44195-1
No. 86972-3

SUPREME COURT
OF THE STATE OF WASHINGTON

SPACE AGE FUELS, INC.,

Appellant,

v.

STATE OF WASHINGTON,

Respondent.

BRIEF OF APPELLANT

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A. INTRODUCTION

The present action arises out of the State of Washington's ("the State") assessment of $235,834.00 in Business and Occupations ("B&O") tax, together with interest and penalties of $114,174.22, against Space Age Fuels, Inc. ("Space Age"). The State assessed the tax based on certain sales of non-branded fuel that Space Age made to wholesale customers in Washington. Space Age's customers purchased this fuel because Space Age had the lowest price, and they ordered the fuel by telephoning, faxing, or e-mailing their orders to Space Age's office in Oregon. After the customers placed their orders, Space Age delivered the fuel to the customers in Washington in Space Age's own trucks.

Believing that the State's assessment of the tax violated the Commerce Clause of the United States Constitution, Space Age filed an administrative appeal with the Washington Department of Revenue ("DOR"), which upheld the assessment. Space Age then paid the tax, interest, and penalties, and initiated this refund action in the Thurston County Superior Court. On cross-motions for summary judgment, the superior court held that the State's assessment of the B&O tax did not violate the Commerce Clause because Space Age's deliveries of the fuel in its own trucks, by themselves, established the "substantial nexus" that is required before a state may

constitutionally impose a tax on a non-resident taxpayer.

The superior court's ruling is contrary to a DOR regulation stating that the State may only impose a tax on inbound sales delivered in the non-resident taxpayer's own trucks "if there is nexus," meaning that the delivery alone does not create the nexus. The ruling is also contrary to United States Supreme Court and Washington Supreme Court authority that only those in-state activities that "are significantly associated with the taxpayer's ability to establish and maintain a market in [the taxing] state" can create the constitutionally-required nexus. This case offers the Court an opportunity to further clarify what constitutes substantial nexus under the Commerce Clause in an era when such clarification is essential for businesses. Because the delivery of a product that the customer has already decided to buy, based on price alone, is not an activity that is significantly associated with the taxpayer's ability to establish and maintain a market in [the] state," the trial court erred in holding that Space Age's deliveries, standing alone, create the constitutionally-required substantial nexus, and thus erred in granting the State's motion for summary judgment.

B. ASSIGNMENT OF ERROR

(1) Assignment of Error

The trial court erred in granting the State's motion for summary

judgment by order entered on January 6, 2012.

(2) Issue Pertaining to Assignment of Error

Did the trial court err in concluding that Space Age's delivery of fuel, in its own trucks, to customers in Washington, standing alone, created the "substantial nexus" required in order to allow the State to impose its B&O tax on Space Age without violating the Commerce Clause of the United States Constitution? (Assignment of Error Number 1).

C. STATEMENT OF THE CASE

(1) Substantive Facts

Space Age is a company engaged in the business of selling fuel at retail and wholesale. CP 53. Space Age is incorporated in Oregon, and its principal place of business is in Clackamas, Oregon. CP 54. The company has approximately 72 employees, including its owner and president. *Id.*

Space Age's wholesale sales are made to independent, "non-branded" companies, *i.e.*, companies not affiliated with recognized oil companies. CP 54. Space Age's ability to make these wholesale sales is driven by one factor: price. *Id.* If Space Age can quote its wholesale customers a lower price than its competitors, it will be able to make a sale; if it cannot, it will not. *Id.*

With the exception of three isolated retail sales, all of Space Age's customers in Washington are wholesale customers. CP 54. All of Space

Age's sales to Washington customers are made over the telephone, at Space Age's office in Oregon. *Id.* In response to customer inquiries for price information, Space Age will provide quotes either by fax, telephone, or e-mail. CP 54, 380.[1] After Space Age accepts a customer's order, Space Age delivers the fuel to the customer in Space Age's own vehicles or, on rare occasions, by common carrier. CP 23, 27-28.

During the audit period,[2] Space Age did not own or lease any office, warehouse, or other place of business in Washington. CP 13. In fact, Space Age did not own, rent, or lease any real property, or any tangible or intangible personal property, in Washington. CP 12-13.

Space Age had no bank accounts in Washington. CP 14. No Space Age employees or representatives were located in Washington. CP 15. No directors, board members, officers, or any other managers or employees of Space Age visited Washington for the purpose of holding or participating in any type of business meeting or conference. CP 21. Space Age had no contracts with any person or entity in Washington. CP 22. Although Space

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[1] Contrary to what the State contended below, Space Age did not "solicit" sales. Instead, Space Age responded to customer inquiries for fuel prices via whatever method the customer requested, telephone, facsimile, or e-mail. CP 376, 380.

[2] The audit period is January 1, 2004 through June 30, 2007. Except as otherwise noted, all of the facts stated herein are relevant to the audit period. Accordingly, for ease of readability, Space Age will hereafter dispense with the introductory phrase "during the audit period."

Age operates approximately 20 retail outlets in Oregon, it has no retail outlets in Washington; with three isolated exceptions, all of Space Age's sales to customers in Washington are at the wholesale level. CP 54. As noted above, Space Age's wholesale sales are made to independent, "non-branded" companies, *id.*, and, as a result, Space Age did not provide its wholesale customers with any advertising material or signage. CP 22.

Space Age has approximately 40 wholesale customers in Washington. CP 54. As is the case with all of Space Age's sales to wholesale customers, the Washington customers place their orders over the telephone by calling Space Age's office in Oregon. *Id.* After Space Age has accepted a customer's order, Space Age delivers the fuel to the wholesale customer in Space Age's own vehicles or, on occasion, by common carrier. CP 23, 27-28. No Washington customer returned any fuel to Space Age. CP 23-24.

Because Space Age's ability to make wholesale sales is driven solely by price, Space Age made no effort to secure new customers for its fuel in Washington. CP 54.[3] Space Age did not provide its customers or any

[3] The State argued below that one of Space Age's employees, David Maydew, came into Washington to solicit new business for Space Age. CP 261. That argument is misleading, however, because it omits that Mr. Maydew's only activity in looking for potential business from Washington customers took place when Mr. Maydew was first employed by Space Age, in 2001. CP 374-75. By the time of the audit period, Mr. Maydew was working in the retail portion of Space Age's business, which involved running Space Age's convenience stores in Oregon. CP 373.

potential customers with Space Age displays, brochures, product samples, or similar items. CP 22. No Space Age employee or representative, while present in Washington, provided instruction, technical assistance, or other expertise regarding the use of fuel sold by Space Age. CP 17-18.

Mr. Maydew was the only Space Age employee who visited any customers in Washington. CP 54. Mr. Maydew visited four out of Space Age's approximately 40 different wholesale customers in Washington for a total of less than one hour. CP 15-17, 56. At no time during any of these visits did Mr. Maydew inventory any products, assess customer product needs, or recommend or suggest the use of any products. CP 19-20. At no time during these visits did Mr. Maydew accept any payment for past, present, or future orders, transport or offer to transport any documents, orders, or products to be returned to Space Age, or in any other manner maintain the account of, provide service to, or accommodate any of these customers in any other way. CP 20.

Mr. Maydew's visits occurred over a multi-year period. CP 57. Space Age did not direct Mr. Maydew to make these visits, and he conducted no company business during these visits. *Id.* Mr. Maydew used his own car, and was not reimbursed for his expenses. *Id.* In fact, Mr. Maydew was on his own time when he stopped by each of the four customers' stores, either going

to or returning from fishing trips in Astoria. *Id.* Mr. Maydew spent less than one hour total while making these visits. *Id.* Because of the fungible nature of non-branded fuel, Mr. Maydew's visits had no impact on Space Age's ability to sell fuel to these four customers. *Id.*

Space Age originally sold fuel to a customer located on East Fourth Plain Boulevard in Vancouver. CP 54. Later, however, that business was sold to BBC Petro Group ("BBC"). *Id.* BBC was the entity that installed a sign that resembled a Space Age sign. CP 54-55. BBC installed that sign without Space Age's permission, knowledge, or assistance. CP 55. Space Age does not supply its customers with signs for their businesses. *Id.* Space Age does not own the East Fourth Plain Boulevard property, and had no legal right to access it. *Id.* Space Age did, however, contact BBC in an effort to have it remove the signage. *Id.* BBC refused to do so. *Id.* Sometime thereafter, the sign was removed by someone unknown to Space Age. *Id.*

(2) Procedural Facts

In late 2007 or early 2008, DOR audited Space Age to verify that Space Age's business activities and transactions were properly reported on its tax returns. CP 6. Following the audit, on October 30, 2008, DOR issued an Auditor's Detail of Differences and Instructions to Taxpayer, and assessed B&O taxes against Space Age in the sum of $235,834 for certain wholesale

sales during the audit period. *Id.*

Space Age believed that DOR's assessment was improper, and on December 18, 2008, Space Age filed an administrative appeal with DOR in accordance with WAC 458-20-100. CP 6. In defense of the appeal DOR made three arguments as to why the requisite nexus existed between Space Age and Washington: (1) the brief visits by Mr. Maydew to four Space Age customers; (2) an alleged exclusive contract between Space Age and a customer called "Quick Stops;"[4] and (3) the signs at the Vancouver gasoline station.

On June 3, 2009, DOR issued a Determination denying Space Age's administrative appeal. CP 6. Space Age filed a petition for reconsideration, and on October 15, 2009, DOR issued a letter denying the petition for reconsideration. *Id.*

On November 9, 2009, Space Age paid DOR the assessed B&O taxes of $235,834, together with interest and penalties thereon in the sum of $114,174.22. CP 6.

Space Age commenced this action in the Thurston County Superior Court on March 11, 2010. CP 5-8. The case was assigned to the Honorable Thomas McPhee.

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[4] The State made no reference to this alleged contract as part of its motion for summary judgment in this matter.

Space Age and the State filed cross-motions for summary judgment CP 62-79, 258-77. Although not argued at the administrative level, the State's primary argument in support of its motion for summary judgment, and in opposition to Space Age's motion for summary judgment, was that Space Age's delivery of fuel, in its own trucks, to customers in Washington was sufficient to create the required substantial nexus. CP 266-70, 402-05, 428-31. The State also argued that Mr. Maydew's visits, along with the supposed Space Age signs at the Vancouver location, also created the requisite substantial nexus. CP 270-73, 405-06, 431-32. Finally, the State argued that the requisite substantial nexus existed because Space Age supplied fuel prices to Washington customers via telephone, facsimile, and e-mail. CP 261, 270.

After oral argument on the cross-motions for summary judgment, the court orally announced its decision from the bench. RPII 3-6.[5] The court addressed each of the three grounds that the State asserted in support of its argument that the required substantial nexus existed. RPII 3-6. First, the court stated that there were disputed issues of material fact as to whether Mr. Maydew's visits to Space Age's customers were sufficient to create the required substantial nexus:

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[5] The record of proceedings consists of two volumes, with the first volume consisting of the oral argument and the second volume consisting of the court's oral ruling. As the two volumes are separately paginated, in this brief Space Age refers to the second volume as "RPII."

> I've already indicated my view that one factor here that was briefed and argued briefly cannot be the basis of my decision this morning, because there are disputed facts that are material to that issue. And those involve the on-site visits by Mr. Maydew on his way to and from fishing.

RPII 3.

Second, the court addressed the State's argument about the telephone calls and faxes between Space Age and its customers:

> [m]y sense of the law is that if that third prong, calls and faxes, was the only prong we had here, that would probably be insufficient to establish a nexus. I don't know of any case that has directly addressed that issue without some accompanying actual presence in the state. But of course we have that here with the deliveries.

RPII 4.

Third, the court addressed the State's delivery argument:

> I'll not repeat all of the factors argued by the state regarding deliveries. There were deliveries in excess of 1,000 over the taxing period. Fuel valued at more than $48 million was involved in those deliveries. And they were done by special licensed trucks owned and operated for the most part by Space Age Fuels. * * *
>
> So the question for me is, is that sufficient to meet the *Lamtec Corporation* test for a substantial nexus. The test is simple. The activities must be substantial and must be associated with the company's abilities to establish and maintain the company's market within the state. I conclude that those deliveries clearly meet that test and that they, by themselves, constitute a substantial nexus. I don't really reach the issue of whether the calls and faxes into the state from the office in Gresham are necessary to complete the substantial nexus analysis. I conclude that these deliveries meet the tests.

RPII 4-5 (emphasis added).

Thereafter, the trial court entered an order granting the State's motion for summary judgment. CP 443-46. Space Age then filed a timely notice of appeal. CP 447-53.

D. SUMMARY OF ARGUMENT

In order for a state to impose a tax upon a non-resident taxpayer without violating the Commerce Clause of the United States Constitution, the tax must, *inter alia*, be applied to an activity with a substantial nexus to the taxing state. An in-state activity creates nexus if it is "substantial" and "significantly associated with the taxpayer's ability to establish and maintain a market within [the taxing] state."

DOR has promulgated a regulation describing when a tax may be assessed based on the sale of products delivered to a customer in Washington in the taxpayer's own trucks. Under that regulation, the State may impose the tax "if there is nexus." In other words, the delivery itself cannot create the nexus. The trial court's ruling that "delivery alone" creates the requisite nexus was contrary to this regulation and erroneous.

An activity is "significantly associated with the taxpayer's ability to establish and maintain a market within [the taxing] state" if it is designed to generate an original or subsequent sale of goods or services in the state. Delivery of a product that the customer has already ordered, even if the

delivery is made in the taxpayer's own trucks, is not an activity "significantly associated with the taxpayer's ability to establish and maintain a market within [the taxing] state." The trial court's ruling to the contrary was erroneous.

E. ARGUMENT[6]

(1) The Commerce Clause Prohibits State Action that Discriminates Against Interstate Commerce and Bars State Regulations that Unduly Burden Interstate Commerce

The Commerce Clause of the United States Constitution authorizes Congress to "regulate Commerce with foreign Nations, and among the several States." U.S. Const. Art I, § 8, cl. 3. The Commerce Clause, "'by its own force' prohibits certain state actions that interfere with interstate commerce." *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992), quoting *South Carolina State Highway Department v. Barnwell Brothers, Inc.*, 303 U.S. 177, 185, 58 S. Ct. 510, 82 L. Ed. 2d 734 (1938). The Commerce Clause addresses

> structural concerns about the effects of state regulation on the national economy. Under the Articles of Confederation, state taxes and duties

[6] This Court is well-acquainted with the standard of review on summary judgment. A party is not entitled to summary judgment unless there is no genuine issue of material fact and it is entitled to judgment as a matter of law. CR 56(c). A court must construe the facts and all inferences from them in the light most favorable to the nonmoving party, here Space Age. *Wilson v. Steinbach*, 98 Wn. 2d 434, 437, 656 P.2d 1030 (1982). The motion should only be granted "if, from all the evidence, reasonable persons could reach but one conclusion." *Id.* This Court reviews a summary judgment de novo. *Dowler v. Clover Park School Dist. No. 400*, 172 Wn. 2d 471, 484, 258 P.3d 676 (2011).

> hindered and suppressed interstate commerce; the Framers intended the Commerce Clause as a cure for these structural ills. It is in this light that we have interpreted the negative implication of the Commerce Clause. Accordingly, we have ruled that the Clause prohibits discrimination against interstate commerce, and bars state regulations that unduly burden interstate commerce.

Quill, supra, 504 U.S. at 312 (citations omitted).[7]

(2) For a State Tax not to Run Afoul of the Commerce Clause, there must be Substantial Nexus Between the Activities of the Taxpayer and the Taxing State

The United States Supreme Court applies a four-part test in evaluating whether a state tax violates the Commerce Clause; the Court

> will sustain a tax against a Commerce Clause challenge so long as "the tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State."

Id. at 311, quoting *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977). *Accord Lamtec Corp. v. Department of Revenue*, 170 Wn. 2d 838, 844, 246 P.3d 788, 791-92, *cert. denied*, ___ U.S. ___, 132 S. Ct. 95 (2011) (for a state to tax an out-of-state corporation the tax must meet the four-part *Complete Auto* test).

[7] In contrast to the structural concerns of the Commerce Clause, the Due Process Clause of the United States Constitution "centrally concerns the fundamental fairness of governmental activity." *Id.*

The Court has observed that

> [t]he *Complete Auto* analysis reflects these concerns about the national economy. The second and third parts of that analysis, which require fair apportionment and non-discrimination, prohibit taxes that pass an unfair share of the tax burden onto interstate commerce. The first and fourth prongs, which require a substantial nexus and a relationship between the tax and state-provided services, limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce.

Quill, supra, 504 U.S. at 313 (footnote omitted).[8]

(3) "Substantial Nexus" Exists Only when Activities Performed in the Taxing State are Significantly Associated with the Taxpayer's Ability to Establish and Maintain a Market in the Taxing State

In determining whether or not the requisite nexus exists, "the crucial factor is whether the activities performed in [the taxing] 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 Industries, Inc. v. Washington State Department of Revenue*, 483 U.S. 232, 250, 107 S. Ct.

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[8] Because the Commerce Clause addresses different concerns than does the Due Process Clause, different tests exist for evaluating the constitutionality of a state tax under the two clauses. *Id.* For a state tax not to run afoul of the Commerce Clause, there must, *inter alia*, be "substantial nexus" between the taxpayer's activity and taxing state; for a state tax not to run afoul of the Due Process Clause, there must exist only "minimum contacts" between the taxpayer and the taxing state. *Id.* This is because "the 'substantial nexus' requirement is not, like due process' 'minimum contacts' requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce." *Id.* Accordingly, the situation may exist where a taxpayer "may have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause." *Id.* at 313 (footnote omitted). It bears repeating that the present case involves only the Commerce Clause.

2810, 97 L. Ed. 2d 199 (1987), quoting *Tyler Pipe Industries, Inc. v. State Department of Revenue*, 105 Wn. 2d 318, 323, 715 P.2d 123, 126 (1986).

(4) The *Lamtec* Decision

This Court analyzed a claim that imposition of the B&O tax on an out-of-state taxpayer violated the Commerce Clause in *Lamtec, supra.* In that case the taxpayer was a manufacturer of insulation and vapor barriers. *Lamtec*, 170 Wn. 2d at 840-41. The taxpayer manufactured its products in New Jersey, and sold them nationwide. *Id.* Its customers placed orders over the telephone. *Id.* at 841. The taxpayer did not have any offices or agents permanently in Washington. *Id.* at 840-41. It did, however, on two or three occasions per year, send three sales employees to visit major customers in Washington. *Id.* at 840. The employees made between 50 and 70 visits to Washington customers during the seven year period at issue. *Id.* The taxpayer estimated that the total amount of time spent in Washington by the employees each year was seven to 11 days. Brief of Respondent DOR, 2008 WL 8014770, at *4.[9]

The employees did not solicit sales directly during these visits. *Lamtec*, 170 Wn. 2d at 841. During these visits the employees sometimes left brochures and product samples with the customers. Brief of Respondent

[9] Cited references to the DOR's brief in *Lamtec* are located at CP 51-52.

DOR, 2008 W. 8014770, at *4. The employees answered customer concerns, addressed issues relating to the use of Lamtec's products, and participated in telephone calls to Lamtec's technical or customer service departments. *Id.*

According to the State, the taxpayer "admitted that it was engaging in efforts to maintain Lamtec's market in Washington" and "Lamtec considered the physical, in-person visits by its sales representatives significant to its business model and marketing program and would not even consider abandoning the visits." Brief of Respondent DOR, 2008 WL 8014770, at *5.

On that record, the *Lamtec* court held that Lamtec had the requisite nexus to allow the state to constitutionally impose the B&O tax:

> [t]he activities [in the state] 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 relationship 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.

Lamtec, 170 Wn. 2d at 851 (emphasis added).[10]

As explained below, Space Age does not take issue with the Court's

[10] Three justices dissented in *Lamtec*, concluding that the visits of Lamtec's employees were "occasional," and "quite insignificant and do not support a holding that its activities had a sufficient nexus to Washington so as to justify imposition of our B&O tax." *Id.* at 852 (Alexander, J., dissenting).

analytical framework in *Lamtec*, which follows the United States Supreme Court's decisions in *Complete Auto* and *Tyler Pipe*. Application of that framework in the present case, however, leads to a different result, *i.e.*, a result that the requisite substantial nexus is missing.

(5) Delivery Alone, by an Out-of-State Seller in its Own Trucks, to a Washington Customer that has Already Decided to Purchase the Seller's Product, does not Create the Requisite Substantial Nexus

As noted above, the trial court concluded that Space Age's deliveries to its customers in Washington, by themselves, created the requisite substantial nexus: "I conclude that those deliveries clearly meet [the *Lamtec*] test and that they, by themselves, constitute a substantial nexus." RPII 5.

(a) The State's Implementing Regulation Acknowledges that Delivery Alone does not Create Substantial Nexus

DOR's own implementing regulations recognize that delivery alone does not create substantial nexus. WAC 458-20-193 states that:

> 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.

WAC 458-20-193(7).[11] The regulation defines "nexus" as "the activity

[11] Having been promulgated with authority delegated by RCW 82.32.300 and RCW 82.01.060(2), the regulation carries the force of law. *E.g. Pierce County v. State of Washington*, 144 Wn. App. 783, 836, 185 P.3d 594, 622 (2008) ("[a]n administrative rule

carried on by the seller in Washington which is significantly associated with the seller's ability to establish or maintain a market for its products in Washington." WAC 458-20-193(2)(f).

The regulation also provides an example that confirms that delivery alone of products by an out-of-state seller to an in-state customer does not create nexus:

> [t]he following examples show how the provisions of this section relating to interstate sales of tangible personal property will apply when the goods originate outside Washington (inbound sales). * * *
>
> (a) Company A is located in California. It sells machine parts at retail and wholesale. Company B is located in Washington and it purchases machine parts for its own use from Company A. Company A uses its own vehicles to deliver the machine parts to its customers in Washington. The sale is subject to the retail sales and B&O tax <u>if the seller has nexus</u>, or use tax <u>if nexus is not present</u>.

WAC 458-20-193(11) (emphasis added).

The example thus acknowledges that the mere delivery of the product by the out-of-state seller does not create nexus. If the mere delivery itself created the nexus, the example would have simply concluded by stating that "[t]he sale is subject to the retail sales and B&O tax." Instead, the example

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has force of law only if the agency promulgated it with delegated authority").

states that the B&O tax may be imposed on these delivered products "if there is nexus." The addition of the phrase "if there is nexus" clearly indicates that the delivery, standing alone, does not create nexus.

In the trial court, the State attempted to distance itself from the regulation by arguing that there are not enough facts in the regulation's example to support the argument that delivery alone cannot create nexus. CP 405. While the State grudgingly conceded that it "does not argue that occasional deliveries in one's own vehicle create nexus," it did argue that "regular and systematic" delivery in one's own vehicle does create nexus." CP 405. This contention, however, does no more than beg the ultimate question, and raises more questions than it purports to answer. When do "occasional" deliveries become "regular and systematic" deliveries? At what point is this amorphous line crossed? Should the constitutional law question of the presence or absence of substantial nexus turn on such an ill-defined standard? To avoid unnecessary litigation, and to encourage business in Washington, the State needs to provide objective guidelines on tax matters. Adoption of the State's litigation argument, however, leaves much room for confusion and little in the way of precise guidance for out-of-state businesses contemplating doing business in Washington.

(b) Delivery is not an Activity Significantly Associated with Space Age's Ability to Establish and Maintain a Market in Washington

The example in WAC 458-20-193(11)(a) is consistent with the judicial definition of the requisite nexus, which requires instate activities that are "substantial" and "significantly associated with the taxpayer's ability to establish and maintain a market in [the taxing] state." *Tyler Pipe*, 483 U.S. at 250; *Lamtec*, 170 Wn.2d at 851. Conversely, an in-state activity cannot create substantial nexus unless it is both "substantial" and "significantly associated with the taxpayer's ability to establish and maintain a market in [the taxing] state." *Tyler Pipe*, 483 U.S. at 250; *Lamtec*, 170 Wn.2d at 851.

No United States Supreme Court case has ever held that delivery alone creates the requisite substantial nexus.[12] While no case has expressly defined what activities are significantly associated with establishing and maintaining a market, a company establishes and maintains a market by making initial and subsequent sales of its products or services. Absent sales, there is no market. Accordingly, activities that are "significantly associated with the taxpayer's ability to establish and maintain a market in [the taxing]

[12] In *Miller Bros. Co. v. State of Maryland*, 347 U.S. 340, 74 S. Ct. 535, 98 L. Ed. 2d 744 (1954), the Court held that delivery of products by a Delaware seller, in its own trucks, to customers in Maryland was insufficient to establish the requisite minimum contacts required under the Due Process Clause. As noted above, the "substantial nexus" test under the Commerce Clause is more stringent than the "minimum contacts" test under the Due Process Clause. *Quill*, 504 U.S. at 313.

state" are activities that occur at the initial and ongoing solicitation stages of the customer relationship and are designed to generate an original or subsequent sales.

In *Tyler Pipe* the taxpayer maintained no office in Washington, owned no property in Washington, and had no employees in Washington. *Tyler Pipe*, 483 U.S. at 249. The taxpayer solicited sales from Washington customers by its executives who had out-of-state offices, and by an independent contractor located in Seattle. *Id.* This Court described the activities of the taxpayer's employees in Washington, and the impact thereof, in the following terms:

> [t]he 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.

Id. at 350, quoting *Tyler Pipe*, 105 Wn. 2d at 325 (emphasis added).

This Court held that these sales and soliciting contacts created the requisite substantial nexus, and the United States Supreme Court affirmed. *Tyler Pipe*, 483 U.S. at 250-51.

In *Standard Pressed Steel Co. v. Washington Department of Revenue*, 419 U.S. 560, 95 S. Ct. 706, 42 L. Ed. 2d 719 (1975), the taxpayer manufactured and sold aerospace fasteners. It was headquartered in

Pennsylvania and had manufacturing plants in Pennsylvania and California. Boeing was the taxpayer's principal customer in Washington. The taxpayer employed Martinson, who lived in the Seattle area. Martinson's "primary duty was to consult with Boeing regarding its anticipated needs and requirements for aerospace fasteners and to follow up any difficulties in the use of [the taxpayer's] products after delivery." *Id.* at 561. Martinson also received help from a group of taxpayer's engineers, who visited Boeing about three days every six weeks. *Id.*

The Washington Court of Appeals held that Martinson's activities created the requisite substantial nexus, and the United States Supreme Court ultimately affirmed that determination, reasoning that the taxpayer's "employee, Martinson, with a full-time job within the State, made possible the realization and continuance of valuable contractual relations between [the taxpayer] and Boeing, *i.e.*, the initial and subsequent sales of the taxpayer's products to Boeing." *Id.* at 562 (emphasis added).

Lamtec also illustrates that nexus-creating activity is activity designed to generate sales. As noted above, in *Lamtec* the taxpayer sent its sales representatives into Washington several times a year to meet with its major customers. *Lamtec*, 170 Wn. 2d at 841. The sales representatives did not solicit sales directly during these visits, *id.*, but they did sometimes leave

brochures and product samples with the customers. Brief of Respondent DOR, 2008 WL 8014770, at *4. The employees answered customer concerns, addressed issues relating to the use of Lamtec's products, and participated in telephone calls to Lamtec's technical or customer service departments. *Id.*

This Court held that "[t]he contacts by Lamtec's sales representatives were designed to maintain its relationship with its customers and to maintain its market within Washington State," and 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." *Lamtec*, 170 Wn.2d at 851 (emphasis added). In other words, the nexus-creating activity, *i.e.*, the activity significantly associated with Lamtec's ability to establish and maintain its market in Washington, was sending its sales representatives to meet with its customers, the purpose of which was to ensure that Lamtec's customers would continue purchasing products from Lamtec.

In contrast to *Tyler Pipe*, *Standard Pressed Steel*, and *Lamtec*, the deliveries by Space Age in the present case have nothing to do with ensuring that Space Age's customers would continue to purchase fuel from Space Age. Space Age's wholesale customers make their buying decision on one factor:

price. CP 54. When a wholesale customer orders fuel from Space Age, Space Age delivers it. The delivery has nothing to do with establishing and maintaining Space Age's market in Washington because the wholesale customer already made the decision to purchase the fuel based solely on price. That same customer will only buy from Space Age the next time it needs fuel if Space Age again has the best price. Unlike Lamtec's sending of sales representatives to Washington to meet with customers to attempt to gain additional future sales, Space Age's delivery of fuel to the Washington wholesale customer does not, and cannot, generate future sales because such future sales will depend only on price. The delivery, therefore, is not an activity significantly associated with establishing or maintaining a market in Washington.[13]

Quill also demonstrates that delivery is not a nexus-creating event. In *Quill* the taxpayer solicited business in North Dakota and nationally through catalogs and flyers, advertisements in national periodicals, and telephone

[13] In the trial court, the State repeatedly made reference to the volume of sales made by Space Age to Washington customers and the number of miles driven by Space Age drivers in Washington, as if the magnitude of the activity was what creates nexus. CP 258, 266, 269, 398, 402, 430. The trial court accepted those arguments as part of its analysis. RPII 4. It is not, however, the amount of activity in Washington alone that matters, but rather the nature of that activity, *i.e.*, whether that activity is "significantly associated with the taxpayer's ability to establish and maintain a market in [the taxing] state." For example, in *Quill* the requisite nexus was lacking even though the taxpayer was the sixth largest vendor of office supplies in the state, mailed 24 tons of catalogs and flyers into the state, and sold over $1,000,000 in goods to 3,000 customers in North Dakota. *Quill*, 504 U.S. at 302, 304.

calls. During the period in question, the taxpayer sold almost $1,000,000 of products to approximately 3,000 customers in North Dakota. The products were all delivered by common carrier or by mail. The Court held that those shipments of products to North Dakota customers were not sufficient to create the substantial nexus required to allow North Dakota to impose its use tax without violating the Commerce Clause. *Quill*, 302 U.S. at 309-19.

Under *Quill*, the State of Washington could not constitutionally impose the B&O tax on Space Age's sales to Washington wholesale customers had Space Age delivered the fuel to those customers via common carrier. Likewise, the State could not constitutionally impose the B&O tax on a competitor of Space Age that used the same business model, except that it delivered the fuel by common carrier. Given the Commerce Clause's structural concerns about the effects of state regulation on the national economy, there is no reason for the constitutionality of the tax to turn on the method by which the fuel is delivered.[14]

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[14] In other areas of tax law the courts have rejected distinctions that states have tried to draw between delivery by common carrier and delivery by the taxpayer in its own vehicles. For example, 15 U.S.C. § 381 (also known as Public Law 86-272) prohibits states from imposing a net income tax on income derived in the state from interstate commerce if the only business activity by the taxpayer in the state is the solicitation of sales and orders are filled by shipment or delivery from a point outside the state. The statute applies regardless of whether the deliveries are made by common carrier or by the taxpayer in its own vehicles. *Department of Transportation v. National Private Truck Council*, 253 Va. 74, 77, 480 S.E.2d 500, 502 (1997).

(c) The State's Authorities do not Lead to a Different Result

In the trial court the State cited a number of in-state and out-of-state authorities in support of its position that delivery alone creates substantial nexus. First, the State argued that this court's decision in *Flight Options, LLC v. Department of Revenue*, 172 Wn. 2d 487, 259 P.3d 234 (2011), supports a conclusion that Space Age's deliveries create substantial nexus. The State is wrong. The issue in *Flight Options* was whether the taxpayer's airplanes had acquired a "tax situs" in Washington such that Washington could impose a property tax upon those planes without violating the Due Process Clause. As the Court stated in the opening paragraph of its opinion, "Flight Options argues that its airplanes do not have a tax situs in Washington and that the due process clause, U.S. Const. amend. XIV, therefore prohibits assessment of taxes on them." *Id.* at 492 (emphasis in original). This Court noted that there is a distinction between Due Process Clause analysis and Commerce Clause analysis: "a finding that the imposition of a tax does not violate the dormant commerce clause is sufficient to establish that the imposition also does not violate the due process clause, even though the converse is not true." *Id.* at 499. Although the Court noted that the number of visits to Washington by the taxpayer's airplanes to Washington "far exceeds the number of visits held sufficient in *Lamtec*, the Court did not hold that those visits were

sufficient to create substantial nexus for Commerce Clause purposes, but rather only that they were sufficient to Due Process Clause purposes:

> we hold that a state may impose an apportioned property tax on airplanes habitually entering the state, even where those airplanes do not operate over fixed routes or on regular schedules. We further hold that an average of two visits to the state each day is sufficiently habitual to establish a tax situs.

Id. at 500, 259 P.3d 234. Contrary to the State's argument, *Flight Options* held nothing about what would or would not be sufficient in-state activities to establish substantial nexus for Commerce Clause purposes.

The State also cited a number of out-of-state cases where the courts upheld various types of taxes against out-of-state companies against constitutional challenges. In every one of those cases the taxpayer was engaged in some sort of in-state activity in addition to delivering products into the state in its own trucks. Several of the cases cited by the State are simply inapposite because they involved only challenges under the Due Process Clause which, as noted above, requires a lower threshold of contact between the taxpayer and the taxing state than does the Commerce Clause.[15]

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[15] *Good's Furniture House, Inc. v. Iowa State Board of Tax Review*, 382 N.W.2d 145, 146 (Iowa), *cert. denied*, 479 U.S. 817 (1986) ("Good's Furniture maintains that the use tax statute does not reach its operations, that the statute violates due process if it does . . . "); *In the Matter of State Sales or Use Tax Liability of Webber Furniture*, 290 N.W.2d 865, 868 (S.D. 1980) ("the question to be decided here is whether appellant's contacts with the State of South Dakota provide a sufficient nexus under the due process clause to support the imposition of a use tax collection liability . . . "); *Cooey-Bentz v. Lindley*, 66 Ohio St. 2d

Another case wrongly analyzed the Due Process Clause and Commerce Clause arguments by simply applying the lesser standard Due Process test to both arguments.[16] Another case discussed both Commerce Clause and Due Process Clause challenges, but discussed nexus only in connection with the Due Process argument.[17]

In each of the other cases cited by the State, the taxpayer engaged in activities in the taxing state in addition to making deliveries in its own vehicles. For example, in *John Swenson Granite, Inc. v. State Tax Assessor*, 685 A.2d 425 (Me. 1996), in addition to making deliveries into Maine, the taxpayer's vice-president visited customers in Maine two to five times a year both to solicit sales and to deal with any existing customer concerns, one of the taxpayer's employees lived in Maine and gave technical advice to the taxpayer's Maine customers four or five times during the audit period, and the taxpayer advertised in telephone directory yellow pages that served several

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54, 419 N.E.2d 1087 (1981).

[16] *Rowe-Genereux, Inc. v. Vermont Department of Taxes*, 138 Vt. 130, 131 n.1, 411 A.2d 1345, 1346 n.1 (1980) ("[d]espite the difference in emphasis, however, the test for determining whether the imposition of a state use tax violates the requirements of either clause is similar. The 'simple but controlling question is whether the state has given anything for which it can ask return'").

[17] *Falcone T/A Hilltop Sales & Service v. Taxation Division Director*, 12 N.J. Tax. 75, 86 (1991) ("I find that the facts of this case provide sufficient transactional nexus to overcome due process objections and that the imposition of an obligation on Falcone to collect sales tax on New Jersey transactions is neither discrimination against interstate commerce nor a burden on interstate commerce").

Maine towns. In *Brown's Furniture, Inc. v. Wagner*, 171 Ill. 2d 410, 665 N.E.2d 795, *cert. denied*, 519 U.S. 866 (1996), in addition to delivering furniture into Illinois, the taxpayer advertised extensively in Illinois. During the ten month audit period the taxpayer "had 2,800 individual advertisements in Illinois media outlets." *Id.* at 414, 665 N.E.2d at 798. And in *Town Crier, Inc v. Department of Revenue*, 315 Ill. App. 286, 733 N.E.2d 780 (2000), the out-of-state merchant, in addition to delivering products into Illinois, also on some occasions installed window dressings at the customers residences in Illinois.

There is language in *Brown's Furniture* that suggests that the Illinois court believed that delivery alone in the taxpayer's own trucks is sufficient to overcome a Commerce Clause challenge. *Brown's Furniture*, *supra*, 171 Ill. 2d at 425, 665 N.E.2d at 803. Yet the court also took pains to address the taxpayer's argument that imposition of the tax would violate the United States Supreme Court's holding in *Miller Bros.* The Court observed that "[n]or was Brown's Furniture's extensive advertising in Illinois media outlets 'incidental.'" *Brown's Furniture*, 171 Ill. 2d at 427, 665 N.E.2d at 804.

More significantly, even if the Illinois court did believe that delivery alone was sufficient to create nexus, this Court should hold otherwise because, as noted above, activities significantly associated with the taxpayer's

ability to establish and maintain a market are activities designed to generate initial and subsequent sales.

F. CONCLUSION

This case offers the Court an opportunity to further clarify what constitutes substantial nexus under the Commerce Claus in an era where such clarification is essential for businesses. Since this case involves a Commerce Clause challenge to the state's imposition of the B&O tax, the proper focus is on whether Space Age engaged in substantial activities in Washington that are significantly associated with Space Age's ability to establish and maintain a market in Washington, not on the volume of sales or number of deliveries. Proper Commerce Clause analysis focuses on the nature of the taxpayer's in-state activities, not on the volume of such activities. The State and the trial court erred by essentially analyzing this case as a Due Process case by arguing, and ruling, that the number of deliveries by Space Age, in and of themselves, created the necessary substantial nexus, without considering the fundamental question of whether Space Age's deliveries were "significantly associated with [Space Age's] ability to establish and maintain a market within [Washington]."

The State's implementing regulation, and Example 11 given therein, correctly state that deliveries by an out-of-state taxpayer, in its own trucks, to

wholesale customers in Washington do not, in and of themselves, create nexus. Rather, the B&O tax may be imposed on the underlying transaction only "if there is nexus." The regulation properly recognizes that delivery itself is not a nexus-creating activity.

The regulation is consistent with United States Supreme Court precedent. The Court has never held that deliveries alone, whether by common carrier or by the taxpayer in its own trucks, create the requisite substantial nexus. Where the Court has found that substantial nexus existed, the taxpayer was engaged in activities in the state designed to generate initial and subsequent sales of the taxpayer's products. Where, as here, the in-state customer's decision to purchase the product from the out-of-state taxpayer is not based on any in-state activities of the taxpayer, the subsequent delivery of the product by the taxpayer in its own trucks, just like the subsequent shipment of the product by the taxpayer by common carrier, simply is not a nexus-creating activity. The trial court erred in holding to the contrary, and the trial court's judgment must be reversed.

DATED this 22d day of June, 2012.

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DECLARATION OF SERVICE

On said day below I emailed and deposited in the U.S. Mail a true and accurate copy of the Brief of Appellant in Supreme Court Cause No. 86972-3 to the following parties:

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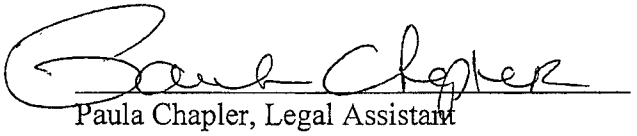
I declare under penalty of perjury under the laws of the State of Washington and the United States that the foregoing is true and correct.

DATED: June 22, 2012, at Tukwila, Washington.



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Per Mr. Talmadge's request, attached please find the Brief of Appellant for filing in the following case:

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