82.45.010(2).
3 (b) The disclosure requirement in this subsection only applies to
4 entities owning an interest in real property located in this state.
5 (2) This information ((~~shall~~)) must be made available to the
6 department of revenue upon request for the purposes of tracking the
7 transfer of the controlling interest in entities owning real property
8 and to determine when the real estate excise tax is applicable in such
9 cases.
10 (3) For the purposes of this section, "controlling interest" has
11 the same meaning as provided in RCW 82.45.033.

12 **PART III**
13 **Modifying the First Mortgage Deduction**

14 **Sec. 301.** RCW 82.04.4292 and 1980 c 37 s 12 are each amended to
15 read as follows:
16 (1) In computing tax there may be deducted from the measure of tax
17 by those engaged in banking, loan, security or other financial
18 businesses, ((~~amounts derived from~~)) interest received on investments
19 or loans primarily secured by first mortgages or trust deeds on
20 nontransient residential properties.
21 (2) Interest deductible under this section includes the portion of
22 fees charged to borrowers, including points and loan origination fees,
23 that is recognized over the life of the loan as an adjustment to yield
24 in the taxpayer's books and records according to generally accepted
25 accounting principles.
26 (3) Subsections (1) and (2) of this section notwithstanding, the
27 following is a nonexclusive list of items that are not deductible under
28 this section:
29 (a) Fees for specific services such as: Document preparation fees;
30 finder fees; brokerage fees; title examination fees; fees for credit
31 checks; notary fees; loan application fees; interest lock-in fees if
32 the loan is not made; servicing fees; and similar fees or amounts;
33 (b) Fees received in consideration for an agreement to make funds
34 available for a specific period of time at specified terms, commonly
35 referred to as commitment fees;

1 (c) Any other fees, or portion of a fee, that is not recognized
2 over the life of the loan as an adjustment to yield in the taxpayer's
3 books and records according to generally accepted accounting
4 principles;
5 (d) Gains on the sale of valuable rights such as service release
6 premiums, which are amounts received when servicing rights are sold;
7 and
8 (e) Gains on the sale of loans, except deferred loan origination
9 fees and points deductible under subsection (2) of this section, are
10 not to be considered part of the proceeds of sale of the loan.
11 (4) Notwithstanding subsection (3) of this section, in computing
12 tax there may be deducted from the measure of tax by those engaged in
13 banking, loan, security, or other financial businesses, amounts
14 received for servicing loans primarily secured by first mortgages or
15 trust deeds on nontransient residential properties, including such
16 loans that secure mortgage-backed or mortgage-related securities, but
17 only if:
18 (a)(i) The loans were originated by the person claiming a deduction
19 under this subsection (4) and that person either sold the loans on the
20 secondary market or securitized the loans and sold the securities on
21 the secondary market; or
22 (ii)(A) The person claiming a deduction under this subsection (4)
23 acquired the loans from the person that originated the loans through a
24 merger or acquisition of substantially all of the assets of the person
25 who originated the loans, or the person claiming a deduction under this
26 subsection (4) is affiliated with the person that originated the loans.
27 For purposes of this subsection, "affiliated" means under common
28 control. "Control" means the possession, directly or indirectly, of
29 more than fifty percent of the power to direct or cause the direction
30 of the management and policies of a person, whether through the
31 ownership of voting shares, by contract, or otherwise; and
32 (B) Either the person who originated the loans or the person
33 claiming a deduction under this subsection (4) sold the loans on the
34 secondary market or securitized the loans and sold the securities on
35 the secondary market; and
36 (b) The amounts received for servicing the loans are determined by
37 a percentage of the interest paid by the borrower and are only received
38 if the borrower makes interest payments.

1 **PART IV**
2 **Direct Seller Business and Occupation Tax Exemption**

3 NEW SECTION. **Sec. 401.** (1) A business and occupation tax
4 exemption is provided in RCW 82.04.423 for certain out-of-state sellers
5 that sell consumer products exclusively to or through a direct seller's
6 representative. The intent of the legislature in enacting this
7 exemption was to provide a narrow exemption for out-of-state businesses
8 engaged in direct sales of consumer products, typically accomplished
9 through in-home parties or door-to-door selling.
10 (2) In *Dot Foods, Inc. v. Dep't of Revenue*, Docket No. 81022-2
11 (September 10, 2009), the Washington supreme court held that the
12 exemption in RCW 82.04.423 applied to a taxpayer: (a) That sold
13 nonconsumer products through its representative in addition to consumer
14 products; and (b) whose consumer products were ultimately sold at
15 retail in permanent retail establishments.
16 (3) The legislature finds that most out-of-state businesses selling
17 consumer products in this state will either be eligible for the
18 exemption under RCW 82.04.423 or could easily restructure their
19 business operations to qualify for the exemption. As a result, the
20 legislature expects that the broadened interpretation of the direct
21 sellers' exemption will lead to large and devastating revenue losses.
22 This comes at a time when the state's existing budget is facing a two
23 billion six hundred million dollar shortfall, which could grow, while
24 at the same time the demand for state and state-funded services is also
25 growing. Moreover, the legislature further finds that RCW 82.04.423
26 provides preferential tax treatment for out-of-state businesses over
27 their in-state competitors and now creates a strong incentive for in-
28 state businesses to move their operations outside Washington.
29 (4) Therefore, the legislature finds that it is necessary to
30 reaffirm the legislature's intent in establishing the direct sellers'
31 exemption and prevent the loss of revenues resulting from the expanded
32 interpretation of the exemption by amending RCW 82.04.423 retroactively
33 to conform the exemption to the original intent of the legislature and
34 by prospectively ending the direct sellers' exemption as of the
35 effective date of this section.

36 **Sec. 402.** RCW 82.04.423 and 1983 1st ex.s. c 66 s 5 are each
37 amended to read as follows:

(1) Prior to the effective date of this section, this chapter ((~~shall~~)) does not apply to any person in respect to gross income derived from the business of making sales at wholesale or retail if such person:

(a) Does not own or lease real property within this state; and

(b) Does not regularly maintain a stock of tangible personal property in this state for sale in the ordinary course of business; and

(c) Is not a corporation incorporated under the laws of this state; and

(d) Makes sales in this state exclusively to or through a direct seller's representative.

(2) For purposes of this section, the term "direct seller's representative" means a person who buys only consumer products on a buy-sell basis or a deposit-commission basis for resale, by the buyer or any other person, in the home or otherwise than in a permanent retail establishment, or who sells at retail, or solicits the sale at retail of, only consumer products in the home or otherwise than in a permanent retail establishment; and

(a) Substantially all of the remuneration paid to such person, whether or not paid in cash, for the performance of services described in this subsection is directly related to sales or other output, including the performance of services, rather than the number of hours worked; and

(b) The services performed by the person are performed pursuant to a written contract between such person and the person for whom the services are performed and such contract provides that the person will not be treated as an employee with respect to such purposes for federal tax purposes.

(3) Nothing in this section ((~~shall~~)) may be construed to imply that a person exempt from tax under this section was engaged in a business activity taxable under this chapter prior to ((~~the enactment of this section~~)) August 23, 1983.

PART V

Business and Occupation Tax Preferences for Manufacturers of Products Derived from Certain Agricultural Products

NEW SECTION. **Sec. 501.** (1)(a) In 1967, the legislature amended RCW 82.04.260 in chapter 149, Laws of 1967 ex. sess. to authorize a preferential business and occupation tax rate for slaughtering, breaking, and/or processing perishable meat products and/or selling the same at wholesale. The legislature finds that RCW 82.04.260(4) was interpreted by the state supreme court on January 13, 2005, in *Agrilink Foods, Inc. v. Department of Revenue*, 153 Wn.2d 392 (2005). The supreme court held that the preferential business and occupation tax rate on the slaughtering, breaking, and/or processing of perishable meat products applied to the processing of perishable meat products into nonperishable finished products, such as canned food.

(b) The legislature intends to narrow the exemption provided for slaughtering, breaking, and/or processing perishable meat products and/or selling such products at wholesale by requiring that the end product be a perishable meat product; a nonperishable meat product that is comprised primarily of animal carcass by weight or volume, other than a canned meat product; or a meat by-product.

(2)(a) A business and occupation tax exemption is provided for (i) manufacturing by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables, and (ii) selling such products at wholesale by the manufacturer to purchasers who transport the goods out of state in the ordinary course of business. This exemption expires July 1, 2012, and is replaced by a preferential business and occupation tax rate.

(b) The legislature finds that the rationale of the *Agrilink* decision, if applied to these tax preferences, could result in preferential tax treatment for any processed food product that contained any fresh fruit or vegetable as an ingredient, however small the amount.

(c) The legislature intends to narrow the tax preference provided to fruit and vegetable manufacturers by requiring that the end product be comprised either (i) exclusively of fruits and/or vegetables, or (ii) of any combination of fruits, vegetables, and certain other substances that, cumulatively, may not exceed the amount of fruits and vegetables contained in the product measured by weight or volume.

NEW SECTION. **Sec. 502.** A new section is added to chapter 82.04 RCW to read as follows:

1 (1) Upon every person engaging within this state in the business of
2 manufacturing:
3 (a) Perishable meat products, by slaughtering, breaking, or
4 processing, if the finished product is a perishable meat product; as to
5 such persons the tax imposed is equal to the value of the perishable
6 meat products manufactured, or, in the case of a processor for hire,
7 the gross income of the business, multiplied by the rate of 0.138
8 percent;
9 (b) Meat products, by dehydration, curing, smoking, or any
10 combination of these activities, if the finished meat products are not
11 canned; as to such persons the tax imposed is equal to the value of the
12 meat products manufactured, or, in the case of a processor for hire,
13 the gross income of the business, multiplied by the rate of 0.138
14 percent;
15 (c) Hides, tallow, meat meal, and other similar meat by-products,
16 if such products are derived in part from animals and manufactured in
17 a rendering plant licensed under chapter 16.68 RCW; as to such persons
18 the tax imposed is equal to the value of the products manufactured, or,
19 in the case of a processor for hire, the gross income of the business,
20 multiplied by the rate of 0.138 percent.
21 (2) Upon every person engaging within this state in the business of
22 selling at wholesale:
23 (a) Perishable meat products; as to such persons the tax imposed is
24 equal to the gross proceeds derived from such sales multiplied by the
25 rate of 0.138 percent;
26 (b) Meat products that have been manufactured by the seller by
27 dehydration, curing, smoking, or any combination of such activities, if
28 the finished meat products are not canned; as to such persons the tax
29 imposed is equal to the gross proceeds derived from such sales
30 multiplied by the rate of 0.138 percent;
31 (c) Hides, tallow, meat meal, and other similar meat by-products,
32 if such products are derived in part from animals and manufactured by
33 the seller in a rendering plant; as to such persons the tax imposed is
34 equal to the gross proceeds derived from such sales multiplied by the
35 rate of 0.138 percent.
36 (3) The definitions in this subsection apply throughout this
37 section unless the context clearly requires otherwise.

(a) "Animal" means all members of the animal kingdom except humans, fish, and insects.

(b) "Carcass" means all or any parts, including viscera, of a slaughtered animal.

(c) "Fish" means any water-breathing animal, including shellfish.

(d) "Hide" means any unprocessed animal pelt or skin.

(e)(i) "Meat products" means:

(A) Products comprised exclusively of animal carcass; and

(B) Products, such as jerky, sausage, and other cured meat products, that are comprised primarily of animal carcass by weight or volume and may also contain water; nitrates; nitrites; acids; binders and extenders; natural or synthetic casings; colorings; flavorings such as soy sauce, liquid smoke, seasonings, citric acid, sugar, molasses, corn syrup, and vinegar; and similar substances.

(ii) Except as provided in (e)(i) of this subsection (3), "meat products" does not include products containing any cereal grains or cereal-grain products, dairy products, legumes and legume products, fruit or vegetable products as defined in RCW 82.04.260, and similar ingredients, unless the ingredient is used as a flavoring. For purposes of this subsection, "flavoring" means a substance that contains the flavoring constituents derived from a spice, fruit or fruit juice, vegetable or vegetable juice, edible yeast, herb, bark, bud, root, leaf, or any other edible substance of plant origin, whose primary function in food is flavoring or seasoning rather than nutritional, and which may legally appear as "natural flavor," "flavor," or "flavorings" in the ingredient statement on the label of the meat product.

(iii) "Meat products" includes only products that are intended for human consumption as food or animal consumption as feed.

(f) "Perishable" means having a high risk of spoilage within thirty days of manufacture without any refrigeration or freezing.

(g) "Rendering plant" means any place of business or location where dead animals or any part or portion thereof, or packing house refuse, are processed for the purpose of obtaining the hide, skin, grease residue, or any other by-product whatsoever.

Sec. 503. RCW 82.04.4266 and 2006 c 354 s 3 are each amended to read as follows:

(1) This chapter ((~~shall~~)) does not apply to the value of products or the gross proceeds of sales derived from:

(a) Manufacturing fruit((~~s~~)) or vegetable((~~s~~)) products by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables; or

(b) Selling at wholesale fruit((~~s~~)) or vegetable((~~s~~)) products manufactured by the seller by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables and sold to purchasers who transport in the ordinary course of business the goods out of this state. A person taking an exemption under this subsection (1)(b) must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state.

(2)(a) "Fruit or vegetable products" means:

(i) Products comprised exclusively of fruits, vegetables, or both; and

(ii) Products comprised of fruits, vegetables, or both, and which may also contain water, sugar, salt, seasonings, preservatives, binders, stabilizers, flavorings, yeast, and similar substances. However, the amount of all ingredients contained in the product, other than fruits, vegetables, and water, may not exceed the amount of fruits and vegetables contained in the product measured by weight or volume.

(b) "Fruit or vegetable products" includes only products that are intended for human consumption as food or animal consumption as feed.

(3) This section expires July 1, 2012.

Sec. 504. RCW 82.04.4266 and 2010 c 114 (SHB 3066) s 111 are each amended to read as follows:

(1) This chapter does not apply to the value of products or the gross proceeds of sales derived from:

(a) Manufacturing fruit((~~s~~)) or vegetable((~~s~~)) products by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables; or

(b) Selling at wholesale fruit((~~s~~)) or vegetable((~~s~~)) products manufactured by the seller by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables and sold to purchasers who transport in the ordinary course of business the goods out of this state. A person taking an exemption under this subsection

(1)(b) must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state.

(2)(a) "Fruit or vegetable products" means:

(i) Products comprised exclusively of fruits, vegetables, or both; and

(ii) Products comprised of fruits, vegetables, or both, and which may also contain water, sugar, salt, seasonings, preservatives, binders, stabilizers, flavorings, yeast, and similar substances. However, the amount of all ingredients contained in the product, other than fruits, vegetables, and water, may not exceed the amount of fruits and vegetables contained in the product measured by weight or volume.

(b) "Fruit or vegetable products" includes only products that are intended for human consumption as food or animal consumption as feed.

(3) A person claiming the exemption provided in this section must file a complete annual survey with the department under RCW 82.32.--- (section 102, chapter 114 (SHB 3066), Laws of 2010).

((~~(3)~~)) (4) This section expires July 1, 2012.

Sec. 505. RCW 82.04.260 and 2009 c 479 s 64, 2009 c 461 s 1, and 2009 c 162 s 34 are each reenacted and amended to read as follows:

(1) Upon every person engaging within this state in the business of manufacturing:

(a) Wheat into flour, barley into pearl barley, soybeans into soybean oil, canola into canola oil, canola meal, or canola by-products, or sunflower seeds into sunflower oil; as to such persons the amount of tax with respect to such business ((~~shall be~~)) is equal to the value of the flour, pearl barley, oil, canola meal, or canola by-product manufactured, multiplied by the rate of 0.138 percent;

(b) Beginning July 1, 2012, seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing by that person; or selling manufactured seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing, to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business ((~~shall be~~)) is equal to the value of the products manufactured or the gross proceeds derived from such sales, multiplied by the rate of 0.138 percent. Sellers must keep and

preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state;

(c) Beginning July 1, 2012, dairy products that as of September 20, 2001, are identified in 21 C.F.R., chapter 1, parts 131, 133, and 135, including by-products from the manufacturing of the dairy products such as whey and casein; or selling the same to purchasers who transport in the ordinary course of business the goods out of state; as to such persons the tax imposed ((~~shall be~~)) is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state;

(d)(i) Beginning July 1, 2012, fruit((~~s~~)) or vegetable((~~s~~)) products by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables, or selling at wholesale fruit((~~s~~)) or vegetable((~~s~~)) products manufactured by the seller by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables and sold to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business ((~~shall be~~)) is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state;

(ii) For purposes of this subsection, "fruit or vegetable products" means:

(A) Products comprised exclusively of fruits, vegetables, or both; or

(B) Products comprised of fruits, vegetables, or both, and which may also contain water, sugar, salt, seasonings, preservatives, binders, stabilizers, flavorings, yeast, and similar substances. However, the amount of all ingredients contained in the product, other than fruits, vegetables, and water, may not exceed the amount of fruits and vegetables contained in the product measured by weight or volume;

(iii) "Fruit and vegetable products" includes only products that are intended for human consumption as food or animal consumption as feed;

(e) Until July 1, 2009, alcohol fuel, biodiesel fuel, or biodiesel feedstock, as those terms are defined in RCW 82.29A.135; as to such persons the amount of tax with respect to the business ((~~shall be~~)) is equal to the value of alcohol fuel, biodiesel fuel, or biodiesel feedstock manufactured, multiplied by the rate of 0.138 percent; and

(f) Alcohol fuel or wood biomass fuel, as those terms are defined in RCW 82.29A.135; as to such persons the amount of tax with respect to the business ((~~shall be~~)) is equal to the value of alcohol fuel or wood biomass fuel manufactured, multiplied by the rate of 0.138 percent.

(2) Upon every person engaging within this state in the business of splitting or processing dried peas; as to such persons the amount of tax with respect to such business ((~~shall be~~)) is equal to the value of the peas split or processed, multiplied by the rate of 0.138 percent.

(3) Upon every nonprofit corporation and nonprofit association engaging within this state in research and development, as to such corporations and associations, the amount of tax with respect to such activities ((~~shall be~~)) is equal to the gross income derived from such activities multiplied by the rate of 0.484 percent.

(4) ((~~Upon every person engaging within this state in the business of slaughtering, breaking and/or processing perishable meat products and/or selling the same at wholesale only and not at retail; as to such persons the tax imposed shall be equal to the gross proceeds derived from such sales multiplied by the rate of 0.138 percent.~~

~~(5)~~)) Upon every person engaging within this state in the business of acting as a travel agent or tour operator; as to such persons the amount of the tax with respect to such activities ((~~shall be~~)) is equal to the gross income derived from such activities multiplied by the rate of 0.275 percent.

((~~(6)~~)) (5) Upon every person engaging within this state in business as an international steamship agent, international customs house broker, international freight forwarder, vessel and/or cargo charter broker in foreign commerce, and/or international air cargo agent; as to such persons the amount of the tax with respect to only international activities ((~~shall be~~)) is equal to the gross income derived from such activities multiplied by the rate of 0.275 percent.

((~~(7)~~)) (6) Upon every person engaging within this state in the business of stevedoring and associated activities pertinent to the movement of goods and commodities in waterborne interstate or foreign commerce; as to such persons the amount of tax with respect to such business ((~~shall be~~)) is equal to the gross proceeds derived from such activities multiplied by the rate of 0.275 percent. Persons subject to taxation under this subsection ((~~shall be~~)) are exempt from payment of taxes imposed by chapter 82.16 RCW for that portion of their business subject to taxation under this subsection. Stevedoring and associated activities pertinent to the conduct of goods and commodities in waterborne interstate or foreign commerce are defined as all activities of a labor, service or transportation nature whereby cargo may be loaded or unloaded to or from vessels or barges, passing over, onto or under a wharf, pier, or similar structure; cargo may be moved to a warehouse or similar holding or storage yard or area to await further movement in import or export or may move to a consolidation freight station and be stuffed, unstuffed, containerized, separated or otherwise segregated or aggregated for delivery or loaded on any mode of transportation for delivery to its consignee. Specific activities included in this definition are: Wharfage, handling, loading, unloading, moving of cargo to a convenient place of delivery to the consignee or a convenient place for further movement to export mode; documentation services in connection with the receipt, delivery, checking, care, custody and control of cargo required in the transfer of cargo; imported automobile handling prior to delivery to consignee; terminal stevedoring and incidental vessel services, including but not limited to plugging and unplugging refrigerator service to containers, trailers, and other refrigerated cargo receptacles, and securing ship hatch covers.

((~~(8)~~)) (7)(a) Upon every person engaging within this state in the business of disposing of low-level waste, as defined in RCW 43.145.010; as to such persons the amount of the tax with respect to such business ((~~shall be~~)) is equal to the gross income of the business, excluding any fees imposed under chapter 43.200 RCW, multiplied by the rate of 3.3 percent.

(b) If the gross income of the taxpayer is attributable to activities both within and without this state, the gross income

attributable to this state ((~~shall~~)) must be determined in accordance with the methods of apportionment required under RCW 82.04.460.

((~~(9)~~)) (8) Upon every person engaging within this state as an insurance producer or title insurance agent licensed under chapter 48.17 RCW or a surplus line broker licensed under chapter 48.15 RCW; as to such persons, the amount of the tax with respect to such licensed activities ((~~shall be~~)) is equal to the gross income of such business multiplied by the rate of 0.484 percent.

((~~(10)~~)) (9) Upon every person engaging within this state in business as a hospital, as defined in chapter 70.41 RCW, that is operated as a nonprofit corporation or by the state or any of its political subdivisions, as to such persons, the amount of tax with respect to such activities ((~~shall be~~)) is equal to the gross income of the business multiplied by the rate of 0.75 percent through June 30, 1995, and 1.5 percent thereafter.

((~~(11)~~)) (10)(a) Beginning October 1, 2005, upon every person engaging within this state in the business of manufacturing commercial airplanes, or components of such airplanes, or making sales, at retail or wholesale, of commercial airplanes or components of such airplanes, manufactured by the seller, as to such persons the amount of tax with respect to such business ((~~shall~~)), in the case of manufacturers, ((~~be~~)) is equal to the value of the product manufactured and the gross proceeds of sales of the product manufactured, or in the case of processors for hire, ((~~be~~)) is equal to the gross income of the business, multiplied by the rate of:

(i) 0.4235 percent from October 1, 2005, through ((~~the later of~~)) June 30, 2007; and

(ii) 0.2904 percent beginning July 1, 2007.

(b) Beginning July 1, 2008, upon every person who is not eligible to report under the provisions of (a) of this subsection ((~~(11)~~)) (10) and is engaging within this state in the business of manufacturing tooling specifically designed for use in manufacturing commercial airplanes or components of such airplanes, or making sales, at retail or wholesale, of such tooling manufactured by the seller, as to such persons the amount of tax with respect to such business ((~~shall~~)), in the case of manufacturers, ((~~be~~)) is equal to the value of the product manufactured and the gross proceeds of sales of the product

manufactured, or in the case of processors for hire, ((~~be~~)) is equal to the gross income of the business, multiplied by the rate of 0.2904 percent.

(c) For the purposes of this subsection ((~~(11)~~)) (10), "commercial airplane" and "component" have the same meanings as provided in RCW 82.32.550.

(d) In addition to all other requirements under this title, a person eligible for the tax rate under this subsection ((~~(11)~~)) (10) must report as required under RCW 82.32.545.

(e) This subsection ((~~(11)~~)) (10) does not apply on and after July 1, 2024.

((~~(12)~~)) (11)(a) Until July 1, 2024, upon every person engaging within this state in the business of extracting timber or extracting for hire timber; as to such persons the amount of tax with respect to the business ((~~shall~~)), in the case of extractors, ((~~be~~)) is equal to the value of products, including by-products, extracted, or in the case of extractors for hire, ((~~be~~)) is equal to the gross income of the business, multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(b) Until July 1, 2024, upon every person engaging within this state in the business of manufacturing or processing for hire: (i) Timber into timber products or wood products; or (ii) timber products into other timber products or wood products; as to such persons the amount of the tax with respect to the business ((~~shall~~)), in the case of manufacturers, ((~~be~~)) is equal to the value of products, including by-products, manufactured, or in the case of processors for hire, ((~~be~~)) is equal to the gross income of the business, multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(c) Until July 1, 2024, upon every person engaging within this state in the business of selling at wholesale: (i) Timber extracted by that person; (ii) timber products manufactured by that person from timber or other timber products; or (iii) wood products manufactured by that person from timber or timber products; as to such persons the amount of the tax with respect to the business ((~~shall be~~)) is equal to the gross proceeds of sales of the timber, timber products, or wood

products multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(d) Until July 1, 2024, upon every person engaging within this state in the business of selling standing timber; as to such persons the amount of the tax with respect to the business ((~~shall be~~)) is equal to the gross income of the business multiplied by the rate of 0.2904 percent. For purposes of this subsection ((~~(12)~~)) (11)(d), "selling standing timber" means the sale of timber apart from the land, where the buyer is required to sever the timber within thirty months from the date of the original contract, regardless of the method of payment for the timber and whether title to the timber transfers before, upon, or after severance.

(e) For purposes of this subsection, the following definitions apply:

(i) "Biocomposite surface products" means surface material products containing, by weight or volume, more than fifty percent recycled paper and that also use nonpetroleum-based phenolic resin as a bonding agent.

(ii) "Paper and paper products" means products made of interwoven cellulosic fibers held together largely by hydrogen bonding. "Paper and paper products" includes newsprint; office, printing, fine, and pressure-sensitive papers; paper napkins, towels, and toilet tissue; kraft bag, construction, and other kraft industrial papers; paperboard, liquid packaging containers, containerboard, corrugated, and solid-fiber containers including linerboard and corrugated medium; and related types of cellulosic products containing primarily, by weight or volume, cellulosic materials. "Paper and paper products" does not include books, newspapers, magazines, periodicals, and other printed publications, advertising materials, calendars, and similar types of printed materials.

(iii) "Recycled paper" means paper and paper products having fifty percent or more of their fiber content that comes from postconsumer waste. For purposes of this subsection ((~~(12)~~)) (11)(e)(iii), "postconsumer waste" means a finished material that would normally be disposed of as solid waste, having completed its life cycle as a consumer item.

(iv) "Timber" means forest trees, standing or down, on privately or

publicly owned land. "Timber" does not include Christmas trees that are cultivated by agricultural methods or short-rotation hardwoods as defined in RCW 84.33.035.

(v) "Timber products" means:

(A) Logs, wood chips, sawdust, wood waste, and similar products obtained wholly from the processing of timber, short-rotation hardwoods as defined in RCW 84.33.035, or both;

(B) Pulp, including market pulp and pulp derived from recovered paper or paper products; and

(C) Recycled paper, but only when used in the manufacture of biocomposite surface products.

(vi) "Wood products" means paper and paper products; dimensional lumber; engineered wood products such as particleboard, oriented strand board, medium density fiberboard, and plywood; wood doors; wood windows; and biocomposite surface products.

((~~(13)~~)) (12) Upon every person engaging within this state in inspecting, testing, labeling, and storing canned salmon owned by another person, as to such persons, the amount of tax with respect to such activities ((~~shall be~~)) is equal to the gross income derived from such activities multiplied by the rate of 0.484 percent.

((~~(14)~~)) (13) Upon every person engaging within this state in the business of printing a newspaper, publishing a newspaper, or both, the amount of tax on such business is equal to the gross income of the business multiplied by the rate of 0.2904 percent.

Sec. 506. RCW 82.04.260 and 2010 c 114 (SHB 3066) s 107 are each amended to read as follows:

(1) Upon every person engaging within this state in the business of manufacturing:

(a) Wheat into flour, barley into pearl barley, soybeans into soybean oil, canola into canola oil, canola meal, or canola by-products, or sunflower seeds into sunflower oil; as to such persons the amount of tax with respect to such business is equal to the value of the flour, pearl barley, oil, canola meal, or canola by-product manufactured, multiplied by the rate of 0.138 percent;

(b) Beginning July 1, 2012, seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing by that person; or selling manufactured seafood products that remain in

a raw, raw frozen, or raw salted state at the completion of the manufacturing, to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business is equal to the value of the products manufactured or the gross proceeds derived from such sales, multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state;

(c) Beginning July 1, 2012, dairy products that as of September 20, 2001, are identified in 21 C.F.R., chapter 1, parts 131, 133, and 135, including by-products from the manufacturing of the dairy products such as whey and casein; or selling the same to purchasers who transport in the ordinary course of business the goods out of state; as to such persons the tax imposed is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state;

(d)(i) Beginning July 1, 2012, fruit((~~s~~)) or vegetable((~~s~~)) products by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables, or selling at wholesale fruit((~~s~~)) or vegetable((~~s~~)) products manufactured by the seller by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables and sold to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state;

(ii) For purposes of this subsection, "fruit or vegetable products" means:

(A) Products comprised exclusively of fruits, vegetables, or both; or

(B) Products comprised of fruits, vegetables, or both, and which may also contain water, sugar, salt, seasonings, preservatives, binders, stabilizers, flavorings, yeast, and similar substances. However, the amount of all ingredients contained in the product, other than fruits, vegetables, and water, may not exceed the amount of fruits and vegetables contained in the product measured by weight or volume;

(iii) "Fruit and vegetable products" includes only products that are intended for human consumption as food or animal consumption as feed;

(e) Until July 1, 2009, alcohol fuel, biodiesel fuel, or biodiesel feedstock, as those terms are defined in RCW 82.29A.135; as to such persons the amount of tax with respect to the business is equal to the value of alcohol fuel, biodiesel fuel, or biodiesel feedstock manufactured, multiplied by the rate of 0.138 percent; and

(f) Wood biomass fuel as defined in RCW 82.29A.135; as to such persons the amount of tax with respect to the business is equal to the value of wood biomass fuel manufactured, multiplied by the rate of 0.138 percent.

(2) Upon every person engaging within this state in the business of splitting or processing dried peas; as to such persons the amount of tax with respect to such business is equal to the value of the peas split or processed, multiplied by the rate of 0.138 percent.

(3) Upon every nonprofit corporation and nonprofit association engaging within this state in research and development, as to such corporations and associations, the amount of tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.484 percent.

(4) ((~~Upon every person engaging within this state in the business of slaughtering, breaking and/or processing perishable meat products and/or selling the same at wholesale only and not at retail; as to such persons the tax imposed is equal to the gross proceeds derived from such sales multiplied by the rate of 0.138 percent.~~

~~(5)~~)) Upon every person engaging within this state in the business of acting as a travel agent or tour operator; as to such persons the amount of the tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.275 percent.

1 (((6))) (5) Upon every person engaging within this state in
2 business as an international steamship agent, international customs
3 house broker, international freight forwarder, vessel and/or cargo
4 charter broker in foreign commerce, and/or international air cargo
5 agent; as to such persons the amount of the tax with respect to only
6 international activities is equal to the gross income derived from such
7 activities multiplied by the rate of 0.275 percent.
8 (((7))) (6) Upon every person engaging within this state in the
9 business of stevedoring and associated activities pertinent to the
10 movement of goods and commodities in waterborne interstate or foreign
11 commerce; as to such persons the amount of tax with respect to such
12 business is equal to the gross proceeds derived from such activities
13 multiplied by the rate of 0.275 percent. Persons subject to taxation
14 under this subsection are exempt from payment of taxes imposed by
15 chapter 82.16 RCW for that portion of their business subject to
16 taxation under this subsection. Stevedoring and associated activities
17 pertinent to the conduct of goods and commodities in waterborne
18 interstate or foreign commerce are defined as all activities of a
19 labor, service or transportation nature whereby cargo may be loaded or
20 unloaded to or from vessels or barges, passing over, onto or under a
21 wharf, pier, or similar structure; cargo may be moved to a warehouse or
22 similar holding or storage yard or area to await further movement in
23 import or export or may move to a consolidation freight station and be
24 stuffed, unstuffed, containerized, separated or otherwise segregated or
25 aggregated for delivery or loaded on any mode of transportation for
26 delivery to its consignee. Specific activities included in this
27 definition are: Wharfage, handling, loading, unloading, moving of
28 cargo to a convenient place of delivery to the consignee or a
29 convenient place for further movement to export mode; documentation
30 services in connection with the receipt, delivery, checking, care,
31 custody and control of cargo required in the transfer of cargo;
32 imported automobile handling prior to delivery to consignee; terminal
33 stevedoring and incidental vessel services, including but not limited
34 to plugging and unplugging refrigerator service to containers,
35 trailers, and other refrigerated cargo receptacles, and securing ship
36 hatch covers.
37 (((8))) (7)(a) Upon every person engaging within this state in the
38 business of disposing of low-level waste, as defined in RCW 43.145.010;

as to such persons the amount of the tax with respect to such business is equal to the gross income of the business, excluding any fees imposed under chapter 43.200 RCW, multiplied by the rate of 3.3 percent.

(b) If the gross income of the taxpayer is attributable to activities both within and without this state, the gross income attributable to this state must be determined in accordance with the methods of apportionment required under RCW 82.04.460.

((~~(9)~~)) (8) Upon every person engaging within this state as an insurance producer or title insurance agent licensed under chapter 48.17 RCW or a surplus line broker licensed under chapter 48.15 RCW; as to such persons, the amount of the tax with respect to such licensed activities is equal to the gross income of such business multiplied by the rate of 0.484 percent.

((~~(10)~~)) (9) Upon every person engaging within this state in business as a hospital, as defined in chapter 70.41 RCW, that is operated as a nonprofit corporation or by the state or any of its political subdivisions, as to such persons, the amount of tax with respect to such activities is equal to the gross income of the business multiplied by the rate of 0.75 percent through June 30, 1995, and 1.5 percent thereafter.

((~~(11)~~)) (10)(a) Beginning October 1, 2005, upon every person engaging within this state in the business of manufacturing commercial airplanes, or components of such airplanes, or making sales, at retail or wholesale, of commercial airplanes or components of such airplanes, manufactured by the seller, as to such persons the amount of tax with respect to such business is, in the case of manufacturers, equal to the value of the product manufactured and the gross proceeds of sales of the product manufactured, or in the case of processors for hire, equal to the gross income of the business, multiplied by the rate of:

(i) 0.4235 percent from October 1, 2005, through June 30, 2007; and

(ii) 0.2904 percent beginning July 1, 2007.

(b) Beginning July 1, 2008, upon every person who is not eligible to report under the provisions of (a) of this subsection ((~~(11)~~)) (10) and is engaging within this state in the business of manufacturing tooling specifically designed for use in manufacturing commercial airplanes or components of such airplanes, or making sales, at retail or wholesale, of such tooling manufactured by the seller, as to such

1 persons the amount of tax with respect to such business is, in the case
2 of manufacturers, equal to the value of the product manufactured and
3 the gross proceeds of sales of the product manufactured, or in the case
4 of processors for hire, be equal to the gross income of the business,
5 multiplied by the rate of 0.2904 percent.
6 (c) For the purposes of this subsection ((~~(11)~~)) (10), "commercial
7 airplane" and "component" have the same meanings as provided in RCW
8 82.32.550.
9 (d) In addition to all other requirements under this title, a
10 person reporting under the tax rate provided in this subsection
11 ((~~(11)~~)) (10) must file a complete annual report with the department
12 under RCW 82.32.--- (section 103, chapter 114 (SHB 3066), Laws of
13 2010).
14 (e) This subsection ((~~(11)~~)) (10) does not apply on and after July
15 1, 2024.
16 ((~~(12)~~)) (11)(a) Until July 1, 2024, upon every person engaging
17 within this state in the business of extracting timber or extracting
18 for hire timber; as to such persons the amount of tax with respect to
19 the business is, in the case of extractors, equal to the value of
20 products, including by-products, extracted, or in the case of
21 extractors for hire, equal to the gross income of the business,
22 multiplied by the rate of 0.4235 percent from July 1, 2006, through
23 June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30,
24 2024.
25 (b) Until July 1, 2024, upon every person engaging within this
26 state in the business of manufacturing or processing for hire: (i)
27 Timber into timber products or wood products; or (ii) timber products
28 into other timber products or wood products; as to such persons the
29 amount of the tax with respect to the business is, in the case of
30 manufacturers, equal to the value of products, including by-products,
31 manufactured, or in the case of processors for hire, equal to the gross
32 income of the business, multiplied by the rate of 0.4235 percent from
33 July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1,
34 2007, through June 30, 2024.
35 (c) Until July 1, 2024, upon every person engaging within this
36 state in the business of selling at wholesale: (i) Timber extracted by
37 that person; (ii) timber products manufactured by that person from
38 timber or other timber products; or (iii) wood products manufactured by

1 that person from timber or timber products; as to such persons the
2 amount of the tax with respect to the business is equal to the gross
3 proceeds of sales of the timber, timber products, or wood products
4 multiplied by the rate of 0.4235 percent from July 1, 2006, through
5 June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30,
6 2024.

7 (d) Until July 1, 2024, upon every person engaging within this
8 state in the business of selling standing timber; as to such persons
9 the amount of the tax with respect to the business is equal to the
10 gross income of the business multiplied by the rate of 0.2904 percent.
11 For purposes of this subsection ((~~(12)~~)) <u>(11)</u>(d), "selling standing
12 timber" means the sale of timber apart from the land, where the buyer
13 is required to sever the timber within thirty months from the date of
14 the original contract, regardless of the method of payment for the
15 timber and whether title to the timber transfers before, upon, or after
16 severance.

17 (e) For purposes of this subsection, the following definitions
18 apply:

19 (i) "Biocomposite surface products" means surface material products
20 containing, by weight or volume, more than fifty percent recycled paper
21 and that also use nonpetroleum-based phenolic resin as a bonding agent.

22 (ii) "Paper and paper products" means products made of interwoven
23 cellulosic fibers held together largely by hydrogen bonding. "Paper
24 and paper products" includes newsprint; office, printing, fine, and
25 pressure-sensitive papers; paper napkins, towels, and toilet tissue;
26 kraft bag, construction, and other kraft industrial papers; paperboard,
27 liquid packaging containers, containerboard, corrugated, and solid-
28 fiber containers including linerboard and corrugated medium; and
29 related types of cellulosic products containing primarily, by weight or
30 volume, cellulosic materials. "Paper and paper products" does not
31 include books, newspapers, magazines, periodicals, and other printed
32 publications, advertising materials, calendars, and similar types of
33 printed materials.

34 (iii) "Recycled paper" means paper and paper products having fifty
35 percent or more of their fiber content that comes from postconsumer
36 waste. For purposes of this subsection ((~~(12)~~)) <u>(11)</u>(e)(iii),
37 "postconsumer waste" means a finished material that would normally be

disposed of as solid waste, having completed its life cycle as a consumer item.

(iv) "Timber" means forest trees, standing or down, on privately or publicly owned land. "Timber" does not include Christmas trees that are cultivated by agricultural methods or short-rotation hardwoods as defined in RCW 84.33.035.

(v) "Timber products" means:

(A) Logs, wood chips, sawdust, wood waste, and similar products obtained wholly from the processing of timber, short-rotation hardwoods as defined in RCW 84.33.035, or both;

(B) Pulp, including market pulp and pulp derived from recovered paper or paper products; and

(C) Recycled paper, but only when used in the manufacture of biocomposite surface products.

(vi) "Wood products" means paper and paper products; dimensional lumber; engineered wood products such as particleboard, oriented strand board, medium density fiberboard, and plywood; wood doors; wood windows; and biocomposite surface products.

(f) Except for small harvesters as defined in RCW 84.33.035, a person reporting under the tax rate provided in this subsection ((~~(12)~~)) (11) must file a complete annual survey with the department under RCW 82.32.--- (section 102, chapter 114 (SHB 3066), Laws of 2010).

((~~(13)~~)) (12) Upon every person engaging within this state in inspecting, testing, labeling, and storing canned salmon owned by another person, as to such persons, the amount of tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.484 percent.

((~~(14)~~)) (13)(a) Upon every person engaging within this state in the business of printing a newspaper, publishing a newspaper, or both, the amount of tax on such business is equal to the gross income of the business multiplied by the rate of 0.2904 percent.

(b) A person reporting under the tax rate provided in this subsection ((~~(14)~~)) (13) must file a complete annual report with the department under RCW 82.32.--- (section 103, chapter 114 (SHB 3066), Laws of 2010).

Sec. 507. RCW 82.04.250 and 2008 c 81 s 5 are each amended to read as follows:

(1) Upon every person engaging within this state in the business of making sales at retail, except persons taxable as retailers under other provisions of this chapter, as to such persons, the amount of tax with respect to such business ((~~shall be~~)) is equal to the gross proceeds of sales of the business, multiplied by the rate of 0.471 percent.

(2) Upon every person engaging within this state in the business of making sales at retail that are exempt from the tax imposed under chapter 82.08 RCW by reason of RCW 82.08.0261, 82.08.0262, or 82.08.0263, except persons taxable under RCW 82.04.260((~~(11)~~)) (10) or subsection (3) of this section, as to such persons, the amount of tax with respect to such business ((~~shall be~~)) is equal to the gross proceeds of sales of the business, multiplied by the rate of 0.484 percent.

(3) Upon every person classified by the federal aviation administration as a federal aviation regulation part 145 certificated repair station and that is engaging within this state in the business of making sales at retail that are exempt from the tax imposed under chapter 82.08 RCW by reason of RCW 82.08.0261, 82.08.0262, or 82.08.0263, as to such persons, the amount of tax with respect to such business ((~~shall be~~)) is equal to the gross proceeds of sales of the business, multiplied by the rate of .2904 percent.

Sec. 508. RCW 82.04.250 and 2010 1st sp.s. c 11 (SSB 6712) s 1 are each amended to read as follows:

(1) Upon every person engaging within this state in the business of making sales at retail, except persons taxable as retailers under other provisions of this chapter, as to such persons, the amount of tax with respect to such business is equal to the gross proceeds of sales of the business, multiplied by the rate of 0.471 percent.

(2) Upon every person engaging within this state in the business of making sales at retail that are exempt from the tax imposed under chapter 82.08 RCW by reason of RCW 82.08.0261, 82.08.0262, or 82.08.0263, except persons taxable under RCW 82.04.260((~~(11)~~)) (10) or subsection (3) of this section, as to such persons, the amount of tax with respect to such business is equal to the gross proceeds of sales of the business, multiplied by the rate of 0.484 percent.

(3) Until July 1, 2024, upon every person classified by the federal aviation administration as a federal aviation regulation part 145 certificated repair station and that is engaging within this state in the business of making sales at retail that are exempt from the tax imposed under chapter 82.08 RCW by reason of RCW 82.08.0261, 82.08.0262, or 82.08.0263, as to such persons, the amount of tax with respect to such business is equal to the gross proceeds of sales of the business, multiplied by the rate of .2904 percent.

Sec. 509. RCW 82.04.250 and 2007 c 54 s 5 are each amended to read as follows:

(1) Upon every person engaging within this state in the business of making sales at retail, except persons taxable as retailers under other provisions of this chapter, as to such persons, the amount of tax with respect to such business ((~~shall be~~)) is equal to the gross proceeds of sales of the business, multiplied by the rate of 0.471 percent.

(2) Upon every person engaging within this state in the business of making sales at retail that are exempt from the tax imposed under chapter 82.08 RCW by reason of RCW 82.08.0261, 82.08.0262, or 82.08.0263, except persons taxable under RCW 82.04.260((~~(11)~~)) (10), as to such persons, the amount of tax with respect to such business ((~~shall be~~)) is equal to the gross proceeds of sales of the business, multiplied by the rate of 0.484 percent.

Sec. 510. RCW 82.04.261 and 2007 c 54 s 7 and 2007 c 48 s 4 are each reenacted and amended to read as follows:

(1) In addition to the taxes imposed under RCW 82.04.260((~~(12)~~)) (11), a surcharge is imposed on those persons who are subject to any of the taxes imposed under RCW 82.04.260((~~(12)~~)) (11). Except as otherwise provided in this section, the surcharge is equal to 0.052 percent. The surcharge is added to the rates provided in RCW 82.04.260((~~(12)~~)) (11) (a), (b), (c), and (d). The surcharge and this section expire July 1, 2024.

(2) All receipts from the surcharge imposed under this section ((~~shall~~)) must be deposited into the forest and fish support account created in RCW 76.09.405.

(3)(a) The surcharge imposed under this section ((~~shall be~~)) is suspended if:

(i) Receipts from the surcharge total at least eight million dollars during any fiscal biennium; or

(ii) The office of financial management certifies to the department that the federal government has appropriated at least two million dollars for participation in forest and fish report-related activities by federally recognized Indian tribes located within the geographical boundaries of the state of Washington for any federal fiscal year.

(b)(i) The suspension of the surcharge under (a)(i) of this subsection (3) ((~~shall~~)) takes effect on the first day of the calendar month that is at least thirty days after the end of the month during which the department determines that receipts from the surcharge total at least eight million dollars during the fiscal biennium. The surcharge ((~~shall be~~)) is imposed again at the beginning of the following fiscal biennium.

(ii) The suspension of the surcharge under (a)(ii) of this subsection (3) ((~~shall~~)) takes effect on the later of the first day of October of any federal fiscal year for which the federal government appropriates at least two million dollars for participation in forest and fish report-related activities by federally recognized Indian tribes located within the geographical boundaries of the state of Washington, or the first day of a calendar month that is at least thirty days following the date that the office of financial management makes a certification to the department under subsection (5) of this section. The surcharge ((~~shall be~~)) is imposed again on the first day of the following July.

(4)(a) If, by October 1st of any federal fiscal year, the office of financial management certifies to the department that the federal government has appropriated funds for participation in forest and fish report-related activities by federally recognized Indian tribes located within the geographical boundaries of the state of Washington but the amount of the appropriation is less than two million dollars, the department ((~~shall~~)) must adjust the surcharge in accordance with this subsection.

(b) The department ((~~shall~~)) must adjust the surcharge by an amount that the department estimates will cause the amount of funds deposited into the forest and fish support account for the state fiscal year that begins July 1st and that includes the beginning of the federal fiscal year for which the federal appropriation is made, to be reduced by

twice the amount of the federal appropriation for participation in forest and fish report-related activities by federally recognized Indian tribes located within the geographical boundaries of the state of Washington.

(c) Any adjustment in the surcharge ((~~shall~~)) takes effect at the beginning of a calendar month that is at least thirty days after the date that the office of financial management makes the certification under subsection (5) of this section.

(d) The surcharge ((~~shall be~~)) is imposed again at the rate provided in subsection (1) of this section on the first day of the following state fiscal year unless the surcharge is suspended under subsection (3) of this section or adjusted for that fiscal year under this subsection.

(e) Adjustments of the amount of the surcharge by the department are final and ((~~shall~~)) may not be used to challenge the validity of the surcharge imposed under this section.

(f) The department ((~~shall~~)) must provide timely notice to affected taxpayers of the suspension of the surcharge or an adjustment of the surcharge.

(5) The office of financial management ((~~shall~~)) must make the certification to the department as to the status of federal appropriations for tribal participation in forest and fish report-related activities.

Sec. 511. RCW 82.04.298 and 2008 c 49 s 1 are each amended to read as follows:

(1) The amount of tax with respect to a qualified grocery distribution cooperative's sales of groceries or related goods for resale, excluding items subject to tax under ((~~RCW 82.04.260(4)~~)) section 502 of this act, to customer-owners of the grocery distribution cooperative is equal to the gross proceeds of sales of the grocery distribution cooperative multiplied by the rate of one and one-half percent.

(2) A qualified grocery distribution cooperative is allowed a deduction from the gross proceeds of sales of groceries or related goods for resale, excluding items subject to tax under ((~~RCW 82.04.260(4)~~)) section 502 of this act, to customer-owners of the grocery distribution cooperative that is equal to the portion of the

gross proceeds of sales for resale that represents the actual cost of the merchandise sold by the grocery distribution cooperative to customer-owners.

(3) The definitions in this subsection apply throughout this section unless the context clearly requires otherwise.

(a) "Grocery distribution cooperative" means an entity that sells groceries and related items to customer-owners of the grocery distribution cooperative and has customer-owners, in the aggregate, who own a majority of the outstanding ownership interests of the grocery distribution cooperative or of the entity controlling the grocery distribution cooperative. "Grocery distribution cooperative" includes an entity that controls a grocery distribution cooperative.

(b) "Qualified grocery distribution cooperative" means:

(i) A grocery distribution cooperative that has been determined by a court of record of the state of Washington to be not engaged in wholesaling or making sales at wholesale, within the meaning of RCW 82.04.270 or any similar provision of a municipal ordinance that imposes a tax on gross receipts, gross proceeds of sales, or gross income, with respect to purchases made by customer-owners, and subsequently changes its form of doing business to make sales at wholesale of groceries or related items to its customer-owners; or

(ii) A grocery distribution cooperative that has acquired substantially all of the assets of a grocery distribution cooperative described in (b)(i) of this subsection.

(c) "Customer-owner" means a person who has an ownership interest in a grocery distribution cooperative and purchases groceries and related items at wholesale from that grocery distribution cooperative.

(d) "Controlling" means holding fifty percent or more of the voting interests of an entity and having at least equal power to direct or cause the direction of the management and policies of the entity, whether through the ownership of voting securities, by contract, or otherwise.

Sec. 512. RCW 82.04.334 and 2007 c 48 s 3 are each amended to read as follows:

This chapter does not apply to any sale of standing timber excluded from the definition of "sale" in RCW 82.45.010(3). The definitions in RCW 82.04.260((~~(12)~~)) (11) apply to this section.

Sec. 513. RCW 82.04.440 and 2006 c 300 s 8 and 2006 c 84 s 6 are each reenacted and amended to read as follows:

(1) Every person engaged in activities that are subject to tax under two or more provisions of RCW 82.04.230 through 82.04.298, inclusive, ((~~shall be~~)) is taxable under each provision applicable to those activities.

(2) Persons taxable under RCW 82.04.2909(2), 82.04.250, 82.04.270, 82.04.294(2), or 82.04.260 (1)(b), (c), ((~~(4),~~)) or (d), (10), or (11), or ((~~(12)~~)) section 502(2) of this act with respect to selling products in this state, including those persons who are also taxable under RCW 82.04.261, ((~~shall be~~)) are allowed a credit against those taxes for any (a) manufacturing taxes paid with respect to the manufacturing of products so sold in this state, and/or (b) extracting taxes paid with respect to the extracting of products so sold in this state or ingredients of products so sold in this state. Extracting taxes taken as credit under subsection (3) of this section may also be taken under this subsection, if otherwise allowable under this subsection. The amount of the credit ((~~shall~~)) may not exceed the tax liability arising under this chapter with respect to the sale of those products.

(3) Persons taxable as manufacturers under RCW 82.04.240 or 82.04.260 (1)(b) or ((~~(12)~~)) (11), including those persons who are also taxable under RCW 82.04.261, ((~~shall be~~)) are allowed a credit against those taxes for any extracting taxes paid with respect to extracting the ingredients of the products so manufactured in this state. The amount of the credit ((~~shall~~)) may not exceed the tax liability arising under this chapter with respect to the manufacturing of those products.

(4) Persons taxable under RCW 82.04.230, 82.04.240, 82.04.2909(1), 82.04.294(1), 82.04.2404, or 82.04.260 (1), (2), ((~~(4),~~)) (10), or (11), or ((~~(12)~~)) section 502(1) of this act, including those persons who are also taxable under RCW 82.04.261, with respect to extracting or manufacturing products in this state ((~~shall be~~)) are allowed a credit against those taxes for any (i) gross receipts taxes paid to another state with respect to the sales of the products so extracted or manufactured in this state, (ii) manufacturing taxes paid with respect to the manufacturing of products using ingredients so extracted in this state, or (iii) manufacturing taxes paid with respect to manufacturing activities completed in another state for products so manufactured in

this state. The amount of the credit ((~~shall~~)) may not exceed the tax liability arising under this chapter with respect to the extraction or manufacturing of those products.

(5) For the purpose of this section:

(a) "Gross receipts tax" means a tax:

(i) Which is imposed on or measured by the gross volume of business, in terms of gross receipts or in other terms, and in the determination of which the deductions allowed would not constitute the tax an income tax or value added tax; and

(ii) Which is also not, pursuant to law or custom, separately stated from the sales price.

(b) "State" means (i) the state of Washington, (ii) a state of the United States other than Washington, or any political subdivision of such other state, (iii) the District of Columbia, and (iv) any foreign country or political subdivision thereof.

(c) "Manufacturing tax" means a gross receipts tax imposed on the act or privilege of engaging in business as a manufacturer, and includes (i) the taxes imposed in RCW 82.04.240, 82.04.2404, 82.04.2909(1), 82.04.260 (1), (2), ((~~(4),~~)) (10), and (11), ((~~and (12)~~)) section 502(1) of this act, and 82.04.294(1); (ii) the tax imposed under RCW 82.04.261 on persons who are engaged in business as a manufacturer; and (iii) similar gross receipts taxes paid to other states.

(d) "Extracting tax" means a gross receipts tax imposed on the act or privilege of engaging in business as an extractor, and includes (i) the tax imposed on extractors in RCW 82.04.230 and 82.04.260((~~(12)~~)) (11); (ii) the tax imposed under RCW 82.04.261 on persons who are engaged in business as an extractor; and (iii) similar gross receipts taxes paid to other states.

(e) "Business", "manufacturer", "extractor", and other terms used in this section have the meanings given in RCW 82.04.020 through 82.04.212, notwithstanding the use of those terms in the context of describing taxes imposed by other states.

Sec. 514. RCW 82.04.4463 and 2008 c 81 s 8 are each amended to read as follows:

(1) In computing the tax imposed under this chapter, a credit is

allowed for property taxes and leasehold excise taxes paid during the calendar year.

(2) The credit is equal to:

(a)(i)(A) Property taxes paid on buildings, and land upon which the buildings are located, constructed after December 1, 2003, and used exclusively in manufacturing commercial airplanes or components of such airplanes; and

(B) Leasehold excise taxes paid with respect to buildings constructed after January 1, 2006, the land upon which the buildings are located, or both, if the buildings are used exclusively in manufacturing commercial airplanes or components of such airplanes; and

(C) Property taxes or leasehold excise taxes paid on, or with respect to, buildings constructed after June 30, 2008, the land upon which the buildings are located, or both, and used exclusively for aerospace product development or in providing aerospace services, by persons not within the scope of (a)(i)(A) and (B) of this subsection (2) and are: (I) Engaged in manufacturing tooling specifically designed for use in manufacturing commercial airplanes or their components; or (II) taxable under RCW 82.04.290(3) or 82.04.250(3); or

(ii) Property taxes attributable to an increase in assessed value due to the renovation or expansion, after: (A) December 1, 2003, of a building used exclusively in manufacturing commercial airplanes or components of such airplanes; and (B) June 30, 2008, of buildings used exclusively for aerospace product development or in providing aerospace services, by persons not within the scope of (a)(ii)(A) of this subsection (2) and are: (I) Engaged in manufacturing tooling specifically designed for use in manufacturing commercial airplanes or their components; or (II) taxable under RCW 82.04.290(3) or 82.04.250(3); and

(b) An amount equal to:

(i)(A) Property taxes paid, by persons taxable under RCW 82.04.260((~~(11)~~)) (10)(a), on machinery and equipment exempt under RCW 82.08.02565 or 82.12.02565 and acquired after December 1, 2003;

(B) Property taxes paid, by persons taxable under RCW 82.04.260((~~(11)~~)) (10)(b), on machinery and equipment exempt under RCW 82.08.02565 or 82.12.02565 and acquired after June 30, 2008; or

(C) Property taxes paid, by persons taxable under RCW

((~~82.04.0250(3) [82.04.250(3)]~~)) 82.04.250(3) or 82.04.290(3), on computer hardware, computer peripherals, and software exempt under RCW 82.08.975 or 82.12.975 and acquired after June 30, 2008.

(ii) For purposes of determining the amount eligible for credit under (i)(A) and (B) of this subsection (2)(b), the amount of property taxes paid is multiplied by a fraction.

((~~(I)~~)) (A) The numerator of the fraction is the total taxable amount subject to the tax imposed under RCW 82.04.260((~~(11)~~)) (10) (a) or (b) on the applicable business activities of manufacturing commercial airplanes, components of such airplanes, or tooling specifically designed for use in the manufacturing of commercial airplanes or components of such airplanes.

((~~(II)~~)) (B) The denominator of the fraction is the total taxable amount subject to the tax imposed under all manufacturing classifications in chapter 82.04 RCW.

((~~(III)~~)) (C) For purposes of both the numerator and denominator of the fraction, the total taxable amount refers to the total taxable amount required to be reported on the person's returns for the calendar year before the calendar year in which the credit under this section is earned. The department may provide for an alternative method for calculating the numerator in cases where the tax rate provided in RCW 82.04.260((~~(11)~~)) (10) for manufacturing was not in effect during the full calendar year before the calendar year in which the credit under this section is earned.

((~~(IV)~~)) (D) No credit is available under (b)(i)(A) or (B) of this subsection (2) if either the numerator or the denominator of the fraction is zero. If the fraction is greater than or equal to nine-tenths, then the fraction is rounded to one.

((~~(V)~~)) (E) As used in ((~~(III)~~)) (b)(ii)(C) of this subsection (2)((~~(b)(ii)(C)~~)), "returns" means the tax returns for which the tax imposed under this chapter is reported to the department.

(3) The definitions in this subsection apply throughout this section, unless the context clearly indicates otherwise.

(a) "Aerospace product development" has the same meaning as provided in RCW 82.04.4461.

(b) "Aerospace services" has the same meaning given in RCW 82.08.975.

(c) "Commercial airplane" and "component" have the same meanings as provided in RCW 82.32.550.

(4) A credit earned during one calendar year may be carried over to be credited against taxes incurred in a subsequent calendar year, but may not be carried over a second year. No refunds may be granted for credits under this section.

(5) In addition to all other requirements under this title, a person taking the credit under this section must report as required under RCW 82.32.545.

(6) This section expires July 1, 2024.

Sec. 515. RCW 82.04.4463 and 2010 c 114 (SHB 3066) s 116 are each amended to read as follows:

(1) In computing the tax imposed under this chapter, a credit is allowed for property taxes and leasehold excise taxes paid during the calendar year.

(2) The credit is equal to:

(a)(i)(A) Property taxes paid on buildings, and land upon which the buildings are located, constructed after December 1, 2003, and used exclusively in manufacturing commercial airplanes or components of such airplanes; and

(B) Leasehold excise taxes paid with respect to buildings constructed after January 1, 2006, the land upon which the buildings are located, or both, if the buildings are used exclusively in manufacturing commercial airplanes or components of such airplanes; and

(C) Property taxes or leasehold excise taxes paid on, or with respect to, buildings constructed after June 30, 2008, the land upon which the buildings are located, or both, and used exclusively for aerospace product development, manufacturing tooling specifically designed for use in manufacturing commercial airplanes or their components, or in providing aerospace services, by persons not within the scope of (a)(i)(A) and (B) of this subsection (2) and are taxable under RCW 82.04.290(3), 82.04.260((~~(11)~~)) (10)(b), or 82.04.250(3); or

(ii) Property taxes attributable to an increase in assessed value due to the renovation or expansion, after: (A) December 1, 2003, of a building used exclusively in manufacturing commercial airplanes or components of such airplanes; and (B) June 30, 2008, of buildings used exclusively for aerospace product development, manufacturing tooling

specifically designed for use in manufacturing commercial airplanes or their components, or in providing aerospace services, by persons not within the scope of (a)(ii)(A) of this subsection (2) and are taxable under RCW 82.04.290(3), 82.04.260((~~(11)~~)) (10)(b), or 82.04.250(3); and

(b) An amount equal to:

(i)(A) Property taxes paid, by persons taxable under RCW 82.04.260((~~(11)~~)) (10)(a), on machinery and equipment exempt under RCW 82.08.02565 or 82.12.02565 and acquired after December 1, 2003;

(B) Property taxes paid, by persons taxable under RCW 82.04.260((~~(11)~~)) (10)(b), on machinery and equipment exempt under RCW 82.08.02565 or 82.12.02565 and acquired after June 30, 2008; or

(C) Property taxes paid, by persons taxable under RCW 82.04.250(3) or 82.04.290(3), on computer hardware, computer peripherals, and software exempt under RCW 82.08.975 or 82.12.975 and acquired after June 30, 2008.

(ii) For purposes of determining the amount eligible for credit under (i)(A) and (B) of this subsection (2)(b), the amount of property taxes paid is multiplied by a fraction.

(A) The numerator of the fraction is the total taxable amount subject to the tax imposed under RCW 82.04.260((~~(11)~~)) (10) (a) or (b) on the applicable business activities of manufacturing commercial airplanes, components of such airplanes, or tooling specifically designed for use in the manufacturing of commercial airplanes or components of such airplanes.

(B) The denominator of the fraction is the total taxable amount subject to the tax imposed under all manufacturing classifications in chapter 82.04 RCW.

(C) For purposes of both the numerator and denominator of the fraction, the total taxable amount refers to the total taxable amount required to be reported on the person's returns for the calendar year before the calendar year in which the credit under this section is earned. The department may provide for an alternative method for calculating the numerator in cases where the tax rate provided in RCW 82.04.260((~~(11)~~)) (10) for manufacturing was not in effect during the full calendar year before the calendar year in which the credit under this section is earned.

(D) No credit is available under (b)(i)(A) or (B) of this

subsection (2) if either the numerator or the denominator of the fraction is zero. If the fraction is greater than or equal to nine-tenths, then the fraction is rounded to one.

(E) As used in (b)(ii)(C) of this subsection (2)((~~(b)(ii)~~)), "returns" means the tax returns for which the tax imposed under this chapter is reported to the department.

(3) The definitions in this subsection apply throughout this section, unless the context clearly indicates otherwise.

(a) "Aerospace product development" has the same meaning as provided in RCW 82.04.4461.

(b) "Aerospace services" has the same meaning given in RCW 82.08.975.

(c) "Commercial airplane" and "component" have the same meanings as provided in RCW 82.32.550.

(4) A credit earned during one calendar year may be carried over to be credited against taxes incurred in a subsequent calendar year, but may not be carried over a second year. No refunds may be granted for credits under this section.

(5) In addition to all other requirements under this title, a person claiming the credit under this section must file a complete annual report with the department under RCW 82.32.--- (section 103, chapter 114 (SHB 3066), Laws of 2010).

(6) This section expires July 1, 2024.

Sec. 516. RCW 82.08.806 and 2009 c 461 s 5 are each amended to read as follows:

(1) The tax levied by RCW 82.08.020 does not apply to sales, to a printer or publisher, of computer equipment, including repair parts and replacement parts for such equipment, when the computer equipment is used primarily in the printing or publishing of any printed material, or to sales of or charges made for labor and services rendered in respect to installing, repairing, cleaning, altering, or improving the computer equipment. This exemption applies only to computer equipment not otherwise exempt under RCW 82.08.02565.

(2) A person taking the exemption under this section must keep records necessary for the department to verify eligibility under this section. This exemption is available only when the purchaser provides

the seller with an exemption certificate in a form and manner prescribed by the department. The seller ((~~shall~~)) must retain a copy of the certificate for the seller's files.

(3) The definitions in this subsection (3) apply throughout this section, unless the context clearly requires otherwise.

(a) "Computer" has the same meaning as in RCW 82.04.215.

(b) "Computer equipment" means a computer and the associated physical components that constitute a computer system, including monitors, keyboards, printers, modems, scanners, pointing devices, and other computer peripheral equipment, cables, servers, and routers. "Computer equipment" also includes digital cameras and computer software.

(c) "Computer software" has the same meaning as in RCW 82.04.215.

(d) "Primarily" means greater than fifty percent as measured by time.

(e) "Printer or publisher" means a person, as defined in RCW 82.04.030, who is subject to tax under RCW 82.04.260((~~(14)~~)) (13) or 82.04.280(1).

(4) "Computer equipment" does not include computer equipment that is used primarily for administrative purposes including but not limited to payroll processing, accounting, customer service, telemarketing, and collection. If computer equipment is used simultaneously for administrative and nonadministrative purposes, the administrative use ((~~shall~~)) must be disregarded during the period of simultaneous use for purposes of determining whether the computer equipment is used primarily for administrative purposes.

Sec. 517. RCW 82.32.550 and 2008 c 81 s 12 are each amended to read as follows:

(1)((~~(a) Chapter 1, Laws of 2003 2nd sp. sess. takes effect on the first day of the month in which the governor and a manufacturer of commercial airplanes sign a memorandum of agreement regarding an affirmative final decision to site a significant commercial airplane final assembly facility in Washington state. The department shall provide notice of the effective date of chapter 1, Laws of 2003 2nd sp. sess. to affected taxpayers, the legislature, and others as deemed appropriate by the department.~~

~~(b) Chapter 1, Laws of 2003 2nd sp. sess. is contingent upon the siting of a significant commercial airplane final assembly facility in the state of Washington. If a memorandum of agreement under subsection (1) of this section is not signed by June 30, 2005, chapter 1, Laws of 2003 2nd sp. sess. is null and void.~~

~~(c)(i) The rate in RCW 82.04.260(11)(a)(ii) takes effect July 1, 2007.~~

~~(ii) If on December 31, 2007, final assembly of a superefficient airplane has not begun in Washington state, the department shall provide notice of such to affected taxpayers, the legislature, and others as deemed appropriate by the department.~~

~~(2) The definitions in this subsection apply throughout this section.~~

~~(a)~~)) "Commercial airplane" has its ordinary meaning, which is an airplane certified by the federal aviation administration for transporting persons or property, and any military derivative of such an airplane.

((~~(b)~~)) (2) "Component" means a part or system certified by the federal aviation administration for installation or assembly into a commercial airplane.

((~~(c) "Final assembly of a superefficient airplane" means the activity of assembling an airplane from components parts necessary for its mechanical operation such that the finished commercial airplane is ready to deliver to the ultimate consumer.~~

~~(d) "Significant commercial airplane final assembly facility" means a location with the capacity to produce at least thirty-six superefficient airplanes a year.~~

~~(e) "Siting" means a final decision by a manufacturer to locate a significant commercial airplane final assembly facility in Washington state.~~

~~(f)~~)) (3) "Superefficient airplane" means a twin aisle airplane that carries between two hundred and three hundred fifty passengers, with a range of more than seven thousand two hundred nautical miles, a cruising speed of approximately mach .85, and that uses fifteen to twenty percent less fuel than other similar airplanes on the market.

Sec. 518. RCW 82.45.195 and 2007 c 48 s 7 are each amended to read as follows:

A sale of standing timber is exempt from tax under this chapter if the gross income from such sale is taxable under RCW 82.04.260((~~(12)~~)) (11)(d).

Sec. 519. RCW 35.102.150 and 2009 c 461 s 4 are each amended to read as follows:

Notwithstanding RCW 35.102.130, a city that imposes a business and occupation tax must allocate a person's gross income from the activities of printing, and of publishing newspapers, periodicals, or magazines, to the principal place in this state from which the taxpayer's business is directed or managed. As used in this section, the activities of printing, and of publishing newspapers, periodicals, or magazines are those activities to which the tax rates in RCW 82.04.260((~~(14)~~)) (13) and 82.04.280(1) apply.

Sec. 520. RCW 48.14.080 and 2009 c 535 s 1102 are each amended to read as follows:

(1) As to insurers, other than title insurers and taxpayers under RCW 48.14.0201, the taxes imposed by this title ((~~shall be~~)) are in lieu of all other taxes, except as otherwise provided in this section.

(2) Subsection (1) of this section does not apply with respect to:

(a) Taxes on real and tangible personal property;

(b) Excise taxes on the sale, purchase, use, or possession of (i) real property; (ii) tangible personal property; (iii) extended warranties; (iv) services, including digital automated services as defined in RCW 82.04.192; and (v) digital goods and digital codes as those terms are defined in RCW 82.04.192; and

(c) The tax imposed in RCW 82.04.260((~~(10)~~)) (9), regarding public and nonprofit hospitals.

(3) For the purposes of this section, the term "taxes" includes taxes imposed by the state or any county, city, town, municipal corporation, quasi-municipal corporation, or other political subdivision.

PART VI
Suspending the Sales and Use Tax Exemption for Livestock Nutrient Equipment and Facilities

Sec. 601. RCW 82.08.890 and 2009 c 469 s 601 are each amended to read as follows:

(1) The tax levied by RCW 82.08.020 does not apply to sales to eligible persons of:

(a) Qualifying livestock nutrient management equipment;

(b) Labor and services rendered in respect to installing, repairing, cleaning, altering, or improving qualifying livestock nutrient management equipment; and

(c)(i) Labor and services rendered in respect to repairing, cleaning, altering, or improving of qualifying livestock nutrient management facilities, or to tangible personal property that becomes an ingredient or component of qualifying livestock nutrient management facilities in the course of repairing, cleaning, altering, or improving of such facilities.

(ii) The exemption provided in this subsection (1)(c) does not apply to the sale of or charge made for: (A) Labor and services rendered in respect to the constructing of new, or replacing previously existing, qualifying livestock nutrient management facilities; or (B) tangible personal property that becomes an ingredient or component of qualifying livestock nutrient management facilities during the course of constructing new, or replacing previously existing, qualifying livestock nutrient management facilities.

(2) The exemption provided in subsection (1) of this section applies to sales made after the livestock nutrient management plan is: (a) Certified under chapter 90.64 RCW; (b) approved as part of the permit issued under chapter 90.48 RCW; or (c) approved as required under subsection (4)(c)(iii) of this section.

(3)(a) The department of revenue must provide an exemption certificate to an eligible person upon application by that person. The department of agriculture must provide a list of eligible persons, as defined in subsection (4)(c)(i) and (ii) of this section, to the department of revenue. Conservation districts must maintain lists of eligible persons as defined in subsection (4)(c)(iii) of this section to allow the department of revenue to verify eligibility. The application must be in a form and manner prescribed by the department and must contain information regarding the location of the dairy or animal feeding operation and other information the department may require.

1 (b) A person claiming an exemption under this section must keep
2 records necessary for the department to verify eligibility under this
3 section. The exemption is available only when the buyer provides the
4 seller with an exemption certificate in a form and manner prescribed by
5 the department. The seller must retain a copy of the certificate for
6 the seller's files.
7 (4) The definitions in this subsection apply to this section and
8 RCW 82.12.890 unless the context clearly requires otherwise:
9 (a) "Animal feeding operation" means a lot or facility, other than
10 an aquatic animal production facility, where the following conditions
11 are met:
12 (i) Animals, other than aquatic animals, have been, are, or will be
13 stabled or confined and fed or maintained for a total of forty-five
14 days or more in any twelve-month period; and
15 (ii) Crops, vegetation, forage growth, or postharvest residues are
16 not sustained in the normal growing season over any portion of the lot
17 or facility.
18 (b) "Conservation district" means a subdivision of state government
19 organized under chapter 89.08 RCW.
20 (c) "Eligible person" means a person: (i) Licensed to produce milk
21 under chapter 15.36 RCW who has a certified dairy nutrient management
22 plan, as required by chapter 90.64 RCW; (ii) who owns an animal feeding
23 operation and has a permit issued under chapter 90.48 RCW; or (iii) who
24 owns an animal feeding operation and has a nutrient management plan
25 approved by a conservation district as meeting natural resource
26 conservation service field office technical guide standards and who
27 possesses an exemption certificate under RCW 82.08.855.
28 (d) "Handling and treatment of livestock manure" means the
29 activities of collecting, storing, moving, or transporting livestock
30 manure, separating livestock manure solids from liquids, or applying
31 livestock manure to the agricultural lands of an eligible person other
32 than through the use of pivot or linear type traveling irrigation
33 systems.
34 (e) "Permit" means either a state waste discharge permit or a
35 national pollutant discharge elimination system permit, or both.
36 (f) "Qualifying livestock nutrient management equipment" means the
37 following tangible personal property for exclusive use in the handling
38 and treatment of livestock manure, including repair and replacement

parts for such equipment: (i) Aerators; (ii) agitators; (iii) augers; (iv) conveyers; (v) gutter cleaners; (vi) hard-hose reel traveler irrigation systems; (vii) lagoon and pond liners and floating covers; (viii) loaders; (ix) manure composting devices; (x) manure spreaders; (xi) manure tank wagons; (xii) manure vacuum tanks; (xiii) poultry house cleaners; (xiv) poultry house flame sterilizers; (xv) poultry house washers; (xvi) poultry litter saver machines; (xvii) pipes; (xviii) pumps; (xix) scrapers; (xx) separators; (xxi) slurry injectors and hoses; and (xxii) wheelbarrows, shovels, and pitchforks.

(g) "Qualifying livestock nutrient management facilities" means the following structures and facilities for exclusive use in the handling and treatment of livestock manure: (i) Flush systems; (ii) lagoons; (iii) liquid livestock manure storage structures, such as concrete tanks or glass-lined steel tanks; and (iv) structures used solely for the dry storage of manure, including roofed stacking facilities.

(5) The exemption under this section does not apply to sales made from the effective date of this section through June 30, 2013.

Sec. 602. RCW 82.12.890 and 2009 c 469 s 602 are each amended to read as follows:

(1) The provisions of this chapter do not apply with respect to the use by an eligible person of:

(a) Qualifying livestock nutrient management equipment;

(b) Labor and services rendered in respect to installing, repairing, cleaning, altering, or improving qualifying livestock nutrient management equipment; and

(c)(i) Tangible personal property that becomes an ingredient or component of qualifying livestock nutrient management facilities in the course of repairing, cleaning, altering, or improving of such facilities.

(ii) The exemption provided in this subsection (1)(c) does not apply to the use of tangible personal property that becomes an ingredient or component of qualifying livestock nutrient management facilities during the course of constructing new, or replacing previously existing, qualifying livestock nutrient management facilities.

(2)(a) To be eligible, the equipment and facilities must be used

exclusively for activities necessary to maintain a livestock nutrient management plan.

(b) The exemption applies to the use of tangible personal property and labor and services made after the livestock nutrient management plan is: (i) Certified under chapter 90.64 RCW; (ii) approved as part of the permit issued under chapter 90.48 RCW; or (iii) approved as required under RCW 82.08.890(4)(c)(iii).

(3) The exemption certificate and recordkeeping requirements of RCW 82.08.890 apply to this section. The definitions in RCW 82.08.890 apply to this section.

(4) The exemption under this section does not apply to the use of tangible personal property and services if first use of the property or services in this state occurs from the effective date of this section through June 30, 2013.

PART VII

Ending the Preferential Business and Occupation Tax Treatment Received by Directors of Corporations

NEW SECTION. **Sec. 701.** (1) In adopting the state's business and occupation tax, the legislature intended to tax virtually all business activities carried on within the state. See Simpson Inv. Co. v. Dep't of Revenue, 141 Wn.2d 139, 149 (2000). The legislature recognizes that the business and occupation tax applies to all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly, unless a specific exemption applies.

(2) One of the major business and occupation tax exemptions is provided in RCW 82.04.360 for income earned as an employee or servant as distinguished from income earned as an independent contractor. The legislature's intent in providing this exemption was to exempt employee wages from the business and occupation tax but not to exempt income earned as an independent contractor.

(3) The legislature finds that corporate directors are not employees or servants of the corporation whose board they serve on and therefore are not entitled to a business and occupation tax exemption under RCW 82.04.360. The legislature further finds that there are no

business and occupation tax exemptions for compensation received for serving as a member of a corporation's board of directors.

(4) The legislature also finds that there is a widespread misunderstanding among corporate directors that the business and occupation tax does not apply to the compensation they receive for serving as a director of a corporation. It is the legislature's expectation that the department of revenue will take appropriate measures to ensure that corporate directors understand and comply with their business and occupation tax obligations with respect to their director compensation. However, because of the widespread misunderstanding by corporate directors of their liability for business and occupation tax on director compensation, the legislature finds that it is appropriate in this unique situation to provide limited relief against the retroactive assessment of business and occupation taxes on corporate director compensation.

(5) The legislature also reaffirms its intent that all income of all independent contractors is subject to business and occupation tax unless specifically exempt under the Constitution or laws of this state or the United States.

Sec. 702. RCW 82.04.360 and 2010 c 106 (E2SHB 1597) s 207 are each amended to read as follows:

(1) This chapter does not apply to any person in respect to his or her employment in the capacity of an employee or servant as distinguished from that of an independent contractor. For the purposes of this section, the definition of employee ((~~shall~~)) includes those persons that are defined in section 3121(d)(3)(B) of the federal internal revenue code of 1986, as amended through January 1, 1991.

(2) Until the effective date of this section, this chapter does not apply to amounts received by an individual from a corporation as compensation for serving as a member of that corporation's board of directors. Beginning on the effective date of this section, such amounts are taxable under RCW 82.04.290(2).

(3) A booth renter is an independent contractor for purposes of this chapter. For purposes of this ((~~sub~~))section, "booth renter" means any person who:

(a) Performs cosmetology, barbering, esthetics, or manicuring services for which a license is required under chapter 18.16 RCW; and

(b) Pays a fee for the use of salon or shop facilities and receives no compensation or other consideration from the owner of the salon or shop for the services performed.

PART VIII
Tax Debts

Sec. 801. RCW 82.32.145 and 1995 c 318 s 2 are each amended to read as follows:

(1) ((~~Upon termination, dissolution, or abandonment of a corporate or limited liability company business, any officer, member, manager, or other person having control or supervision of retail sales tax funds collected and held in trust under RCW 82.08.050, or who is charged with the responsibility for the filing of returns or the payment of retail sales tax funds collected and held in trust under RCW 82.08.050, shall be personally liable for any unpaid taxes and interest and penalties on those taxes, if such officer or other person wilfully fails to pay or to cause to be paid any taxes due from the corporation pursuant to chapter 82.08 RCW. For the purposes of this section, any retail sales taxes that have been paid but not collected shall be deductible from the retail sales taxes collected but not paid.~~

~~For purposes of this subsection "wilfully fails to pay or to cause to be paid" means that the failure was the result of an intentional, conscious, and voluntary course of action.~~

~~(2) The officer, member or manager, or other person shall be liable only for taxes collected which~~)) Whenever the department has issued a warrant under RCW 82.32.210 for the collection of unpaid retail sales tax funds collected and held in trust under RCW 82.08.050 from a limited liability business entity and that business entity has been terminated, dissolved, or abandoned, or is insolvent, the department may pursue collection of the entity's unpaid sales taxes, including penalties and interest on those taxes, against any or all of the responsible individuals. For purposes of this subsection, "insolvent" means the condition that results when the sum of the entity's debts exceeds the fair market value of its assets. The department may presume that an entity is insolvent if the entity refuses to disclose to the department the nature of its assets and liabilities.

(2) Personal liability under this section may be imposed for state and local sales taxes.

(3)(a) For a responsible individual who is the current or a former chief executive or chief financial officer, liability under this section applies regardless of fault or whether the individual was or should have been aware of the unpaid sales tax liability of the limited liability business entity.

(b) For any other responsible individual, liability under this section applies only if he or she willfully fails to pay or to cause to be paid to the department the sales taxes due from the limited liability business entity.

(4)(a) Except as provided in this subsection (4)(a), a responsible individual who is the current or a former chief executive or chief financial officer is liable under this section only for sales tax liability accrued during the period that he or she was the chief executive or chief financial officer. However, if the responsible individual had the responsibility or duty to remit payment of the limited liability business entity's sales taxes to the department during any period of time that the person was not the chief executive or chief financial officer, that individual is also liable for sales tax liability that became due during the period that he or she had the duty to remit payment of the limited liability business entity's taxes to the department but was not the chief executive or chief financial officer.

(b) All other responsible individuals are liable under this section only for sales tax liability that became due during the period he or she had the ((~~control, supervision,~~)) responsibility((~~,~~)) or duty to ((~~act for the corporation described in subsection (1) of this section, plus interest and penalties on those taxes.~~

~~(3)~~)) remit payment of the limited liability business entity's taxes to the department.

(5) Persons ((~~liable under~~)) described in subsection ((~~(1)~~)) (3)(b) of this section are exempt from liability under this section in situations where nonpayment of the ((~~retail sales tax funds held in trust~~)) limited liability business entity's sales taxes is due to reasons beyond their control as determined by the department by rule.

((~~(4)~~)) (6) Any person having been issued a notice of assessment

under this section is entitled to the appeal procedures under RCW 82.32.160, 82.32.170, 82.32.180, 82.32.190, and 82.32.200.

((~~(5) This section applies only in situations where the department has determined that there is no reasonable means of collecting the retail sales tax funds held in trust directly from the corporation.~~

~~(6)~~)) (7) This section does not relieve the ((~~corporation or~~)) limited liability ((~~company~~)) business entity of ((~~other tax liabilities~~)) its sales tax liability or otherwise impair other tax collection remedies afforded by law.

((~~(7)~~)) (8) Collection authority and procedures prescribed in this chapter apply to collections under this section.

(9) The definitions in this subsection apply throughout this section unless the context clearly requires otherwise.

(a) "Chief executive" means: The president of a corporation; or for other entities or organizations other than corporations or if the corporation does not have a president as one of its officers, the highest ranking executive manager or administrator in charge of the management of the company or organization.

(b) "Chief financial officer" means: The treasurer of a corporation; or for entities or organizations other than corporations or if a corporation does not have a treasurer as one of its officers, the highest senior manager who is responsible for overseeing the financial activities of the entire company or organization.

(c) "Limited liability business entity" means a type of business entity that generally shields its owners from personal liability for the debts, obligations, and liabilities of the entity, or a business entity that is managed or owned in whole or in part by an entity that generally shields its owners from personal liability for the debts, obligations, and liabilities of the entity. Limited liability business entities include corporations, limited liability companies, limited liability partnerships, trusts, general partnerships and joint ventures in which one or more of the partners or parties are also limited liability business entities, and limited partnerships in which one or more of the general partners are also limited liability business entities.

(d) "Manager" has the same meaning as in RCW 25.15.005.

(e) "Member" has the same meaning as in RCW 25.15.005, except that

the term only includes members of member-managed limited liability companies.

(f) "Officer" means any officer or assistant officer of a corporation, including the president, vice-president, secretary, and treasurer.

(g)(i) "Responsible individual" includes any current or former officer, manager, member, partner, or trustee of a limited liability business entity with an unpaid tax warrant issued by the department.

(ii) "Responsible individual" also includes any current or former employee or other individual, but only if the individual had the responsibility or duty to remit payment of the limited liability business entity's unpaid sales tax liability reflected in a tax warrant issued by the department.

(iii) Whenever any taxpayer has one or more limited liability business entities as a member, manager, or partner, "responsible individual" also includes any current and former officers, members, or managers of the limited liability business entity or entities or of any other limited liability business entity involved directly in the management of the taxpayer. For purposes of this subsection (9)(g)(iii), "taxpayer" means a limited liability business entity with an unpaid tax warrant issued against it by the department.

(h) "Willfully fails to pay or to cause to be paid" means that the failure was the result of an intentional, conscious, and voluntary course of action.

PART IX
Repealing the Sales and Use Tax Exemptions for Bottled Water and Candy

Sec. 901. RCW 82.08.0293 and 2009 c 483 s 2 are each amended to read as follows:

(1) The tax levied by RCW 82.08.020 ((~~shall~~)) does not apply to sales of food and food ingredients. "Food and food ingredients" means substances, whether in liquid, concentrated, solid, frozen, dried, or dehydrated form, that are sold for ingestion or chewing by humans and are consumed for their taste or nutritional value. "Food and food ingredients" does not include:

1 (a) "Alcoholic beverages," which means beverages that are suitable
2 for human consumption and contain one-half of one percent or more of
3 alcohol by volume; and
4 (b) "Tobacco," which means cigarettes, cigars, chewing or pipe
5 tobacco, or any other item that contains tobacco.
6 (2) Until July 1, 2013, the exemption of "food and food
7 ingredients" provided for in subsection (1) of this section ((~~shall~~))
8 does not apply to prepared food, soft drinks, bottled water, candy, or
9 dietary supplements. Beginning July 1, 2013, the exemption of "food
10 and food ingredients" provided for in subsection (1) of this section
11 does not apply to prepared food, soft drinks, candy, or dietary
12 supplements.
13 (a) "Prepared food" means:
14 (i) Food sold in a heated state or heated by the seller;
15 (ii) Food sold with eating utensils provided by the seller,
16 including plates, knives, forks, spoons, glasses, cups, napkins, or
17 straws. A plate does not include a container or packaging used to
18 transport the food; or
19 (iii) Two or more food ingredients mixed or combined by the seller
20 for sale as a single item, except:
21 (A) Food that is only cut, repackaged, or pasteurized by the
22 seller; or
23 (B) Raw eggs, fish, meat, poultry, and foods containing these raw
24 animal foods requiring cooking by the consumer as recommended by the
25 federal food and drug administration in chapter 3, part 401.11 of The
26 Food Code, published by the food and drug administration, as amended or
27 renumbered as of January 1, 2003, so as to prevent foodborne illness.
28 (b) "Prepared food" does not include the following food or food
29 ingredients, if the food or food ingredients are sold without eating
30 utensils provided by the seller:
31 (i) Food sold by a seller whose proper primary North American
32 industry classification system (NAICS) classification is manufacturing
33 in sector 311, except subsector 3118 (bakeries), as provided in the
34 "North American industry classification system--United States, 2002";
35 (ii) Food sold in an unheated state by weight or volume as a single
36 item; or
37 (iii) Bakery items. The term "bakery items" includes bread, rolls,

1 buns, biscuits, bagels, croissants, pastries, donuts, Danish, cakes,
2 tortes, pies, tarts, muffins, bars, cookies, or tortillas.
3 (c) "Soft drinks" means nonalcoholic beverages that contain natural
4 or artificial sweeteners. Soft drinks do not include beverages that
5 contain: Milk or milk products; soy, rice, or similar milk
6 substitutes; or greater than fifty percent of vegetable or fruit juice
7 by volume.
8 (d) "Dietary supplement" means any product, other than tobacco,
9 intended to supplement the diet that:
10 (i) Contains one or more of the following dietary ingredients:
11 (A) A vitamin;
12 (B) A mineral;
13 (C) An herb or other botanical;
14 (D) An amino acid;
15 (E) A dietary substance for use by humans to supplement the diet by
16 increasing the total dietary intake; or
17 (F) A concentrate, metabolite, constituent, extract, or combination
18 of any ingredient described in this subsection;
19 (ii) Is intended for ingestion in tablet, capsule, powder, softgel,
20 gelcap, or liquid form, or if not intended for ingestion in such form,
21 is not represented as conventional food and is not represented for use
22 as a sole item of a meal or of the diet; and
23 (iii) Is required to be labeled as a dietary supplement,
24 identifiable by the "supplement facts" box found on the label as
25 required pursuant to 21 C.F.R. Sec. 101.36, as amended or renumbered as
26 of January 1, 2003.
27 (e) "Candy" means a preparation of sugar, honey, or other natural
28 or artificial sweeteners in combination with chocolate, fruits, nuts,
29 or other ingredients or flavorings in the form of bars, drops, or
30 pieces. "Candy" does not include any preparation containing flour and
31 does not require refrigeration.
32 (f) "Bottled water" means water that is placed in a sealed
33 container or package for human consumption. Bottled water is calorie
34 free and does not contain sweeteners or other additives except that it
35 may contain: (i) Antimicrobial agents; (ii) fluoride; (iii)
36 carbonation; (iv) vitamins, minerals, and electrolytes; (v) oxygen;
37 (vi) preservatives; and (vii) only those flavors, extracts, or essences

derived from a spice or fruit. "Bottled water" includes water that is delivered to the buyer in a reusable container that is not sold with the water.

(3) Notwithstanding anything in this section to the contrary, the exemption of "food and food ingredients" provided in this section ((~~shall apply~~)) applies to food and food ingredients that are furnished, prepared, or served as meals:

(a) Under a state administered nutrition program for the aged as provided for in the older Americans act (P.L. 95-478 Title III) and RCW 74.38.040(6);

(b) That are provided to senior citizens, individuals with disabilities, or low-income persons by a not-for-profit organization organized under chapter 24.03 or 24.12 RCW; or

(c) That are provided to residents, sixty-two years of age or older, of a qualified low-income senior housing facility by the lessor or operator of the facility. The sale of a meal that is billed to both spouses of a marital community or both domestic partners of a domestic partnership meets the age requirement in this subsection (3)(c) if at least one of the spouses or domestic partners is at least sixty-two years of age. For purposes of this subsection, "qualified low-income senior housing facility" means a facility:

(i) That meets the definition of a qualified low-income housing project under ((~~Title~~)) 26 U.S.C. Sec. 42 of the federal internal revenue code, as existing on August 1, 2009;

(ii) That has been partially funded under ((~~Title~~)) 42 U.S.C. Sec. 1485 ((~~of the federal internal revenue code~~)); and

(iii) For which the lessor or operator has at any time been entitled to claim a federal income tax credit under ((~~Title~~)) 26 U.S.C. Sec. 42 of the federal internal revenue code.

(4)(a) Subsection (1) of this section notwithstanding, the retail sale of food and food ingredients is subject to sales tax under RCW 82.08.020 if the food and food ingredients are sold through a vending machine, and in this case the selling price for purposes of RCW 82.08.020 is fifty-seven percent of the gross receipts.

(b) This subsection (4) does not apply to hot prepared food and food ingredients, other than food and food ingredients which are heated after they have been dispensed from the vending machine.

1 (c) For tax collected under this subsection (4), the requirements
2 that the tax be collected from the buyer and that the amount of tax be
3 stated as a separate item are waived.

4 **Sec. 902.** RCW 82.08.0293 and 2010 c 106 (E2SHB 1597) s 216 are
5 each amended to read as follows:
6 (1) The tax levied by RCW 82.08.020 does not apply to sales of food
7 and food ingredients. "Food and food ingredients" means substances,
8 whether in liquid, concentrated, solid, frozen, dried, or dehydrated
9 form, that are sold for ingestion or chewing by humans and are consumed
10 for their taste or nutritional value. "Food and food ingredients" does
11 not include:
12 (a) "Alcoholic beverages," which means beverages that are suitable
13 for human consumption and contain one-half of one percent or more of
14 alcohol by volume; and
15 (b) "Tobacco," which means cigarettes, cigars, chewing or pipe
16 tobacco, or any other item that contains tobacco.
17 (2) Until July 1, 2013, the exemption of "food and food
18 ingredients" provided for in subsection (1) of this section does not
19 apply to prepared food, soft drinks, bottled water, candy, or dietary
20 supplements. Beginning July 1, 2013, the exemption of "food and food
21 ingredients" provided for in subsection (1) of this section does not
22 apply to prepared food, soft drinks, candy, or dietary supplements.
23 For purposes of this subsection, the following definitions apply:
24 (a) "Dietary supplement" means any product, other than tobacco,
25 intended to supplement the diet that:
26 (i) Contains one or more of the following dietary ingredients:
27 (A) A vitamin;
28 (B) A mineral;
29 (C) An herb or other botanical;
30 (D) An amino acid;
31 (E) A dietary substance for use by humans to supplement the diet by
32 increasing the total dietary intake; or
33 (F) A concentrate, metabolite, constituent, extract, or combination
34 of any ingredient described in this subsection;
35 (ii) Is intended for ingestion in tablet, capsule, powder, softgel,
36 gelcap, or liquid form, or if not intended for ingestion in such form,

is not represented as conventional food and is not represented for use as a sole item of a meal or of the diet; and

(iii) Is required to be labeled as a dietary supplement, identifiable by the "supplement facts" box found on the label as required pursuant to 21 C.F.R. Sec. 101.36, as amended or renumbered as of January 1, 2003.

(b)(i) "Prepared food" means:

(A) Food sold in a heated state or heated by the seller;

(B) Food sold with eating utensils provided by the seller, including plates, knives, forks, spoons, glasses, cups, napkins, or straws. A plate does not include a container or packaging used to transport the food; or

(C) Two or more food ingredients mixed or combined by the seller for sale as a single item, except:

(I) Food that is only cut, repackaged, or pasteurized by the seller; or

(II) Raw eggs, fish, meat, poultry, and foods containing these raw animal foods requiring cooking by the consumer as recommended by the federal food and drug administration in chapter 3, part 401.11 of The Food Code, published by the food and drug administration, as amended or renumbered as of January 1, 2003, so as to prevent foodborne illness.

(ii) "Prepared food" does not include the following food or food ingredients, if the food or food ingredients are sold without eating utensils provided by the seller:

(A) Food sold by a seller whose proper primary North American industry classification system (NAICS) classification is manufacturing in sector 311, except subsector 3118 (bakeries), as provided in the "North American industry classification system--United States, 2002";

(B) Food sold in an unheated state by weight or volume as a single item; or

(C) Bakery items. The term "bakery items" includes bread, rolls, buns, biscuits, bagels, croissants, pastries, donuts, Danish, cakes, tortes, pies, tarts, muffins, bars, cookies, or tortillas.

(c) "Soft drinks" means nonalcoholic beverages that contain natural or artificial sweeteners. Soft drinks do not include beverages that contain: Milk or milk products; soy, rice, or similar milk substitutes; or greater than fifty percent of vegetable or fruit juice by volume.

(d) "Candy" means a preparation of sugar, honey, or other natural or artificial sweeteners in combination with chocolate, fruits, nuts, or other ingredients or flavorings in the form of bars, drops, or pieces. "Candy" does not include any preparation containing flour and does not require refrigeration.

(e) "Bottled water" means water that is placed in a sealed container or package for human consumption. Bottled water is calorie free and does not contain sweeteners or other additives except that it may contain: (i) Antimicrobial agents; (ii) fluoride; (iii) carbonation; (iv) vitamins, minerals, and electrolytes; (v) oxygen; (vi) preservatives; and (vii) only those flavors, extracts, or essences derived from a spice or fruit. "Bottled water" includes water that is delivered to the buyer in a reusable container that is not sold with the water.

(3) Notwithstanding anything in this section to the contrary, the exemption of "food and food ingredients" provided in this section applies to food and food ingredients that are furnished, prepared, or served as meals:

(a) Under a state administered nutrition program for the aged as provided for in the older Americans act (P.L. 95-478 Title III) and RCW 74.38.040(6);

(b) That are provided to senior citizens, individuals with disabilities, or low-income persons by a not-for-profit organization organized under chapter 24.03 or 24.12 RCW; or

(c) That are provided to residents, sixty-two years of age or older, of a qualified low-income senior housing facility by the lessor or operator of the facility. The sale of a meal that is billed to both spouses of a marital community or both domestic partners of a domestic partnership meets the age requirement in this subsection (3)(c) if at least one of the spouses or domestic partners is at least sixty-two years of age. For purposes of this subsection, "qualified low-income senior housing facility" means a facility:

(i) That meets the definition of a qualified low-income housing project under 26 U.S.C. Sec. 42 of the federal internal revenue code, as existing on August 1, 2009;

(ii) That has been partially funded under 42 U.S.C. Sec. 1485 ((~~of the federal internal revenue code~~)); and

(iii) For which the lessor or operator has at any time been entitled to claim a federal income tax credit under 26 U.S.C. Sec. 42 of the federal internal revenue code.

(4)(a) Subsection (1) of this section notwithstanding, the retail sale of food and food ingredients is subject to sales tax under RCW 82.08.020 if the food and food ingredients are sold through a vending machine. Except as provided in (b) of this subsection, the selling price of food and food ingredients sold through a vending machine for purposes of RCW 82.08.020 is fifty-seven percent of the gross receipts.

(b) For soft drinks and hot prepared food and food ingredients, other than food and food ingredients which are heated after they have been dispensed from the vending machine, the selling price is the total gross receipts of such sales divided by the sum of one plus the sales tax rate expressed as a decimal.

(c) For tax collected under this subsection (4), the requirements that the tax be collected from the buyer and that the amount of tax be stated as a separate item are waived.

Sec. 903. RCW 82.12.0293 and 2009 c 483 s 4 are each amended to read as follows:

(1) The provisions of this chapter ((~~shall~~)) do not apply in respect to the use of food and food ingredients for human consumption. "Food and food ingredients" has the same meaning as in RCW 82.08.0293.

(2) Until July 1, 2013, the exemption of "food and food ingredients" provided for in subsection (1) of this section ((~~shall~~)) does not apply to prepared food, soft drinks, bottled water, candy, or dietary supplements. Beginning July 1, 2013, the exemption of "food and food ingredients" provided for in subsection (1) of this section does not apply to prepared food, soft drinks, candy, or dietary supplements. "Prepared food," "soft drinks," ((~~and~~)) "dietary supplements," "candy," and "bottled water" have the same meanings as in RCW 82.08.0293.

(3) Notwithstanding anything in this section to the contrary, the exemption of "food and food ingredients" provided in this section ((~~shall~~)) apply to food and food ingredients which are furnished, prepared, or served as meals:

(a) Under a state administered nutrition program for the aged as

provided for in the older Americans act (P.L. 95-478 Title III) and RCW 74.38.040(6);

(b) Which are provided to senior citizens, individuals with disabilities, or low-income persons by a not-for-profit organization organized under chapter 24.03 or 24.12 RCW; or

(c) That are provided to residents, sixty-two years of age or older, of a qualified low-income senior housing facility by the lessor or operator of the facility. The sale of a meal that is billed to both spouses of a marital community or both domestic partners of a domestic partnership meets the age requirement in this subsection (3)(c) if at least one of the spouses or domestic partners is at least sixty-two years of age. For purposes of this subsection, "qualified low-income senior housing facility" has the same meaning as in RCW 82.08.0293.

NEW SECTION. **Sec. 904.** A new section is added to chapter 82.08 RCW to read as follows:

(1) Subject to the conditions in this section, the tax levied by RCW 82.08.020 does not apply to sales of bottled water for human use dispensed or to be dispensed to patients, pursuant to a prescription for use in the cure, mitigation, treatment, or prevention of disease or other medical condition. For purposes of this section, "prescription" means an order, formula, or recipe issued in any form of oral, written, electronic, or other means of transmission by a duly licensed practitioner authorized by the laws of this state to prescribe.

(2) Except for sales of bottled water delivered to the buyer in a reusable container that is not sold with the water, sellers must collect tax on sales subject to this exemption. Any buyer that has paid at least twenty-five dollars in state and local sales taxes on purchases of bottled water subject to this exemption may apply for a refund of the taxes directly from the department in a form and manner prescribed by the department. The department must deny any refund application if the amount of the refund requested is less than twenty-five dollars. No refund may be made for taxes paid more than four years after the end of the calendar year in which the tax was paid to the seller.

(3) The provisions of RCW 82.32.060 apply to refunds authorized under this section.

(4) With respect to sales of bottled water delivered to the buyer in a reusable container that is not sold with the water, buyers claiming the exemption provided in this section must provide the seller with an exemption certificate in a form and manner prescribed by the department. The seller must retain a copy of the certificate for the seller's files.

NEW SECTION. **Sec. 905.** A new section is added to chapter 82.12 RCW to read as follows:

The provisions of this chapter do not apply in respect to the use of bottled water for human use dispensed or to be dispensed to patients, pursuant to a prescription for use in the cure, mitigation, treatment, or prevention of disease or medical condition. "Prescription" has the same meaning as in section 904 of this act.

NEW SECTION. **Sec. 906.** A new section is added to chapter 82.08 RCW to read as follows:

(1) Subject to the conditions in this section, the tax levied by RCW 82.08.020 does not apply to sales of bottled water for human use to persons who do not otherwise have a readily available source of potable water.

(2) Except for sales of bottled water delivered to the buyer in a reusable container that is not sold with the water, sellers must collect tax on sales subject to this exemption. Any buyer that has paid at least twenty-five dollars in state and local sales taxes on purchases of bottled water subject to this exemption may apply for a refund of the taxes directly from the department in a form and manner prescribed by the department. The department must deny any refund application if the amount of the refund requested is less than twenty-five dollars. No refund may be made for taxes paid more than four years after the end of the calendar year in which the tax was paid to the seller.

(3) The provisions of RCW 82.32.060 apply to refunds authorized under this section.

(4)(a) With respect to sales of bottled water delivered to the buyer in a reusable container that is not sold with the water, buyers claiming the exemption provided in this section must provide the seller

with an exemption certificate in a form and manner prescribed by the department. The seller must retain a copy of the certificate for the seller's files.

(b) The department may waive the requirement for an exemption certificate in the event of disaster or similar circumstance.

NEW SECTION. **Sec. 907.** A new section is added to chapter 82.12 RCW to read as follows:

The provisions of this chapter do not apply in respect to the use of bottled water for human use by persons who do not otherwise have a readily available source of potable water.

NEW SECTION. **Sec. 908.** A new section is added to chapter 82.04 RCW to read as follows:

(1)(a) Subject to the requirements and limits in this section, candy manufacturers are entitled to a credit against the tax due under this chapter. The credit equals one thousand dollars for:

(i) Each full-time employment position that has been maintained in this state on a full-time basis for a continuous period of at least twelve consecutive months; or

(ii) Each full-time equivalent seasonal employee hired by a seasonal employer.

(b) Once a full-time employment position has been filled, the position does not cease to be maintained for a continuous period solely due to periods in which the position goes vacant, as long as:

(i) The cumulative period of any vacancies in that position is not more than one hundred twenty days in the twelve consecutive month period for which the position must be filled to earn a credit under this section; and

(ii) During any vacancy, the employer is training or actively recruiting a replacement permanent, full-time employee for the position.

(c) For full-time employment positions initially filled before July 1, 2010:

(i) The twelve consecutive month period for which the position must be filled to earn a credit under this section begins on the later of August 1, 2009, or the date that the employment position was initially filled; and

(ii) A second credit may be earned if the employment position is maintained on a full-time basis for an additional twelve consecutive month period.

(2)(a) The credit may only be claimed on a tax return filed electronically with the department using the department's online tax filing service, unless the department grants a waiver for good cause shown. For purposes of this subsection, "good cause" has the same meaning as in RCW 82.32.080(8)(a) (i), (ii), (iii), and (vi) and (b).

(b) Credit may be claimed only on tax returns originally due after July 31, 2010.

(c) The department must disallow any credit claimed on tax returns filed with the department after July 31, 2012.

(3)(a) Credits claimed may not exceed the tax otherwise due under this chapter on the manufacturing and retail or wholesale sale of candy manufactured by the taxpayer.

(b) No refunds may be granted for credits under this section.

(c) The credit provided in this section is in addition to any other credit that may be available to the candy manufacturer with respect to the same employment positions.

(4) No application is necessary for the credit. Candy manufacturers claiming the credit must keep records necessary for the department to verify eligibility under this section.

(5) A candy manufacturer claiming credit under this section must report to the department as provided in RCW 82.32.--- (section 103, chapter 114 (SHB 3066), Laws of 2010).

(6) The employment security department must provide to the department such information needed by the department to verify eligibility under this section.

(7) Pursuant to chapter 43.136 RCW, the citizen commission for performance measurement of tax preferences must schedule the credit under this section for a tax preference review by the joint legislative audit and review committee in 2011.

(8) For purposes of this section, the following definitions apply:

(a) "Candy" has the same meaning as in RCW 82.08.0293.

(b) "Candy manufacturer" means a person that manufactures candy. For purposes of this subsection "manufactures" has the same meaning as "to manufacture" in RCW 82.04.120.

1 (c) "Full-time" means a normal work week of at least thirty-five
2 hours.
3 (d) "Seasonal employee" means an employee of a seasonal employer
4 who works on a seasonal basis. "Seasonal basis" means a continuous
5 employment period of less than twelve consecutive months.
6 (e) "Seasonal employer" means a person who regularly hires more
7 than ten percent of its employees to work on a seasonal basis.

8 NEW SECTION. **Sec. 909.** If any provision of section 908 of this
9 act or its application to any person or circumstance is held
10 unconstitutional: (1) Section 908 of this act is considered invalid in
11 its entirety; and (2) section 908 of this act and the application of
12 any provision of that section to any person or circumstance is
13 considered null and void and of no effect.

14 NEW SECTION. **Sec. 910.** A new section is added to chapter 82.32
15 RCW to read as follows:
16 (1) The department must compile a list of products meeting the
17 definition of candy in RCW 82.08.0293 and products that are similar to
18 candy but do not meet that definition. The list must identify each
19 item as either subject to sales or use tax or not subject to sales or
20 use tax. The list will be made in a form and manner prescribed by the
21 department and must be made available on the department's internet web
22 site. The list must also provide information about how to request a
23 binding ruling from the department on the taxability of products not on
24 the list.
25 (2) In compiling the list described in subsection (1) of this
26 section, the department may:
27 (a) Evaluate the experiences of other member states of the
28 streamlined sales and use tax agreement that impose retail sales tax on
29 candy;
30 (b) Accept technical assistance from persons that sell, market, or
31 distribute candy; and
32 (c) Consider any other resource the department finds useful in
33 compiling the list.
34 (3) The creation of a list under subsection (1) of this section and
35 any modifications to the list are not subject to the rule-making
36 provisions of chapter 34.05 RCW.

(4) For products that are not identified on the list created by the department under subsection (1) of this section, taxpayers may request a binding written ruling from the department on the taxability of the product.

PART X
PUD Privilege Tax Clarification

Sec. 1001. RCW 54.28.011 and 1957 c 278 s 12 are each amended to read as follows:

"Gross revenue" ((~~shall~~)) mean<u>s</u> the amount received from the sale of electric energy<u>, which also includes any regularly recurring charge billed to consumers as a condition of receiving electric energy, and</u> excluding any tax levied by a municipal corporation upon the district pursuant to RCW 54.28.070.

PART XI
Temporarily Increasing the Business and Occupation Tax on Service Businesses while Increasing the Small Business Credit for the Same Businesses

<u>NEW SECTION.</u> **Sec. 1101.** A new section is added to chapter 82.04 RCW to read as follows:

(1) Beginning May 1, 2010, through June 30, 2013, an additional rate of tax of 0.30 percent is added to the rate provided for in RCW 82.04.255, 82.04.285, and 82.04.290(2)(a).

(2)(a) The additional rate in subsection (1) of this section does not apply to persons engaging within this state in business as a hospital. "Hospital" has the meaning provided in chapter 70.41 RCW but also includes any hospital that comes within the scope of chapter 71.12 RCW if the hospital is also licensed under chapter 70.41 RCW.

(b) The additional rate in subsection (1) of this section does not apply to amounts received from performing scientific research and development services including but not limited to research and development in the physical, engineering, and life sciences (such as agriculture, bacteriological, biotechnology, chemical, life sciences, and physical science research and development laboratories or services).

Sec. 1102. RCW 82.04.4451 and 1997 c 238 s 2 are each amended to read as follows:

(1) In computing the tax imposed under this chapter, a credit is allowed against the amount of tax otherwise due under this chapter, as provided in this section. ((~~The maximum credit for a taxpayer~~)) Except for taxpayers that report at least fifty percent of their taxable amount under RCW 82.04.255, 82.04.290(2)(a), and 82.04.285, the maximum credit for a taxpayer for a reporting period is thirty-five dollars multiplied by the number of months in the reporting period, as determined under RCW 82.32.045. For a taxpayer that reports at least fifty percent of its taxable amount under RCW 82.04.255, 82.04.290(2)(a), and 82.04.285, the maximum credit for a reporting period is seventy dollars multiplied by the number of months in the reporting period, as determined under RCW 82.32.045.

(2) When the amount of tax otherwise due under this chapter is equal to or less than the maximum credit, a credit is allowed equal to the amount of tax otherwise due under this chapter.

(3) When the amount of tax otherwise due under this chapter exceeds the maximum credit, a reduced credit is allowed equal to twice the maximum credit, minus the tax otherwise due under this chapter, but not less than zero.

(4) The department may prepare a tax credit table consisting of tax ranges using increments of no more than five dollars and a corresponding tax credit to be applied to those tax ranges. The table shall be prepared in such a manner that no taxpayer will owe a greater amount of tax by using the table than would be owed by performing the calculation under subsections (1) through (3) of this section. A table prepared by the department under this subsection ((~~shall~~)) must be used by all taxpayers in taking the credit provided in this section.

Sec. 1103. RCW 82.32.045 and 2006 c 256 s 1 are each amended to read as follows:

(1) Except as otherwise provided in this chapter, payments of the taxes imposed under chapters 82.04, 82.08, 82.12, 82.14, and 82.16 RCW, along with reports and returns on forms prescribed by the department, are due monthly within twenty-five days after the end of the month in which the taxable activities occur.

(2) The department of revenue may relieve any taxpayer or class of taxpayers from the obligation of remitting monthly and may require the return to cover other longer reporting periods, but in no event may returns be filed for a period greater than one year. For these taxpayers, tax payments are due on or before the last day of the month next succeeding the end of the period covered by the return.

(3) The department of revenue may also require verified annual returns from any taxpayer, setting forth such additional information as it may deem necessary to correctly determine tax liability.

(4) Notwithstanding subsections (1) and (2) of this section, the department may relieve any person of the requirement to file returns if the following conditions are met:

(a) The person's value of products, gross proceeds of sales, or gross income of the business, from all business activities taxable under chapter 82.04 RCW, is less than:

(i) Twenty-eight thousand dollars per year; or

(ii) Forty-six thousand six hundred and sixty-seven dollars per year for persons generating at least fifty percent of their taxable amount from activities taxable under RCW 82.04.255, 82.04.290(2)(a), and 82.04.285;

(b) The person's gross income of the business from all activities taxable under chapter 82.16 RCW is less than twenty-four thousand dollars per year; and

(c) The person is not required to collect or pay to the department of revenue any other tax or fee which the department is authorized to collect.

PART XII
Property Management Salaries

Sec. 1201. RCW 82.04.394 and 1998 c 338 s 2 are each amended to read as follows:

(1) This chapter does not apply to:

(a) Amounts received by a nonprofit property management company from the owner of a property for gross wages and benefits paid directly to or on behalf of on-site personnel from property management trust accounts that are required to be maintained under RCW ((~~18.85.310~~)) 18.85.285; or

1 (b) Amounts received by a property management company from a
2 housing authority for gross wages and benefits paid directly to or on
3 behalf of on-site personnel from property management trust accounts
4 that are required to be maintained under RCW 18.85.285.

5 (2) ((As used in)) The definitions in this subsection apply to this
6 section((,)).

7 (a) "On-site personnel" means a person who meets all of the
8 following conditions: (((a))) (i) The person works primarily at the
9 owner's property; (((b))) (ii) the person's duties include leasing
10 property units, maintaining the property, collecting rents, or similar
11 activities; and (((c))) (iii) under a written property management
12 agreement: (((i))) (A) The person's compensation is the ultimate
13 obligation of the property owner and not the property manager; (((ii)))
14 (B) the property manager is liable for payment only as agent of the
15 owner; and (((iii))) (C) the property manager is the agent of the owner
16 with respect to the on-site personnel and that all actions, including,
17 but not limited to, hiring, firing, compensation, and conditions of
18 employment, taken by the property manager with respect to the on-site
19 personnel are subject to the approval of the property owner.

20 (b) "Nonprofit property management company" means a property
21 management company that is exempt from tax under 26 U.S.C. Sec. 501(c)
22 of the federal internal revenue code, as it exists on January 1, 2010.

23 (c) "Housing authority" means a city or county housing authority
24 created pursuant to chapter 35.82 RCW.

25 **Sec. 1202.** RCW 82.04.394 and 2010 c 106 (E2SHB 1597) s 209 are
26 each amended to read as follows:

27 (1) This chapter does not apply to:

28 (a) Amounts received by a nonprofit property management company
29 from the owner of a property for gross wages and benefits paid directly
30 to or on behalf of on-site personnel from property management trust
31 accounts that are required to be maintained under RCW 18.85.285; or

32 (b) Amounts received by a property management company from a
33 housing authority for gross wages and benefits paid directly to or on
34 behalf of on-site personnel from property management trust accounts
35 that are required to be maintained under RCW 18.85.285.

36 (2) ((As used in)) The definitions in this subsection apply to this
37 section((,)).

(a) "On-site personnel" means a person who meets all of the following conditions: (((a))) (i) The person works primarily at the owner's property; (((b))) (ii) the person's duties include leasing property units, maintaining the property, collecting rents, or similar activities; and (((c))) (iii) under a written property management agreement: (((i))) (A) The person's compensation is the ultimate obligation of the property owner and not the property manager; (((ii))) (B) the property manager is liable for payment only as agent of the owner; and (((iii))) (C) the property manager is the agent of the owner with respect to the on-site personnel and that all actions, including, but not limited to, hiring, firing, compensation, and conditions of employment, taken by the property manager with respect to the on-site personnel are subject to the approval of the property owner.

(b) "Nonprofit property management company" means a property management company that is exempt from tax under 26 U.S.C. Sec. 501(c) of the federal internal revenue code, as it exists on January 1, 2010.

(c) "Housing authority" means a city or county housing authority created pursuant to chapter 35.82 RCW.

PART XIII
Temporarily Increasing Beer Taxes

Sec. 1301. RCW 66.24.290 and 2009 c 479 s 43 are each amended to read as follows:

(1) Any microbrewer or domestic brewery or beer distributor licensed under this title may sell and deliver beer and strong beer to holders of authorized licenses direct, but to no other person, other than the board. Any certificate of approval holder authorized to act as a distributor under RCW 66.24.270 shall pay the taxes imposed by this section.

(a) Every such brewery or beer distributor shall report all sales to the board monthly, pursuant to the regulations, and shall pay to the board as an added tax for the privilege of manufacturing and selling the beer and strong beer within the state a tax of one dollar and thirty cents per barrel of thirty-one gallons on sales to licensees within the state and on sales to licensees within the state of bottled and canned beer, including strong beer, shall pay a tax computed in

1 gallons at the rate of one dollar and thirty cents per barrel of
2 thirty-one gallons.

3 (b) Any brewery or beer distributor whose applicable tax payment is
4 not postmarked by the twentieth day following the month of sale will be
5 assessed a penalty at the rate of two percent per month or fraction
6 thereof. Beer and strong beer shall be sold by breweries and
7 distributors in sealed barrels or packages.

8 (c) The moneys collected under this subsection shall be distributed
9 as follows: (i) Three-tenths of a percent shall be distributed to
10 border areas under RCW 66.08.195; and (ii) of the remaining moneys:
11 (A) Twenty percent shall be distributed to counties in the same manner
12 as under RCW 66.08.200; and (B) eighty percent shall be distributed to
13 incorporated cities and towns in the same manner as under RCW
14 66.08.210.

15 (d) Any licensed retailer authorized to purchase beer from a
16 certificate of approval holder with a direct shipment endorsement or a
17 brewery or microbrewery shall make monthly reports to the liquor
18 control board on beer purchased during the preceding calendar month in
19 the manner and upon such forms as may be prescribed by the board.

20 (2) An additional tax is imposed on all beer and strong beer
21 subject to tax under subsection (1) of this section. The additional
22 tax is equal to two dollars per barrel of thirty-one gallons. All
23 revenues collected during any month from this additional tax shall be
24 deposited in the state general fund by the twenty-fifth day of the
25 following month.

26 (3)(a) An additional tax is imposed on all beer and strong beer
27 subject to tax under subsection (1) of this section. The additional
28 tax is equal to ninety-six cents per barrel of thirty-one gallons
29 through June 30, 1995, two dollars and thirty-nine cents per barrel of
30 thirty-one gallons for the period July 1, 1995, through June 30, 1997,
31 and four dollars and seventy-eight cents per barrel of thirty-one
32 gallons thereafter.

33 (b) The additional tax imposed under this subsection does not apply
34 to the sale of the first sixty thousand barrels of beer each year by
35 breweries that are entitled to a reduced rate of tax under 26 U.S.C.
36 Sec. 5051, as existing on July 1, 1993, or such subsequent date as may
37 be provided by the board by rule consistent with the purposes of this
38 exemption.

(c) All revenues collected from the additional tax imposed under this subsection (3) shall be deposited in the state general fund.

(4) An additional tax is imposed on all beer and strong beer that is subject to tax under subsection (1) of this section that is in the first sixty thousand barrels of beer and strong beer by breweries that are entitled to a reduced rate of tax under 26 U.S.C. Sec. 5051, as existing on July 1, 1993, or such subsequent date as may be provided by the board by rule consistent with the purposes of the exemption under subsection (3)(b) of this section. The additional tax is equal to one dollar and forty-eight and two-tenths cents per barrel of thirty-one gallons. By the twenty-fifth day of the following month, three percent of the revenues collected from this additional tax shall be distributed to border areas under RCW 66.08.195 and the remaining moneys shall be transferred to the state general fund.

(5)(a) From the effective date of this section through June 30, 2013, an additional tax is imposed on all beer and strong beer subject to tax under subsection (1) of this section. The additional tax is equal to fifteen dollars and fifty cents per barrel of thirty-one gallons.

(b) The additional tax imposed under this subsection does not apply to the sale of the first sixty thousand barrels of beer each year by breweries that are entitled to a reduced rate of tax under 26 U.S.C. Sec. 5051 of the federal internal revenue code, as existing on July 1, 1993, or such subsequent date as may be provided by the board by rule consistent with the purposes of this exemption.

(c) All revenues collected from the additional tax imposed under this subsection shall be deposited in the state general fund.

(6) The board may make refunds for all taxes paid on beer and strong beer exported from the state for use outside the state.

((~~(6)~~)) (7) The board may require filing with the board of a bond to be approved by it, in such amount as the board may fix, securing the payment of the tax. If any licensee fails to pay the tax when due, the board may forthwith suspend or cancel his or her license until all taxes are paid.

PART XIV

Temporarily Imposing Taxes on Carbonated Beverages

1 NEW SECTION. **Sec. 1401.** Unless the context clearly requires
2 otherwise, the definitions in this section apply throughout this
3 chapter.
4 (1)(a) "Carbonated beverage" means any packaged nonalcoholic liquid
5 intended for human consumption that contains carbonation by natural or
6 artificial means and any of the following substances: Caffeine,
7 extracts, fruit juice or concentrated fruit juice, herbs, sweeteners,
8 or syrup. "Packaged" includes cans, bottles, and other similar sealed
9 containers. "Syrup" means a concentrated mixture in either liquid or
10 powdered form that contains sugar or a sugar substitute and that is an
11 ingredient used to make carbonated beverages.
12 (b) "Carbonated beverage" does not include carbonated bottled
13 water. For the purpose of this subsection, "bottled water" has the
14 same meaning as provided in section 901 of this act.
15 (2) "Ounce" means United States fluid ounce.
16 (3) "Previously taxed carbonated beverages" means carbonated
17 beverages to which the tax under this chapter has been previously
18 imposed.
19 (4) Except for terms defined in this section, the definitions in
20 chapters 82.04, 82.08, and 82.12 RCW apply to this chapter.

21 NEW SECTION. **Sec. 1402.** (1) From the effective date of this
22 section through June 30, 2013, a tax is imposed on every person for the
23 privilege of selling, at wholesale or retail, carbonated beverages in
24 this state. The rate of the tax is equal to two cents per twelve
25 ounces of carbonated beverages sold in this state.
26 (2)(a) In calculating the amount of tax due under this section, if
27 the total amount of carbonated beverages sold in this state during the
28 reporting period is not a whole number, the taxable quantity must be
29 rounded as provided in (b) of this subsection.
30 (b) For a fraction of an ounce that is equal to or greater than
31 one-half ounce, the taxable quantity must be rounded up to the nearest
32 ounce. For a fraction of an ounce that is less than one-half ounce,
33 the taxable quantity must be rounded down to the nearest ounce.
34 (3) Chapter 82.32 RCW applies to the tax imposed in this section.
35 The tax reporting frequency for the tax imposed in this section must
36 coincide with the taxpayer's reporting frequency for the tax imposed in
37 chapter 82.04 RCW.

(4) The department may require taxpayers to report the taxable quantity of carbonated beverages in units of measure other than ounces.

(5) The tax imposed in this section is in addition to all other taxes imposed in this title on the same taxable event.

NEW SECTION. **Sec. 1403.** (1) The tax imposed in this chapter does not apply to any successive sale of previously taxed carbonated beverages.

(2) Any person claiming the exemption provided in this section must maintain documentation establishing that the carbonated beverages were previously taxed under this chapter. The documentation may be in the form of information on the invoice, or certification from the previous seller, stating: (a) That all or a specific stated portion of the carbonated beverages were previously subject to the tax imposed in this chapter; and (b) the amount of tax remitted or to be remitted to the department in respect of the carbonated beverages.

NEW SECTION. **Sec. 1404.** (1) For each calendar year, the tax imposed in this chapter does not apply in respect to the first ten million dollars of carbonated beverages sold in this state by any bottler as measured by the gross proceeds of sales of carbonated beverages at retail and wholesale by the bottler. If a bottler is affiliated with any other bottler or distributor, the ten million dollar threshold for the exemption in this subsection (1) is based on the combined gross proceeds of sales by all affiliated persons from all sales at wholesale and retail of carbonated beverages in this state during the calendar year.

(2) Successive sales by any person of carbonated beverages exempt under subsection (1) of this section are also exempt from the tax imposed in this chapter. Any person claiming the exemption provided in this subsection (2) must maintain documentation establishing that the carbonated beverages were previously sold in this state by a person exempt under subsection (1) of this section. The documentation may be in the form of information on the invoice, or certification from the previous seller, stating that the carbonated beverages were previously exempt under subsection (1) of this section.

(3) For purposes of this section, the following definitions apply:

1 (a) "Affiliated" has the same meaning as provided in section 110 of
2 this act.
3 (b) "Bottler" means a person who bottles, cans, or otherwise
4 packages carbonated beverages in beverage containers.
5 (c) "Distributor" means a person, other than a bottler, that makes
6 sales at wholesale of carbonated beverages.

7 NEW SECTION. **Sec. 1405.** The tax imposed in this chapter does not
8 apply to any activity or person that the state is prohibited from
9 taxing under the Constitution of this state or the Constitution or laws
10 of the United States.

11 NEW SECTION. **Sec. 1406.** This part constitutes a new chapter in
12 Title 82 RCW.

13 **PART XV**
14 **Limiting the Bad Debt Deduction**

15 NEW SECTION. **Sec. 1501.** The legislature intends with sections
16 1502 and 1503 of this act to supersede the holding of the supreme court
17 of the state of Washington in *Puget Sound National Bank v. Department*
18 *of Revenue*, 123 Wn.2d 284 (1994).

19 **Sec. 1502.** RCW 82.08.037 and 2007 c 6 s 102 are each amended to
20 read as follows:
21 (1) A seller is entitled to a credit or refund for sales taxes
22 previously paid on bad debts, as that term is used in 26 U.S.C. Sec.
23 166, as amended or renumbered as of January 1, 2003.
24 (2) For purposes of this section, "bad debts" does not include:
25 (a) Amounts due on property that remains in the possession of the
26 seller until the full purchase price is paid;
27 (b) Expenses incurred in attempting to collect debt; ((~~and~~))
28 (c) Debts sold or assigned by the seller to third parties, where
29 the third party is without recourse against the seller; and
30 (d) Repossessed property.
31 (3) If a credit or refund of sales tax is taken for a bad debt and
32 the debt is subsequently collected in whole or in part, the tax on the

amount collected must be paid and reported on the return filed for the period in which the collection is made.

(4) Payments on a previously claimed bad debt are applied first proportionally to the taxable price of the property or service and the sales or use tax thereon, and secondly to interest, service charges, and any other charges.

(5) If the seller uses a certified service provider as defined in RCW 82.32.020 to administer its sales tax responsibilities, the certified service provider may claim, on behalf of the seller, the credit or refund allowed by this section. The certified service provider must credit or refund the full amount received to the seller.

(6) The department ((~~shall~~)) must allow an allocation of bad debts among member states to the streamlined sales tax agreement, as defined in RCW 82.58.010(1), if the books and records of the person claiming bad debts support the allocation.

(7) A person's right to claim a credit or refund under this section is not assignable. No person other than the original seller in the transaction that generated the bad debt or, as provided in subsection (5) of this section, a certified service provider, is entitled to claim a credit or refund under this section. If the original seller in the transaction that generated the bad debt has sold or assigned the debt instrument to a third party with recourse, the original seller may claim a credit or refund under this section only after the debt instrument is reassigned by the third party to the original seller.

Sec. 1503. RCW 82.12.037 and 2007 c 6 s 103 are each amended to read as follows:

(1) A seller is entitled to a credit or refund for use taxes previously paid on bad debts, as that term is used in 26 U.S.C. Sec. 166, as amended or renumbered as of January 1, 2003.

(2) For purposes of this section, "bad debts" does not include:

(a) Amounts due on property that remains in the possession of the seller until the full purchase price is paid;

(b) Expenses incurred in attempting to collect debt; ((~~and~~))

(c) Debts sold or assigned by the seller to third parties, where the third party is without recourse against the seller; and

(d) Repossessed property.

(3) If a credit or refund of use tax is taken for a bad debt and the debt is subsequently collected in whole or in part, the tax on the amount collected must be paid and reported on the return filed for the period in which the collection is made.

(4) Payments on a previously claimed bad debt are applied first proportionally to the taxable price of the property or service and the sales or use tax thereon, and secondly to interest, service charges, and any other charges.

(5) If the seller uses a certified service provider as defined in RCW 82.32.020 to administer its use tax responsibilities, the certified service provider may claim, on behalf of the seller, the credit or refund allowed by this section. The certified service provider must credit or refund the full amount received to the seller.

(6) The department ((~~shall~~)) must allow an allocation of bad debts among member states to the streamlined sales and use tax agreement, as defined in RCW 82.58.010(1), if the books and records of the person claiming bad debts support the allocation.

(7) A person's right to claim a credit or refund under this section is not assignable. No person other than the original seller in the transaction that generated the bad debt or, as provided in subsection (5) of this section, a certified service provider, is entitled to claim a credit or refund under this section. If the original seller in the transaction that generated the bad debt has sold or assigned the debt instrument to a third party with recourse, the original seller may claim a credit or refund under this section only after the debt instrument is reassigned by the third party to the original seller.

PART XVI
Data Centers

Sec. 1601. RCW 82.08.--- and 2010 1st sp.s. c 1 (ESSB 6789) s 2 are each amended to read as follows:

(1) An exemption from the tax imposed by RCW 82.08.020 is provided for sales to qualifying businesses of eligible server equipment to be installed, without intervening use, in an eligible computer data center, and to charges made for labor and services rendered in respect to installing eligible server equipment. The exemption also applies to sales to qualifying businesses of eligible power infrastructure,

including labor and services rendered in respect to constructing, installing, repairing, altering, or improving eligible power infrastructure.

(2)(a) In order to claim the exemption under this section, a qualifying business must submit an application to the department for an exemption certificate. The application must include the information necessary, as required by the department, to determine that a business qualifies for the exemption under this section. The department must issue exemption certificates to qualifying businesses. The department may assign a unique identification number to each exemption certificate issued under this section.

(b) A qualifying business claiming the exemption under this section must present the seller with an exemption certificate in a form and manner prescribed by the department. The seller must retain a copy of the certificate for the seller's files.

(3)(a) ((~~A qualifying business must establish~~)) Within six years of the ((~~first day of the calendar quarter in which the business first receives an exemption under this section or section 3 of this act that it has~~)) date that the department issued an exemption certificate under this section to a qualifying business with respect to an eligible computer data center, the qualifying business must establish that net employment at the eligible computer data center has increased ((~~employment in a computer data center~~)) by a minimum of:

(i) Thirty-five family wage ((~~jobs from the date the eligible computer data center first became operational~~)) employment positions; or

(ii) Three family wage employment positions for each twenty thousand square feet of space or less that is newly dedicated to housing working servers at the eligible computer data center. For qualifying businesses that lease space at an eligible computer data center, the number of family wage employment positions that must be increased under this subsection (3)(a)(ii) is based only on the space occupied by the lessee in the eligible computer data center.

(b) In calculating the net increase in family wage employment positions:

(i) The owner of an eligible computer data center, in addition to its own net increase in family wage employment positions, may include:

(A) The net increase in family wage employment positions employed by qualifying businesses leasing space within the eligible computer data center from the owner; and

(B) The net increase in family wage employment positions described in (c)(ii)(B) of this subsection (3).

(ii)(A) Lessees of the owner of an eligible computer data center, in addition to their own net increase in family wage employment positions, may include:

(I) A portion of the net increase in family wage employment positions employed by the owner; and

(II) A portion of the net increase in family wage employment positions described in (c)(ii)(B) of this subsection (3).

(B) The portion of the net increase in family wage employment positions to be counted under this subsection (3)(b)(ii) by each lessee must be in proportion to the amount of space in the eligible computer data center occupied by the lessee compared to the total amount of space in the eligible computer data center occupied by all lessees that are qualifying businesses.

(c)(i) For purposes of this subsection, family wage ((~~jobs~~)) employment positions are new permanent employment positions requiring forty hours of weekly work, or their equivalent, on a full-time basis at the eligible computer data center and ((~~paying~~)) receiving a wage equivalent to or greater than one hundred fifty percent of the per capita personal income of the county in which the qualified project is located. ((~~The qualifying business must provide~~)) An employment position may not be counted as a family wage employment position unless the employment position is entitled to health insurance coverage ((~~for employees~~)) provided by the employer of the employment position. For purposes of this subsection (3)(c), "new permanent employment position" means an employment position that did not exist or that had not previously been filled as of the date that the department issued an exemption certificate to the owner or lessee of an eligible computer data center, as the case may be.

(ii)(A) Family wage employment positions include positions filled by employees of the owner of the eligible computer data center and by employees of qualifying businesses leasing space from the owner of the eligible computer data center.

1 (B) Family wage employment positions also include individuals
2 performing work at an eligible computer data center as an independent
3 contractor hired by the owner of the eligible computer data center or
4 as an employee of an independent contractor hired by the owner of the
5 eligible computer data center, if the work is necessary for the
6 operation of the computer data center, such as security and building
7 maintenance, and provided that all of the requirements in (c)(i) of
8 this subsection (3) are met.
9 ((~~(b)~~)) (d) All previously exempted sales and use taxes are
10 immediately due and payable for a qualifying business that does not
11 meet the requirements of this subsection.
12 (4) A qualifying business claiming an exemption under this section
13 or RCW 82.12.--- (section 3, chapter 1 (ESSB 6789), Laws of 2010 1st
14 sp. sess.) must complete an annual report with the department as
15 required under section 103, chapter 114 (SHB 3066), Laws of 2010.
16 (5)(a) The exemption provided in this section does not apply to:
17 (i) Any person who has received the benefit of the deferral program
18 under chapter 82.60 RCW on: (A) The construction, renovation, or
19 expansion of a structure or structures used as a computer data center;
20 or (B) machinery or equipment used in a computer data center; and
21 (ii) Any person affiliated with a person within the scope of (a)(i)
22 of this subsection (5). For purposes of this subsection, "affiliated"
23 means that one person has a direct or indirect ownership interest of at
24 least twenty percent in another person.
25 (b) If a person claims an exemption under this section and
26 subsequently receives the benefit of the deferral program under chapter
27 82.60 RCW on either the construction, renovation, or expansion of a
28 structure or structures used as a computer data center or machinery or
29 equipment used in a computer data center, the person must repay the
30 amount of taxes exempted under this section. Interest as provided in
31 chapter 82.32 RCW applies to amounts due under this section until paid
32 in full.
33 (6) For purposes of this section the following definitions apply
34 unless the context clearly requires otherwise:
35 (a)(i) "Computer data center" means a facility comprised of one or
36 more buildings, which may be comprised of multiple businesses,
37 constructed or refurbished specifically, and used primarily, to house
38 working servers, where the facility has the following characteristics:

(A) Uninterruptible power supplies, generator backup power, or both; (B) sophisticated fire suppression and prevention systems; and (C) enhanced physical security, such as: Restricted access to the facility to selected personnel; permanent security guards; video camera surveillance; an electronic system requiring passcodes, keycards, or biometric scans, such as hand scans and retinal or fingerprint recognition; or similar security features.

(ii) For a computer data center comprised of multiple buildings, each separate building constructed or refurbished specifically, and used primarily, to house working servers is considered a computer data center if it has all of the characteristics listed in (a)(i)(A) through (C) of this subsection (6).

(iii) A facility comprised of one building or more than one building must have a combined square footage of at least one hundred thousand square feet.

(b) "Electronic data storage and data management services" include, but are not limited to: Providing data storage and backup services, providing computer processing power, hosting enterprise software applications, and hosting web sites. The term also includes providing services such as e-mail, web browsing and searching, media applications, and other online services, regardless of whether a charge is made for such services.

(c)(i) "Eligible computer data center" means a computer data center:

(A) Located in a rural county as defined in RCW 82.14.370;

(B) Having at least twenty thousand square feet dedicated to housing working servers, where the server space has not previously been dedicated to housing working servers; and

(C) For which the commencement of construction occurs after March 31, 2010, and before July 1, 2011. For purposes of this section, "commencement of construction" means the date that a building permit is issued under the building code adopted under RCW 19.27.031 for construction of the computer data center. The construction of a computer data center includes the expansion, renovation, or other improvements made to existing facilities, including leased or rented space. "Commencement of construction" does not include soil testing, site clearing and grading, site preparation, or any other related

1 activities that are initiated before the issuance of a building permit
2 for the construction of the foundation of a computer data center.
3 (ii) With respect to facilities in existence on April 1, 2010 that
4 are expanded, renovated, or otherwise improved after March 31, 2010, an
5 eligible computer data center includes only the portion of the computer
6 data center meeting the requirements in (c)(i)(B) of this subsection
7 (6).
8 (d) "Eligible power infrastructure" means all fixtures and
9 equipment necessary for the transformation, distribution, or management
10 of electricity that is required to operate eligible server equipment
11 within an eligible computer data center. The term includes electrical
12 substations, generators, wiring, and cogeneration equipment.
13 (e) "Eligible server equipment" means the original server equipment
14 installed in an eligible computer data center on or after April 1,
15 2010, and replacement server equipment. For purposes of this
16 subsection (6)(e), "replacement server equipment" means server
17 equipment that: (i) Replaces existing server equipment, if the sale or
18 use of the server equipment to be replaced qualified for an exemption
19 under this section or RCW 82.12.--- (section 3, chapter 1 (ESSB 6789),
20 Laws of 2010 1st sp. sess.); and (ii) is installed and put into regular
21 use before April 1, 2018.
22 (f) "Qualifying business" means a business entity that exists for
23 the primary purpose of engaging in commercial activity for profit and
24 that is the owner ((~~or lessee~~)) of an eligible computer data center or
25 the lessee of at least twenty thousand square feet within an eligible
26 computer data center dedicated to housing working servers, where the
27 server space has not previously been dedicated to housing working
28 servers. The term does not include the state or federal government or
29 any of their departments, agencies, and institutions; tribal
30 governments; political subdivisions of this state; or any municipal,
31 quasi-municipal, public, or other corporation created by the state or
32 federal government, tribal government, municipality, or political
33 subdivision of the state.
34 (g) "Server" means blade or rack-mount server computers used in a
35 computer data center exclusively to provide electronic data storage and
36 data management services for internal use by the owner or lessee of the
37 computer data center, for clients of the owner or lessee of the

computer data center, or both. "Server" does not include personal computers.

(h) "Server equipment" means the server chassis and all computer hardware contained within the server chassis. "Server equipment" also includes computer software necessary to operate the server. "Server equipment" does not include the racks upon which the server chassis is installed, and computer peripherals such as keyboards, monitors, printers, mice, and other devices that work outside of the computer.

(7) This section expires April 1, 2018.

Sec. 1602. RCW 82.12.--- and 2010 1st sp.s. c 1 (ESSB 6789) s 3 are each amended to read as follows:

(1) An exemption from the tax imposed by RCW 82.12.020 is provided for the use by qualifying businesses of eligible server equipment to be installed, without intervening use, in an eligible computer data center, and to the use of labor and services rendered in respect to installing such server equipment. The exemption also applies to the use of power infrastructure, including labor and services rendered in respect to installing, repairing, altering, or improving such infrastructure.

(2) A qualifying business is not eligible for the exemption under this section unless the department issued an exemption certificate to the qualifying business for the exemption provided in RCW 82.08.--- (section 2, chapter 1 (ESSB 6789), Laws of 2010 1st sp. sess.).

(3)(a) The exemption provided in this section does not apply to:

(i) Any person who has received the benefit of the deferral program under chapter 82.60 RCW on: (A) The construction, renovation, or expansion of a structure or structures used as a computer data center; or (B) machinery or equipment used in a computer data center; and

(ii) Any person affiliated with a person within the scope of (a)(i) of this subsection (3). For purposes of this subsection, "affiliated" means that one person has a direct or indirect ownership interest of at least twenty percent in another person.

(b) If a person has received the benefit of the exemption under this section and subsequently receives the benefit of the deferral program under chapter 82.60 RCW on either the construction, renovation, or expansion of a structure or structures used as a computer data center or machinery or equipment used in a computer data center, the

person must repay the amount of taxes exempted under this section. Interest as provided in chapter 82.32 RCW applies to amounts due under this subsection (3)(b) until paid in full. A person is not required to repay taxes under this subsection with respect to property and services for which the person is required to repay taxes under RCW 82.08.--- (section 2, chapter 1 (ESSB 6789), Laws of 2010 1st sp. sess.).

(4) The definitions and requirements in RCW 82.08.--- (section 2, chapter 1 (ESSB 6789), Laws of 2010 1st sp. sess.) apply to this section.

(5) This section expires April 1, 2018.

PART XVII
Miscellaneous Provisions

NEW SECTION. **Sec. 1701.** If a court of competent jurisdiction, in a final judgment not subject to appeal, adjudges any provision of section 104(1)(c) of this act unconstitutional or otherwise invalid, Part I of this act is null and void in its entirety.

NEW SECTION. **Sec. 1702.** Part I of this act applies with respect to gross income of the business, as defined in RCW 82.04.080, including gross income from royalties as defined in RCW 82.04.2907, generated on and after June 1, 2010. For purposes of calculating the thresholds in section 104(1)(c) of this act for the 2010 tax year, property, payroll, and receipts are based on the entire 2010 tax year.

NEW SECTION. **Sec. 1703.** Except as provided in section 202 of this act, section 201 of this act applies to tax periods beginning January 1, 2006.

NEW SECTION. **Sec. 1704.** Sections 402 and 702 of this act apply both retroactively and prospectively.

NEW SECTION. **Sec. 1705.** In accordance with Article VIII, section 5 of the state Constitution, sections 702 and 1704 of this act do not authorize refunds of business and occupation tax validly collected before July 1, 2010, on amounts received by an individual from a

corporation as compensation for serving as a member of that corporation's board of directors.

NEW SECTION. **Sec. 1706.** Section 402 of this act does not affect any final judgments, not subject to appeal, entered by a court of competent jurisdiction before the effective date of this section.

NEW SECTION. **Sec. 1707.** Except as provided in section 1701 of this act, if any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected.

NEW SECTION. **Sec. 1708.** Except as otherwise provided in this act, this act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and takes effect May 1, 2010.

NEW SECTION. **Sec. 1709.** Parts III and XIII and sections 101 through 106, 108 through 112, 501 through 503, 505, 507, 510 through 514, 516 through 519, 901, 903 through 911, and 1201 of this act are necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and take effect June 1, 2010.

NEW SECTION. **Sec. 1710.** Sections 106, 901, and 1201 of this act expire July 1, 2010.

NEW SECTION. **Sec. 1711.** Sections 503, 505, and 514 of this act expire June 10, 2010.

NEW SECTION. **Sec. 1712.** Sections 504, 506, and 515 of this act are necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and take effect June 10, 2010.

NEW SECTION. **Sec. 1713.** Parts VI, VII, and XIV and sections 107, 702, 902, and 1202 of this act are necessary for the immediate

1 preservation of the public peace, health, or safety, or support of the
2 state government and its existing public institutions, and take effect
3 July 1, 2010.

4 NEW SECTION. **Sec. 1714.** Section 507 of this act expires July 13,
5 2010.

6 NEW SECTION. **Sec. 1715.** Section 508 of this act takes effect July
7 13, 2010.

8 NEW SECTION. **Sec. 1716.** Section 508 of this act expires July 1,
9 2011.

10 NEW SECTION. **Sec. 1717.** Section 509 of this act takes effect July
11 1, 2011.

12 NEW SECTION. **Sec. 1718.** Section 1001 of this act applies
13 prospectively only.

14 NEW SECTION. **Sec. 1719.** Sections 1502 and 1503 of this act apply
15 to claims for credit or refund filed with the department of revenue
16 after June 30, 2010.

Passed by the Senate April 12, 2010.
Passed by the House April 10, 2010.
Approved by the Governor April 23, 2010.
Filed in Office of Secretary of State April 23, 2010.

SIDLEY AUSTIN LLP

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Appellate Court Case Title:	Citibank South Dakota, Appellant v. State of Washington Department of Revenue, Respondent
Superior Court Case Number:	21-2-02141-1

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