NO. 46939-1

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

IRWIN NATURALS,

Appellant,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

BRIEF OF RESPONDENT

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I. INTRODUCTION

Irwin Naturals received over $15 million from sales to Washington customers during the period at issue, and seeks in this case to avoid paying taxes on $5 million of that amount, on the theory that those sales are "dissociated" from the rest. But case law over the last 50 years has all but eliminated the theory that a taxpayer with nexus to a state may "dissociate" a portion of its inbound sales to avoid state taxation.

The United States Supreme Court has expressly rejected "dissociation" with respect to taxes an interstate seller collects from its customers, such as sales and use taxes. *Nat'l Geographic Soc'y v. California Bd. of Equalization*, 430 U.S. 551, 561, 97 S. Ct. 1386, 51 L. Ed. 2d 631 (1977). In addition, as this Court recently recognized, the foundations of the 1951 case forming the basis of the dissociation theory have been eroded by subsequent precedent. *Avnet v. Dep't of Revenue*, No. 45108-5-II, slip op. at 15 (Wn. App. April 28, 2015). Those subsequent cases reject the same theory Irwin relies on: that a company can avoid tax by receiving or processing orders on some sales separately from the parts of its business that sends employees into the destination state. Instead, a taxpayer is not immune from taxation under the commerce clause on the sales of an independently operated division.

Under current jurisprudence, a state must have a nexus with the taxpayer and the transaction it seeks to tax. In determining taxpayer nexus, courts look at the bundle of corporate activity and whether a company's in-state activities help it maintain its market in the state. Nexus with the transaction requires a minimum connection between the state and the taxable activity. Under the authority provided by this Court's recent decision in *Avnet*, Irwin has not established that any of its Washington-bound sales are immune from Washington tax.

Irwin employees visited Washington for over 100 total days during the tax period to market the company's nutritional products, hired four independent firms to do additional marketing or to use its connections to the local market, and implemented a marketing strategy in which the promotion and sale of goods through its "retail channel" were inextricably linked with those of its "wholesale channel." Moreover, it is undisputed that every contested transaction involves the sale of goods that Irwin shipped into Washington at the buyer's request. These undisputed facts preclude Irwin from establishing its entitlement to a tax refund. Washington has substantial nexus to tax all of Irwin's inbound sales.

The trial court correctly ruled that Irwin failed to prove a violation of the commerce clause as a matter of law. *National Geographic* and *Avnet* dictate the outcome of this case. This Court should affirm.

II. COUNTERSTATEMENT OF THE ISSUES

1. The United States Supreme Court in *National Geographic* held that an out-of-state seller cannot avoid the obligation to collect use taxes on its sales of goods shipped into a state by proving that particular transactions are "dissociated" with its in-state activities. Did the trial court correctly rule that Irwin could not avoid sales taxes on its Washington retail sales under a dissociation theory?

2. Irwin admits it has nexus to Washington for its wholesale sales due to its marketing activities here, but contests nexus for its retail sales. Irwin's retail and wholesale businesses sold the same types of products and Irwin had a strategy to transfer products from one channel to the other to maximize overall sales in the Washington market. Did the trial court correctly conclude that Irwin cannot avoid business and occupation taxes on its Washington retail sales?

3. Did the trial court correctly rule that the Department's interpretative rule, WAC 458-20-193, does not permit Irwin to "dissociate" sales made through its "retail channel" from its concededly taxable wholesale sales?[1]

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[1] The Department has reversed the order of issues from those presented in Appellant's opening brief. Sales and use taxes are addressed first because there is controlling United States Supreme Court authority directly on point. The second and third issues concern business and occupation taxes, the outcome of which is dictated by this Court's recent decision in *Avnet*.

III. STATEMENT OF THE CASE

A. Irwin's Washington Activities

1. Irwin's Washington sales

Irwin is a major nutritional product seller in the Washington market, with substantial Washington revenues. CP 45-46, 85-86, 88-89. Irwin is based in Los Angeles, California, and sends products to Washington by common carrier. CP 45-46. Between 2002 and 2009, the tax period at issue, Irwin earned over $15 million in total gross revenue selling its products to Washington customers. CP 45, 88-89.

Irwin's products and brand have a significant Washington presence. In addition to health food stores, Irwin products are available at numerous grocery stores in Washington such as Albertsons, Associated Grocers, Big Lots/Pic and Save, Bimart, CVS, Drug Emporium, Grocery Outlet, Haggen, Hi-School Pharmacy, Kmart, Longs Drug, QFC, Rite Aid, Rosauers, Target, Tidymans, Trader Joe's, Unified Grocers, Vitamin World, Walgreens, and 7-Eleven. CP 85-86. Amazon.com and drugstore.com, which also have Washington locations, carry Irwin products. CP 85-86. Irwin has strong brand recognition, and people know the Irwin name. CP 118 (testimony of marketing representative hired by Irwin to promote its products).

During the tax period, Irwin developed, marketed, and sold nutritional products wholesale to Washington retailers and distributors, and at retail directly to Washington consumers. CP 45. Irwin sold at wholesale to distributors, health food stores, and grocery stores. Irwin made these sales throughout the tax period at issue in this case. From 2002 through 2009, Irwin earned approximately $10.1 million in gross revenue from these wholesale sales. CP 45. Irwin agrees that it owes tax on these wholesale sales. *See* CP 11 (conceding nexus for wholesale sales).

Irwin also sold products at retail directly to Washington consumers. CP 45. These sales were typically initiated through online or phone orders. CP 45. Irwin started making direct consumer retail sales in 2004, after it already had a store presence in Washington. CP 45. Irwin earned approximately $5 million in gross revenue on its retail sales to Washington customers during the tax period. *See* CP 28-29 (showing the sales figures by year). The taxes on these sales are the subject of the dispute in this case.

2. Irwin's Washington marketing

Irwin employed an extensive marketing strategy in Washington to maintain its market here. During the tax period, senior Irwin employees visited Washington in person numerous times. CP 83-84, 187-89. For

example, Mike Berg, Vice President of Sales & Marketing, spent approximately 28 to 35 days in Washington between 2002 and 2009. CP 188. Jeff Sugawara, Vice President of Sales, spent approximately 30 to 32 days here over the same time period. They each engaged in new item presentation, category review, and promotional planning. CP 188. Lisa Clarke, an Inside Sales Representative, spent approximately 20 to 30 days in Washington over the same time period engaging in new item presentation, education of sales staff, and trade show exhibitions. CP 188.

Klee Irwin, the company's namesake, founder, and owner, spent two to six days in Washington between 2002 and 2004 engaging in new item presentation. At least 11 other employees made visits to Washington to market Irwin products. CP 188-89. One Irwin sales representative lived in Washington during 2003 and 2004. CP 84, 188.

Irwin did not limit its Washington marketing activities to visits by its employees. Irwin also contracted with four firms to assist it in marketing its products to Washington stores. CP 94-111. Irwin contracted with (1) Evergreen Sales & Service, in Issaquah, (2) Quality Reset Services, in Spokane, (3) Kahler-Senders Group, in Fife, and (4) Mittenthal Associates/P&GB, in Bellevue. CP 78-79; 94-111. These companies provided a number of in-state services on behalf of Irwin in Washington, including:

- Providing retailers with specifications to set up new products;
- Receiving product orders directly from retailers;
- Answering questions from retailers about order status;
- Attending retailer shows on Irwin's behalf; and
- Acting as an intermediary between retailers and Irwin on business matters such as promotional programs and insurance coverage.

CP 83. Irwin's independent representatives received commissions based on whether they sold current active products or new products. *See, e.g.*, CP 106. In addition, the representatives agreed to adhere strictly to Irwin's price schedules, terms, and conditions of sale. *E.g.*, CP 107. The representatives were to "act only as an agent for [Irwin]." *E.g.*, CP 107.

Mittenthal Associates, one of the companies Irwin hired to promote its products, received $152,300 from Irwin during the tax period. CP 81. Irwin approached Mittenthal to market its products in Washington because Mittenthal, in its words, is "very good at what we do. We sell product." CP 115. Mittenthal made presentations to Costco regarding Irwin products. CP 116. Mittenthal sometimes presented together with Mike Berg, Irwin Vice President & Sales Representative. CP 119. Irwin admits that the various trips by its employees and independent representatives created sufficient nexus for Washington to tax its

wholesale sales, but it contends they did not create sufficient nexus for its retail sales. CP 11.

Most Irwin wholesale customers used imagery and promotional materials provided by Irwin. CP 91. These customers often sold Irwin products on their websites. CP 92. Irwin also advertised directly to consumers using a variety of radio and television commercials. CP 89.

3. Commonalities between Irwin's wholesale and retail sales

Irwin's wholesale and retail sales involved the same type of products—nutritional products. Almost every Irwin product sold at a Washington grocery or health store listed a phone number or email address allowing consumers to contact Irwin. CP 86. In addition, product packaging for in-store products (which were part of Irwin's wholesale sales) contained a website, such as irwinnaturals.com. CP 86. These websites provided consumers with information about Irwin products and a way to obtain single-dose samples. CP 86. Irwin sold products to wholesale customers under the brands "Irwin Naturals," "Nature's Secret" and "Applied Nutrition" from 2002 through 2006. CP 193. Some consumers who purchased Irwin products from Irwin's wholesale customers made phone inquiries to Irwin about buying additional Irwin products. *See* CP 47.

Irwin executed a marketing strategy that integrated its wholesale and retail sales. In 2004, two years after Irwin began selling products at wholesale to Washington stores, Irwin began promoting products directly to Washington consumers through infomercials. CP 87. One of Irwin's objectives was to shift products that it sold directly to consumers at retail to its wholesale customers, which would run "As Seen On TV" campaigns. CP 87. As stated by Vice President Mark Green, "The business plan in 2004 with respect to the Retail Channel was to offer products through infomercials for retail sale and then, as sales began to peak, offer those products for wholesale sale through retailers and distributors in the Wholesale Channel." CP 47.

A prime example of this integrated market strategy involved the product "Dual Action Cleanse," which was Irwin's "primary product" in its retail business. CP 87. After first selling the product directly to consumers, Irwin in 2006 began selling the product to Washington stores at wholesale, which displayed "As Seen On TV" advertising. CP 87. Irwin not surprisingly sold this product for a lower price to the stores at wholesale than when it sold to consumers at retail, but it continued to sell substantial amounts of the product in both the wholesale and retail channels throughout the tax period. CP 48.

B. Procedural Background

The Department of Revenue audited Irwin's books and records and issued assessments for unpaid business and occupation (B&O), retail sales, and litter taxes for 2002 through 2009.[2] CP 10, 11, 58. Irwin paid the assessments, together with associated penalties and interest, and filed this action seeking a refund under RCW 82.32.180. CP 10-12.

Both parties moved for summary judgment. The trial court determined that the material facts were undisputed, and it ruled that Washington had substantial nexus under the commerce clause to tax all of Irwin's Washington sales. The trial granted summary judgment to the Department, and denied Irwin's motion. CP 247-48. Irwin appeals.

IV. ARGUMENT

The United States Supreme Court has expressly held that a seller of goods cannot "dissociate" a portion of its inbound sales for sales or use tax purposes, and therefore Irwin owes sales tax for its Washington retail sales to consumers because it did not collect the tax from those consumers. Washington also constitutionally imposed B&O tax on those sales under the standards outlined in this Court's recent holding in *Avnet*.

Irwin seeks to turn back the clock on the modern commerce clause case law, relying on a pair of 1951 cases. This Court should decline the

[2] Because Irwin does not mention the litter tax in its assignments of error or present argument related to that tax, it is not part of this appeal.

invitation and instead apply the current legal standards, as it recently did in *Avnet*.

This Court reviews questions of law and orders granting summary judgment de novo. *In re Estate of Hambleton*, 181 Wn.2d 802, 817, 335 P.3d 398 (2014). "Whether an out-of-state company has a substantial nexus with Washington is a question of law reviewed de novo." *Space Age Fuels, Inc. v. Dep't of Revenue*, 178 Wn. App. 756, 762, 315 P.3d 604 (2013). "Taxes are presumed valid, and the company bears the burden of showing that a substantial nexus does not exist." *Id.* The trial court correctly concluded as a matter of law that Washington has substantial nexus with Irwin and with the inbound retail sales at issue in this case.

A. Under Current Law, Companies Engaging In Interstate Commerce Must Pay Their "Fair Share" Of State Taxes.

Before 1977, states could not directly tax interstate commerce, but certain indirect taxes or taxes imposed on a local component of the interstate activity were permitted. In 1977, the United States Supreme Court overruled the line of cases prohibiting states from directly taxing interstate commerce. The Court held that a state tax is consistent with the commerce clause "when 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." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977).

Instead of carving out an area of "tax immunity" for interstate commerce, the *Complete Auto Transit* test permits states to ensure interstate commerce pays its "fair share" of the state's tax burden while shielding it from discriminatory treatment and an undue risk of multiple taxation. Here, there is no dispute that Washington's retail sales tax and retailing B&O tax as applied to Irwin's retail sales are both fairly apportioned and nondiscriminatory as required by the commerce clause.

Only the "substantial nexus" prong is in dispute in this case. "A substantial nexus exists when a company's activities in Washington are both substantial and significantly associated with its ability to establish and maintain a market in Washington for its sales." *Space Age Fuels*, 178 Wn. App. at 762.

A frequent but rarely successful taxpayer argument relating to substantial nexus is "dissociation," or the issue of whether the commerce clause would ever prohibit a state from taxing a portion of an interstate seller's in-state sales that are unrelated to other in-state activities such as marketing. The concept arose from the 1951 case *Norton Co. v. Illinois Dep't of Revenue*, 340 U.S. 534, 71 S. Ct. 377, 95 L. Ed. 517 (1951). *Norton*, however, does not reflect current law.

Soon after the United States Supreme Court overruled the ban on states directly taxing interstate commerce, the Court rejected "dissociation" for "indirect" taxes, or taxes such as sales and use taxes that an interstate seller collects from its customers. *Nat'l Geographic Soc'y v. California Bd. of Equalization*, 430 U.S. 551, 561, 97 S. Ct. 1386, 51 L. Ed. 2d 631 (1977). Consistent with its prior decisions concerning mail-order sales into the state by the independently operated divisions of national retailers, the Court held that a taxpayer with a physical presence in the state cannot "dissociate" inbound mail order sales based on a lack of connection between those transactions and the seller's in-state activities. *Id.* Under *National Geographic*, Irwin must collect and remit sales tax on its retail sales to Washington consumers. Having failed to do so, it is liable for the tax. *See* RCW 82.08.050(1), (3) (seller liable for uncollected sales tax).

Although *National Geographic* relied on cases involving other types of taxes (including Washington's B&O tax), it did not expressly decide whether the concept of dissociation could still apply with respect to these other taxes. However, there is no question that "*Norton's* foundations have been eroded by subsequent precedent." *Avnet v. Dep't of Revenue,* No. 45108-5-II, slip op. at 15 (Wn. App. April 28, 2015). This Court, synthesizing a sequence of United States Supreme Court

cases, held in *Avnet* that there need not be a direct connection between a taxpayer's in-state activities and particular sales for the state to impose its B&O tax on those sales. *Id.* at 14. "Some connection" is required, however, which is found by looking at whether the taxpayer's activities are significant in establishing and maintaining a market for goods in this state. *Id.* at 17.

Washington has substantial nexus to Irwin based on Irwin's extensive marketing here through employees and independent contractors, which Irwin admits for its $10.1 million in wholesale sales. These marketing contacts were directed at maintaining a market here, where Irwin has a presence at health and grocery stores throughout the state. Irwin took advantage of this market by moving products from its retail business to its wholesale business. And Washington has nexus to all the transactions in this case because it is undisputed that all the customers received the products in Washington. Given the strong connection between Irwin's Washington activities and its sales into the state, Irwin cannot prove any Washington sales should be "dissociated."

B. The United States Supreme Court Does Not Permit "Dissociation" of Sales Taxes.

The bulk of the taxes at issue in this case are sales taxes. Irwin correctly does not contest that Washington imposes a sales tax on inbound

sales to Washington customers. Rather, Irwin argues that the commerce clause prohibits Washington from holding Irwin accountable for failing to collect sales taxes from its Washington customers. The United States Supreme Court has rejected an indistinguishable argument relying on the same case authority.

Washington imposes a retail sales tax on each retail sale of tangible personal property in this state. RCW 82.08.020. The sales tax is paid by the buyer, but collected by the seller. RCW 82.08.050. If the seller does not collect the tax, the seller is liable for the tax. *Id.* The Department held Irwin liable for sales tax because it did not collect and remit sales or use tax from its Washington retail purchasers. *See* CP 58. The use tax is similar to the sales tax and applies when personal property is used in this state and no sales tax has been paid in this or any other state. *See* RCW 82.12.020. Washington taxes interstate sales of goods that are inbound to Washington. *See, e.g., Lamtec Corp. v. Dep't of Revenue*, 151 Wn. App. 451, 215 P.3d 968 (2009), *aff'd*, 170 Wn.2d 838, 246 P.3d 788 (2011); *see also* WAC 458-20-193.

1. Under *National Geographic*, imposing sales taxes on Irwin for its Washington sales complies with commerce clause limitations.

The sales tax issue is controlled by *National Geographic Society v. California Board of Equalization*, 430 U.S. 551, 97 S. Ct. 1386, 51 L. Ed.

2d 631 (1977). The issue in *National Geographic* was whether California could require out-of-state seller National Geographic to collect use tax on direct mail-order sales of globes, maps, and atlases sent to California addresses. *Id.* at 554. National Geographic maintained two offices in California from which it solicited advertising for its magazine. However, neither office performed any activity relating to National Geographic's mail-order business. Thus, National Geographic argued that its in-state activity—which was all related to advertising sales, not mail-order sales—should be disregarded in determining whether it must collect California use tax on mail-order sales. More specifically, "[t]he Society argues . . . that there must exist a nexus or relationship not only between the seller and the taxing State, but also between the activity of the seller sought to be taxed and the seller's activity within the State." *Nat'l Geographic*, 430 U.S. at 560.

The Supreme Court squarely rejected National Geographic's dissociation argument:

> [T]he relevant constitutional test to establish the requisite nexus for requiring an out-of-state seller to collect and pay the use tax is not whether the duty to collect the use tax relates to the seller's activities carried on within the State, but simply whether the facts demonstrate "some definite link, some minimum connection, between [the State and] the *person* . . . it seeks to tax."

Nat'l Geographic, 430 U.S. at 561 (quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45, 74 S. Ct. 535, 98 L. Ed. 744 (1954)) (emphasis in original). In other words, no connection between in-state marketing or activities and inbound sales is required. Rather, the taxpayer's physical presence in the state supported the state's taxing jurisdiction over all of the sales of goods shipped into the state. *See also D. H. Holmes Co. Ltd. v. McNamara*, 486 U.S. 24, 31, 108 S. Ct. 1619, 100 L. Ed. 2d 21 (1988) (rejecting taxpayer's argument that it lacked nexus to Louisiana for its interstate mail-order catalogs where it had a significant presence inside the state and directed the supplier to deliver the goods to its customers in the state). *National Geographic* emphatically forecloses Irwin's argument with respect to sales taxes.

2. This Court should reject Irwin's arguments for disregarding *National Geographic*.

Irwin correctly acknowledges that *National Geographic*, if still good law, forecloses its argument. App.'s Br. at 23 ("In *National Geographic*, the Court held that the taxpayer was not permitted to dissociate its mail order sales for sales and use tax purposes."). To avoid the effect of *National Geographic*, Irwin tries to persuade this Court that the case is no longer is good law. App.'s Br. at 23 (asserting *National Geographic* has been "diminished, if not tacitly overruled"). Irwin argues

that this Court should ignore the clear holding in *National Geographic* because: (1) the *National Geographic* Court relied on dicta in *Norton*, and (2) the Supreme Court's decision was "incomplete" because it relied on the due process clause rather than the commerce clause. App's Br. at 23-29.

Neither argument has merit. Irwin first asserts that *National Geographic* relied on dicta in *Norton*. App.'s Br. at 23-24. So what? Irwin offers no authority for the proposition that the Supreme Court's reliance on dicta in a previous case is grounds for ignoring a holding in a subsequent case that is not dicta.

In *Norton*, the Court held that if a taxpayer could prove inbound mail order sales were "dissociated" from its local activities, Illinois could not impose its occupation tax on the interstate seller. *Norton Co. v. Illinois Dep't of Revenue*, 340 U.S. 534, 71 S. Ct. 377, 95 L. Ed. 517 (1951). The holding made sense in the context of the prohibition of direct state taxation of interstate sales applied by the Supreme Court at the time, which drew a line between taxable "local transactions," and those that were "clearly interstate in nature," and thus immune from tax. *See Avnet*, slip op. at 16 (noting that *Norton's* holding rested on the discarded "tax immunity" doctrine). The Court determined that the taxpayer had met its

burden to show that its in-state activities were local in nature and not connected to some of its interstate mail-order sales. *Id.* at 539.

The Court in *National Geographic*, having recently allowed direct taxation of interstate sales in *Complete Auto Transit*, opted to distinguish *Norton* rather than overrule the case outright. It did so based on the type of tax at issue. The Court in *Norton* had stated that the burden on an interstate seller to collect a tax owed by a customer would be less onerous than the state taxing the seller itself. *Norton*, 340 U.S. at 537. In *National Geographic*, the Court cited this point and expanded on it to hold that California's requirement that National Geographic collect use tax on its interstate sales was consistent with the commerce clause. *Nat'l Geographic*, 430 U.S. at 558. Nothing about this sequence undermines *National Geographic* in any way.

Irwin's second argument—that *National Geographic* was "incomplete" because it addressed only the due process clause and not the commerce clause—is simply incorrect. The briefing and decision provided a thorough analysis of the commerce clause. CP 230-39 (commerce clause arguments in appellant's brief); *Nat'l Geographic*, 430 U.S. at 554 (commerce clause at issue), 557-61 (discussing commerce clause cases).

The taxpayer made the same argument as Irwin does here. It alleged that its mail order business had no connection to its in-state advertising business, and therefore it had no "physical presence" for its mail order business. *See* CP 221-41 (National Geographic's Supreme Court brief). The taxpayer relied primarily on *Norton*. CP 237-38.

The Supreme Court rejected the taxpayer's reliance on *Norton*. *Nat'l Geographic*, 430 U.S. at 558 The Court discussed or cited numerous other commerce clause cases, including *Standard Pressed Steel, Co. v. Dep't of Revenue*, 419 U.S. 560, 562-63, 95 S. Ct. 706, 42 L. Ed 719 (1975), and *Complete Auto Transit*, the case Irwin says the Supreme Court ignored. *Nat'l Geographic*, 430 U.S. at 557-58.

Irwin also makes the related observation that *National Geographic* did not discuss the four prong commerce clause test from *Complete Auto Transit*, the case decided just one month earlier. App.'s Br. at 28. But the only prong at issue in *National Geographic* was the first—substantial nexus—the same prong at issue in this case. The Court analyzed this prong in the context of the taxpayer's dissociation argument and held that "such dissociation does not bar the imposition of the use collection duty." *Nat'l Geographic*, 430 U.S. at 560.

The only reasonable interpretation of *National Geographic* is that substantial nexus does not mean what Irwin asserts it does. The Court in

National Geographic concluded that California could tax sales inbound to California because the taxpayer had a sufficient connection to the state through its in-state activities, even if those in-state activities were not directly connected to the sales of those goods. *Nat'l Geographic*, 430 U.S. at 562. Likewise, substantial nexus is easily met in this case because Irwin has extensive connections to Washington sufficient to meet the constitutional test through its marketing activities. In fact, Irwin concedes it has such a connection for its wholesale sales. CP 11. Under this precedent, Irwin cannot dissociate retail sales for sales tax purposes.

C. Washington Has Nexus To Impose B&O Tax On All Of Irwin's In-State Sales Because Of Its Washington Contacts And The Relationship Between Its Sales Channels

While the Supreme Court in *National Geographic* held that dissociation was not available for sales and use taxes, it did not specifically rule on whether such a theory might work to carve out an exception to a taxpayer's substantial nexus for a tax like Washington's B&O tax. Washington imposes a B&O tax for the act or privilege of engaging in business activities in Washington. RCW 82.04.220. The tax applies to every person engaging in this state in the business of making sales at retail. RCW 82.04.250. The tax applies to inbound, but not outbound, interstate sales. *See* WAC 458-20-193.

1. For the same reasons as in *Avnet*, this Court should reject Irwin's dissociation arguments.

In the context of Washington's business and occupation tax, this Court recently rejected similar "transactional nexus" and "dissociation" claims based on much of the same case law Irwin relies on. *Avnet*, No. 45108-5-II, slip op. at 13-18 (attached as Appendix A).[3] Like Irwin, Avnet conceded that it had "taxpayer . . . nexus," or sufficient connection to the taxpayer, but argued that its instate activities were not sufficiently connected to some of its interstate sales. *Id.*, slip op. at 13. Avnet and Irwin both argued that Washington lacked "transactional nexus" with certain sales, and that they could dissociate some of their Washington sales from their Washington marketing activities. *Id.*; App.'s Br. at 20.

Avnet had a Washington office that engaged in building and maintaining the company's worldwide market. *Avnet*, slip op. at 18. Employees at that office serviced accounts, developed and implemented new marketing programs, recruited new customers, and offered extensive engineering support. *Id.* Avnet sought to "dissociate" two categories of sales: (1) national sales, which involved Avnet customers who placed orders from a location outside Washington with an Avnet office outside Washington, but received the products at their Washington locations, and

[3] The first issue in *Avnet* was whether a certain category of sales known as drop shipments were taxable under Washington statutes or rules. That is not an issue in this appeal because Irwin admits its retail sales were received in Washington.

(2) drop shipped sales, which also involved Avnet customers located outside Washington that placed orders with an Avnet office outside Washington, but instead of physically receiving the product, directed Avnet to ship the product directly to their customers in Washington. *Id.* at 3. With both categories of sales, Avnet argued that its Washington office was not involved in any way with the sales.

This Court rejected Avnet's claims, holding that in-state employee market research and product development created nexus even for orders placed and filled with an out-of-state office. *See id.* at 3, 18. This Court held that *Norton*, the primary case relied on here by Irwin, has "been eroded by subsequent precedent" and that "the United States Supreme Court has explicitly removed at least two of *Norton's* chief doctrinal underpinnings." *Id.* at 15, 16. This Court also instructed that "subsequent precedents have expanded the range of activities relevant to the substantial nexus analysis." *Id.* at 16. Avnet had substantial nexus with Washington sufficient to tax all of its Washington destination sales. *Id.* at 18. *Avnet* dictates the same result here, where Irwin has adopted an integrated marketing strategy designed to develop the market for both its "retail channel" and "wholesale channel" of nutritional product sales.

2. Under modern commerce clause standards, Washington constitutionally imposed B&O tax on Irwin.

Contemporary dormant commerce clause case law looks at the bundle of in-state corporate activity to determine whether a state can fairly tax sales in the state. *Avnet*, slip op. at 16 (quoting *General Motors Corp. v. Washington*, 377 U.S. 436, 447-48, 84 S. Ct. 1564, 12 L. Ed. 2d 430 (1964)). The Court also looks at "whether the taxpayer's instate activities were significant in establishing and maintaining a market for goods in the state." *Avnet*, slip op. at 17 (citing *Tyler Pipe Indus., Inc. v. Dep't of Revenue*, 483 U.S. 232, 250, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987)). No direct connection between Irwin's Washington activities and retail sales is required. *Avnet*, slip op. at 17. Due to Irwin's extensive presence here, Irwin cannot possibly meet its burden to demonstrate that Washington lacks substantial nexus to tax all of Irwin's Washington sales.

This Court in *Avnet* relied on United States Supreme Court cases that illustrate "a progressive broadening" of the types of activities that may establish substantial nexus for purposes of state taxation of interstate commerce. *Id.* In *General Motors*, for instance, Justice Clark, who wrote the dissenting opinion in *Norton*, wrote for the majority in 1964 that "the test" for evaluating a taxpayer's claim of dissociation was whether "the bundle of corporate activity" it carried on within the state supported the taxpayer's ability to establish and hold a market for its in-state sales. *General Motors Corp.*, 377 U.S. at 447-48. The Court found that although

none of General Motors' in-state personnel were involved in handling the orders for four divisions of the company, the taxpayer's sales in general were attributable to the increased demand generated by the corporation's in-state business activities. Accordingly, Washington could impose B&O tax on all of General Motors' Washington destination sales, including those ordered directly from out-of-state offices and independently operated warehouses. 377 U.S. at 447. The dissent in *General Motors* believed that the majority departed from *Norton*. 377 U.S. at 454 ("This decision departs from [*Norton*], and adopts a test there rejected.").

The Court continued this broadening trend in *Standard Pressed Steel* in 1975. There, a taxpayer's in-state activities consisted of a single employee working from a home office whose main function was to gather information needed to qualify as a supplier for the taxpayer's principal in-state customer, the Boeing Company. *Standard Pressed Steel*, 419 U.S. at 561. As in *General Motors*, the Court refused to limit its consideration only to the elements of particular transactions (*e.g.*, solicitation, ordering, fulfillment, delivery, payment) in evaluating the taxpayer's dissociation argument. 419 U.S. at 563. Instead, the Court examined the role of the seller's sole in-state technical consultant in maintaining relationships and contributing information that was important to establish and maintain *the market* for its sales. *Id.* at 562. In the Court's view, the contention that

those activities were too "thin and inconsequential" to support the state's taxing jurisdiction "verges on the frivolous." *Id.*

Following *General Motors* and *Standard Pressed Steel*, all of a seller's in-state business activities that are related, directly or indirectly, to establishing and maintaining a market for its sales are relevant in evaluating whether a state has taxing jurisdiction over the seller's interstate sales transactions. The practical effect of the seller's activities is the relevant focus, not the mechanics of particular sales transactions or the departmentalization of business operations. As one commentator noted, the Court in *Standard Pressed Steel* "seems to have liberated the State completely from the restraints of *Norton*." Walter Hellerstein, *State Taxation of Interstate Business and the Supreme Court, 1974 Term: Standard Pressed Steel and Colonial Pipeline*, 62 Va. L. Rev. 149, 155 (1976). Irwin's claim to the contrary is incorrect and should be rejected.

The Court continued its focus on the taxpayer's market-creating activities with a case again originating out of Washington. In *Tyler Pipe*, the Court agreed with the Washington Supreme Court's determination 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." *Tyler Pipe Indus., Inc. v. Dep't of Revenue*, 483 U.S. 232, 250, 107

S. Ct. 2810, 97 L. Ed. 2d 199 (1987) (quoting *Tyler Pipe Indus., Inc. v. Dep't of Revenue,* 105 Wn.2d 318, 323, 715 P.2d 123 (1986)).

Tyler Pipe involved an out-of-state business that sold pipe and drainage products in Washington. *Tyler Pipe*, 483 U.S. at 249. It had no office, property, or employees in Washington. *Id.* Its sole presence was an independent contractor supervised by an out-of-state manager. *Id.* The independent contractor visited customers, solicited orders, and gathered data about the market. *Id.* Like Irwin, Tyler Pipe argued that about a third of its orders were placed with its out-of-state business and were dissociated from the in-state activities. *Tyler Pipe*, 105 Wn.2d at 321. In affirming the Washington Supreme Court, the Court concluded the presence of the independent contractor created nexus for all the taxpayer's Washington sales. *Tyler Pipe*, 483 U.S. at 251.

The take-away from this sequence of modern commerce clause cases is that the focus is on the broader scope of market-creating activities of a seller, rather than the activities involved in making any particular sale. Irwin's multiple sales visits and its independent representatives, together with its integrated marketing strategy to promote the sales of products through both its wholesale and retail channels, easily satisfy the modern nexus requirements, regardless of whether the concept of dissociation retains any viability.

Consistent with federal case law, Washington appellate courts have repeatedly rejected arguments of "dissociation." *See Avnet*, No. 45108-5-II (Wn. App. April 28, 2015) (rejecting dissociation argument where employees serviced accounts, developed marketing, recruited customers, and offered engineering support in Washington, even though the particular sales were placed and fulfilled with out-of-state offices); *Chicago Bridge & Iron Co. v. Dep't of Revenue*, 98 Wn.2d 814, 821, 659 P.2d 463 (1983) (rejecting dissociation claim for products where contracts were negotiated and formalized out of state); *Dep't of Revenue v. J.C. Penney Co., Inc.*, 96 Wn.2d 38, 47-48, 633 P.2d 870 (1981) (in-state activities of store employees relating to handling credit card accounts "not sufficiently dissociated" from finance charge income); *Lamtec Corp.*, 151 Wn. App. at 467-68 (interstate sales not dissociated from in-state assistance to customers); *General Motors Corp. v. City of Seattle*, 107 Wn. App. 42, 25 P.3d 1022 (2001) (advertising in local market, warranty sales to retail buyers, and monthly visits by sales representatives provided nexus for wholesale sales to local dealers where orders were made online or with an out-of-state office and goods were shipped by common carrier from another state).

Disregarding over 50 years of United States Supreme Court authority, the most recent case Irwin cites holding that a taxpayer proved

dissociation of some of its sales is *B.F. Goodrich Co. v. State*, 38 Wn.2d 663, 231 P.3d 325 (1951). And even in that case, our Supreme Court expressed obvious skepticism of the theory. *Id.* at 675 ("Were we free to decide this case differently, we might well do so.").

To summarize the current test for substantial nexus and dissociation, there need not be a direct connection between Irwin's in-state activities and particular sales to impose business and occupation tax. *Avnet*, slip op. at 17. There must be some connection, which may be found by looking at whether Irwin's in-state activities were significant in establishing and maintaining a market for its goods in the state. *Id.* (citing *Tyler Pipe*, 483 U.S. at 250-51 and *General Motors*, 377 U.S. at 447-48). "The taxpayer carries a heavy burden in showing the absence of such a connection." *Id.* at 18 (citing *American Oil Co. v. Neill*, 380 U.S. 451, 458, 85 S. Ct. 1130, 14 L. Ed. 2d 1 (1965)).

Under the undisputed facts, Irwin cannot carry its burden. Not only were Irwin's extensive marketing activities in Washington significant in establishing and maintaining a market for its goods here, but also a strong relationship existed between its retail and wholesale lines of business. This far exceeded the connection required to sustain the Department's assessment of B&O tax on Irwin's retail sales.

Irwin's characterization of its strategy related to its "Dual Action Cleanse" product, its "primary retail product," is illustrative. CP 87. Irwin asserts that it would originally offer the product only at retail, and when those sales peaked, offer the product at wholesale. App.'s Br. at 14. The "goal of this business strategy was to maximize the revenue of the sale" of the product "over its product life." *Id.*

This shows that the market for retail and wholesale sales was integrated and related. The company aimed to maximize its sales through both channels and then switch products from one channel to the other to maintain the greatest possible market. The in-state marketing for wholesale sales allowed the company to keep the market for that product.

Irwin speculates that because the prices offered by its wholesale customers were lower than its retail prices for a particular product, no one would have purchased the product at retail after buying it from a wholesale customer. App.'s Br. at 14-15. The evidence in the record contradicts the theory. Chief Financial Officer Mark Green's affidavit reveals that despite "Dual Action Cleanse" becoming available in 2006 in stores for lower prices than online or by phone, Irwin continued to sell a substantial amount of the product through the retail channel. In fact, even by 2009, when sales figures for the product jumped in the wholesale channel, $634,929 in sales were still generated in the retail channel, nearly

as much as the $692,829 generated in the wholesale channel. CP 48. Irwin cannot prove, as it must, that its in-state wholesale marketing activities are in no way related to its retail sales.

There are other ways sales in the two channels were related. Customers in stores could view "As Seen On TV" advertising associated with the Dual Action Cleanse product and then order different Irwin products online or by phone that were not available in stores. *See* CP 91-92. Irwin simply cannot meet its burden of showing that the markets were not related in any way.

Irwin sold the same types of products—nutritional products—at wholesale and retail. CP 76-77. The wholesale products had Irwin labels on them. CP 118. Products purchased from wholesalers also had website information for Irwin contained in the packaging. CP 86-87. Irwin is a recognizable brand and name. CP 118. Products were available through both wholesalers' websites and Irwin's websites. CP 77, 92.

Irwin's extensive bundle of corporate activity in Washington justifies Washington's taxation of Irwin's retail sales to Washington consumers.[4] Regardless whether Irwin operated its two lines of business independently, the markets for these two lines of business were not

[4] In addition to employee visits, the presence of third-party representatives who market Irwin products is sufficient alone to create substantial nexus. *See Scripto, Inc. v. Carson*, 362 U.S. 207, 210-12, 80 S. Ct. 619, 4 L. Ed. 2d 660 (1960).

distinct. Therefore, even if "dissociation" still exists in some form, Irwin falls far short of its burden to prove that taxation of its retail sales violated the commerce clause.

3. *Complete Auto Transit* and *Quill* do not address dissociation.

To combat the series of on-point case law from the United States Supreme Court and Washington appellate courts repeatedly rejecting dissociation arguments, Irwin asserts that *Complete Auto Transit* and *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992) reaffirm the dissociation holding from *Norton* because they both require nexus. *See* App.'s Br. at 19-20. But neither addresses dissociation. Irwin's argument is a non sequitur.

Complete Auto Transit concerned the taxation of a company that transported vehicles from out-of-state into Mississippi. *Complete Auto Transit*, 430 U.S. at 276. There was no suggestion about multiple lines of business, or multiple types of business activities. The sole question was whether Mississippi could directly tax the interstate activities of the motor carrier. Reasoning that Mississippi's tax did not violate any of the four prongs of what would become the Court's commerce clause test, the Court held that the tax was valid. *Id.* at 288-89. The Court in Complete Auto Transit did not analyze or even mention *Norton*, and the holding in that

case is hardly an endorsement of the *Norton* majority opinion. *Complete Auto* has nothing to do with dissociation.

Quill similarly does not address dissociation, or a business that has multiple operations or product lines. *Quill* addressed a North Dakota sales and use tax collection requirement imposed on an out-of-state mail order company that did not send employees or independent representatives into the State or have any other in-state contacts. *Quill*, 504 U.S. at 301. *Quill* preserved "a safe harbor for vendors 'whose only connection with customers in the [taxing] State is by common carrier or the United States mail.'" *Id.* at 315 (quoting *Nat'l Bellas Hess, Inc. v. Illinois Dep't. of Revenue*, 386 U.S. 753, 758, 87 S. Ct. 1389, 18 L. Ed. 2d 505 (1967)).[5] *Quill* is distinguishable from this case because Irwin sent employees and independent representatives into Washington to conduct business activity on its behalf.[6]

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[5] The Court in *Quill* also explained that the due process clause was concerned with "notice" and "fair play," while "the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy." *Id.* at 312. Irwin fails to describe what "structural concern" is offended by Washington's taxation of its interstate retail sales to Washington customers.

[6] *Quill*'s physical presence requirement has not been extended to B&O taxes, as the decision repeatedly implied that its reasoning was limited to sales and use taxes. *See Quill*, 504 U.S. at 317; *see also General Motors Corp. v. City of Seattle*, 107 Wn. App. 42, 55, 25 P.3d 1022 (2001) (declining to extend *Quill*'s physical presence requirement in the B&O tax context). *Quill*'s holding has also been called into substantial doubt by the concurring opinion in a recent United States Supreme Court decision, *Direct Mktg. Ass'n v. Brohl*, __ U.S. __, 135 S. Ct. 1124, 1135, 191 L. Ed. 2d 97 (2015) (Kennedy, J., concurring) ("A case questionable even when decided, *Quill* now harms States to a

Irwin also asserts that "the state must have sufficient nexus with the instate transactions. . . ." App.'s Br. at 20. It is true that the state must have a connection to the transaction it seeks to tax. *See MeadWestvaco v. Illinois Dep't of Revenue*, 553 U.S. 16, 24, 128 S. Ct. 1498, 170 L. Ed. 2d 404 (2008) (there must be a minimum connection and rational relationship between a state and the transaction it seeks to tax). But that connection is met if the purchaser receives the goods in the taxing state. *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 184, 115 S. Ct. 1331, 131 L. Ed. 2d 261 (1995) ("It has long been settled that a sale of taxable goods has a sufficient nexus to the State in which the sale is consummated to be treated as a local transaction taxable by that State."); *Ford Motor Co. v. City of Seattle*, 160 Wn.2d 32, 54, 156 P.3d 185 (2007) ("a long line of precedent sanctions using the gross proceeds from wholesale sales delivered into a jurisdiction as the measure of a B&O tax, when the taxpayer is engaged in the business of fostering wholesale sales within the taxing jurisdiction."). Washington plainly has nexus to the transactions at issue because all the goods were shipped to and received by Irwin's Washington customers. Irwin's argument that there must be a different

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degree far greater than could have been anticipated earlier [due to drastically increased internet sales]").

kind of connection is not supported by any current commerce clause case authority.[7] *See Avnet*, slip op. at 17.

Washington clearly has nexus with all of Irwin's inbound sales. None of the contested sales were wholly out-of-state transactions. And it is undisputed that the purchasers were all in Washington and received the goods in Washington. This easily meets the minimum nexus requirement.

4. The Department's rule provides no basis independent of the commerce clause to "dissociate" sales.

In challenging Washington's imposition of B&O tax on its Washington retail sales, Irwin relies on language in the Department's interpretive rule on interstate sales, WAC 458-20-193,[8] contending it permits Avnet to avoid tax even if the commerce clause does not. App.'s Br. at 9-16. Rule 193 does not support Irwin's argument. Rule 193 is an interpretive rule that "parallels the rule for determining nexus under federal commerce clause analysis." *Lamtec*, 151 Wn. App. at 460-61.

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[7] The Supreme Court has described the transactional nexus concept in its discussion of both the due process and commerce clauses. *E.g. MeadWestvaco*, 553 U.S. at 24 (referring to due process clause); *Jefferson Lines,* 514 U.S. at 184 (discussing connection in terms of substantial nexus under first commerce clause factor). Although a number of cases require some connection between the state and the transaction taxed, none of the modern cases require a connection between in-state marketing activities and inbound interstate sales.

[8] This subsection of the rule provides in relevant part, "If a seller carries on significant activity in this state and conducts no other business in the state except the business of making sales, this person has the distinct burden of establishing that the in-state activities are not significantly associated in any way with the sales into this state."

The Department has revised Rule 193 many times to respond to developments in commerce clause case law. For example, in 1960, the Department amended the Rule to incorporate *Norton* and *B.F. Goodrich*. Former Rule 193 (1960). *See* Appendix D. But in 1974, the Department further revised the rule to reflect the "functional approach" embraced by the United States Supreme Court in subsequent decisions, including *General Motors* and *Standard Pressed Steel*, both of which specifically addressed Washington's B&O tax. *See* Appendix C. And in 1991, the Department removed language suggesting a taxpayer could "dissociate" sales based on the absence of any participation by an in-state representative with a sale transaction. *See* Appendix B. The 1991 revision reflected a key holding in *Tyler Pipe* that rejected a taxpayer's dissociation claim. *See Avnet*, slip op. at 17-18 (describing *Tyler Pipe*).

Rule 193 essentially equates "dissociation" with the absence of nexus. Rule 193 is consistent with *Tyler Pipe*'s focus on whether a taxpayer's in-state activities are directed towards maintaining a market in the state.

But even if Irwin were correct that Rule 193 provided a different standard than the commerce clause, Irwin's argument fails. "Interpretive rules do not constrain the courts." *Avnet, slip op.* at 9; *see also Space Age Fuels*, 178 Wn. App. at 764 (explaining that even if a different subsection

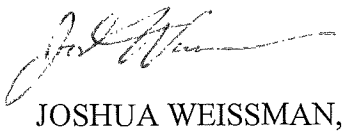
of Rule 193 interpreted the dormant commerce clause, this Court "would not defer to its interpretation because the Department does not administer or enforce the commerce clause of the United States Constitution"). Rule 193 provides Irwin "no more haven" than the B&O statute or the commerce clause does. *Avnet*, slip op. at 12. Irwin's claims must "succeed or fail on the merits of its constitutional arguments." *Id.* And Irwin's constitutional claims, like those in *Avnet*, are without merit.

V. CONCLUSION

Irwin ignores 50 years of commerce clause case law, relying instead on a 1951 case whose applicability has been expressly rejected for sales and use taxes, and eroded as applied to B&O taxes. Irwin employees visited Washington over 100 days during the tax period, Irwin paid four firms to market products here, and Irwin products were available at numerous Washington stores. Further, Irwin sold the same types of products (and sometimes the exact same product) in both its wholesale and retail "channels," and it pursued a strategy to maximize sales by shifting products between the two channels. And all of the contested retail sales were delivered to Washington customers. The trial court correctly determined that Washington had substantial nexus with Irwin as a matter of law for its Washington retail sales. This Court should affirm the trial court's order granting summary judgment to the Department.

RESPECTFULLY SUBMITTED this 8th day of May, 2015.

ROBERT W. FERGUSON
Attorney General



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APPENDIX A

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

AVNET, INC., Respondent/Cross Appellant, v. STATE OF WASHINGTON, DEPARTMENT OF REVENUE, Appellant/Cross Respondent.	No. 45108-5-II PUBLISHED OPINION

BJORGEN, A.C.J. — Avnet Inc. challenges the assessment by the Department of Revenue (Department) of business and occupation (B&O) tax on two categories of sales of goods delivered to Washington addresses. The trial court granted summary judgment to Avnet regarding one category of sales and to the Department regarding the other. The Department appeals, arguing that the B&O tax applies to all of Avnet's Washington-bound sales. Avnet cross-appeals, arguing that both the Department's own rules and the federal constitution's

commerce clause[1] prohibit the State from imposing the B&O tax on either of the disputed categories of sales.

Because the B&O statute and regulations subject both categories of Avnet's Washington-bound sales to the B&O tax consistently with the commerce clause, we reverse the grant of summary judgment to Avnet and remand for entry of judgment in favor of the Department. We otherwise affirm.

FACTS

Avnet Inc., a New York corporation headquartered in Arizona, describes itself as "one of the largest distributors of electronic components, computer products and embedded technology serving customers globally." Clerk's Papers (CP) at 194, 424. All of Avnet's products ship from distribution centers outside Washington. During the period at issue here, however, Avnet maintained an office in Redmond, Washington with more than 40 employees, serving customers in Washington and eastern Idaho and conducting other activities related to market and product development.

Following an audit, the Department determined that Avnet had miscalculated the amount of B&O tax due[2] for 2003 through 2005 by improperly excluding two categories of sales of Washington-bound products described as "National Sales" and "Third Party Drop-Shipped Sales." CP at 195. The Department determined that Avnet owed, with interest included, $556,330 in back taxes from the audit period, $386,179 of which arose from the Washington-bound national and drop-shipped sales at issue here.

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[1] U.S. CONST., art. I, § 8, cl. 3.

[2] Avnet paid B&O tax on all sales during the audit period of Washington-bound products in which its Redmond office directly participated, which amounts are not at issue here.

The national sales category involves transactions where an Avnet customer places an order from a location outside Washington with an Avnet sales office outside Washington, but directs Avnet to ship some or all of the products to one of the customer's Washington facilities. The drop-shipped sales category also involves an Avnet customer located outside Washington placing an order with an Avnet sales office outside Washington. In this type of sale, however, Avnet's customer directs Avnet to ship products to a third party located in Washington, generally the Avnet customer's own customer. Nothing in the record indicates that Avnet's Redmond office participated in soliciting or filling orders, investigating customer credit, or providing technical support to the end users in the specific sales at issue in this appeal.

After an unsuccessful administrative appeal, Avnet paid the contested amount under protest and filed this action in Thurston County Superior Court. Both parties moved for summary judgment. After hearing argument, the trial court granted Avnet's motion and denied the Department's as to the drop-shipped sales, but granted the Department's motion and denied Avnet's as to the national sales. The Department appeals and Avnet cross-appeals.

ANALYSIS

I. STANDARD OF REVIEW

An appellate court reviews a grant of summary judgment de novo and performs the same inquiry as the trial court. *Macias v. Saberhagen Holdings, Inc.*, 175 Wn.2d 402, 407-08, 282 P.3d 1069 (2012). A party moving for summary judgment bears the burden of demonstrating that there is no genuine issue of material fact. *Atherton Condo. Apartment-Owners Ass'n Bd. of Dirs. v. Blume Dev. Co.*, 115 Wn.2d 506, 516, 799 P.2d 250 (1990). A court should grant summary judgment only if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to

any material fact and that the moving party is entitled to a judgment as a matter of law." CR 56(c).

The meaning of a statute is a question of law we also review de novo. *Dep't of Ecology v. Campbell & Gwinn, LLC*, 146 Wn.2d 1, 9, 43 P.3d 4 (2002). The "fundamental objective" of statutory interpretation "is to ascertain and carry out the Legislature's intent." *Campbell & Gwinn*, 146 Wn.2d at 9-10. Where a "statute's meaning is plain on its face, then the court must give effect to that plain meaning as an expression of legislative intent." *Campbell & Gwinn*, 146 Wn.2d at 9-10. Such plain meaning "is discerned from all that the Legislature has said in the statute and related statutes which disclose legislative intent about the provision in question." *Campbell & Gwinn*, 146 Wn.2d at 11-12. If "the statute remains susceptible to more than one reasonable meaning" after such inquiry, it is ambiguous and we must "resort to aids to construction, including legislative history." *Campbell & Gwinn*, 146 Wn.2d at 12.

The rules of statutory construction also apply to the interpretation of administrative regulations adopted pursuant to statutory authority. *Cannon v. Dep't of Licensing*, 147 Wn.2d 41, 56, 50 P.3d 627 (2002). In this context, appellate courts "interpret[] a WAC provision to ascertain and give effect to its underlying policy and intent." *Cannon*, 147 Wn.2d at 56. "Rules and regulations are to be given a rational, sensible interpretation," and courts will not consider them "ambiguous simply because different interpretations are conceivable." *Cannon*, 147 Wn.2d at 56-57. As with statutes, courts do not generally apply canons of construction to unambiguous administrative regulations. *Cannon*, 147 Wn.2d at 57. Courts should, however, "avoid a literal reading of a provision if it would result in unlikely, absurd, or strained consequences." *Cannon*, 147 Wn.2d at 57.

"When its meaning is in doubt, a tax statute 'must be construed most strongly against the taxing power and in favor of the taxpayer.'" *Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 842-43, 246 P.3d 788 (2011) (quoting *Ski Acres, Inc. v. Kittitas County*, 118 Wn.2d 852, 857, 827 P.2d 1000 (1992)). Courts presume, however, that taxes are valid. *Lamtec*, 170 Wn.2d at 843. A party challenging the imposition of a tax thus bears the burden of proving that some exemption applies. *Lamtec*, 170 Wn.2d at 843; RCW 82.32.180. Where a court finds ambiguity in a provision providing for a tax exemption or deduction, the court must strictly construe the provision *against* the taxpayer. *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn.2d 139, 149-50, 3 P.3d 741 (2000).

II. THE DEPARTMENT'S APPEAL

We begin with the Department's appeal, which challenges the trial court's grant of summary judgment to Avnet as to the drop-shipped sales. The Department argues that under applicable statutes and regulations the drop-shipped sales are subject to the B&O tax. Avnet contends that the trial court correctly ruled that the B&O tax does not apply to its Washington-bound drop-shipped sales because Avnet did not receive the goods in Washington within the meaning of the Department's own regulations.[3] The Department is correct.

A. The B&O Statute and Implementing Regulations

Washington imposes the B&O tax "for the act or privilege of engaging in business activities" in the state. Former RCW 82.04.220 (1961);[4] *Lamtec*, 170 Wn.2d at 843. The statute

[3] As an alternative basis, Avnet argues that the trial court was correct in granting summary judgment, because the drop-shipped sales lacked the required constitutional nexus with Washington. In part III below, we conclude that constitutional nexus is present for both categories of sales.

[4] The legislature amended this provision in 2010, but the audit period here at issue predates that amendment.

requires "every person that has a substantial nexus with this state"[5] and who conducts activities here "with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly" to pay a percentage of the gross receipts of any resulting proceeds. Former RCW 82.04.220; RCW 82.04.140; *Lamtec*, 170 Wn.2d at 843.

For wholesale sales, the statute imposes "[u]pon every person engaging within this state in the business of making sales at wholesale" a B&O tax "equal to the gross proceeds of sales of such business multiplied by the rate of 0.484 percent." RCW 82.04.270. The statute defines "[s]ale" as "any transfer of the ownership of, title to, or possession of property for a valuable consideration." RCW 82.04.040(1). In interpreting this statute, our Supreme Court has held that "'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*, 141 Wn.2d at 149 (alteration in original) (quoting *Time Oil Co. v. State*, 79 Wn.2d 143, 146, 483 P.2d 628 (1971) and *Budget Rent-A-Car of Wash.-Or., Inc. v. Dep't of Revenue*, 81 Wn.2d 171, 175, 500 P.2d 764 (1972)).

In the drop-shipped sales, Avnet did not deliver the products to its own buyer outside Washington. Instead, it delivered the products to its buyer's customer in this state. Thus, the only transfer of possession of property to any buyer occurred within the State of Washington. Under the terms of RCW 82.04.040 and .270, read consistently with the interpretive principles noted above, this brought the drop-shipped sales within the reach of the B&O tax.

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[5] Avnet concedes that its activities here give it substantial nexus with Washington, which the statute defines broadly. RCW 82.04.067.

This conclusion is supported by WAC 458-20-103 (WAC Rule 103),[6] which defines when a sale takes place in Washington for tax purposes:

> [f]or the purpose of determining [B&O] tax liability of persons selling tangible personal property, a sale takes place in this state when the goods sold are delivered to the buyer in this state, irrespective of whether title to the goods passes to the buyer at a point within or without this state.

Again, Avnet did not deliver the products to its own buyer outside Washington. Instead, it delivered the products to its buyer's customer in this state. Thus, the only delivery to any buyer that occurred was within the state of Washington. Under both the definitions of "sale" in RCW 82.04.040's and WAC Rule 103's criteria for determining when a sale takes place in this state, the drop shipped sales took place in Washington. Therefore, RCW 82.04.270 and WAC Rule 103 by their terms subject the proceeds of these sales to the wholesale B&O tax.

Avnet argues to the contrary from WAC 458-20-193(7) (WAC Rule 193(7)), which provides:

> 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 Rule 193(2)(d) specifies also that "'[r]eceipt' or 'received' means the purchaser or its agent first either taking physical possession of the goods or having dominion and control over them." Avnet contends that, regardless of its nexus with Washington, the wholesale B&O tax does not apply to the drop-shipped sales because Avnet's customer, the wholesale buyer, did not take physical possession of or exercise dominion and control over the goods in Washington; only the retail customer, Avnet's buyer's customer, received the goods within the meaning of the rule.

[6] The relevant portions of the rules at issue have not changed since the audit period. We therefore cite the current version.

Avnet's argument relies on one of the specific examples given in WAC Rule 193(11)(h):

> Company X is located in Ohio and has no office, employees, or other agents located in Washington or any other contact which would create nexus. Company X receives by mail an order from Company Y for parts which are to be shipped to a Washington location. Company X purchases the parts from Company Z who is located in Washington and requests that the parts be drop shipped to Company Y. Since Company X has no nexus in Washington, Company X is not subject to B&O tax or required to collect retail sales tax. Company X has not taken possession or dominion or control over the parts in Washington.

Avnet asserts that this example "specifically addresses" the type of transaction at issue here, positing itself as "Company Z," its buyer as "Company X," and its buyer's customer as "Company Y." Br. of Resp't/Cross Appellant at 8-10. Because the example states that "Company X has not taken possession or dominion or control over the parts in Washington," WAC Rule 193(11)(h), Avnet argues that its buyers do not receive the goods within the meaning of WAC Rule 193(7), and the wholesale B&O tax therefore does not apply to those transactions.[7]

This example, however, is not as apt as Avnet contends. First, it addresses the tax liability not of Avnet (Company Z), but of Avnet's buyer (Company X), a matter not at issue in this appeal. Second, the fact that Avnet's immediate customer (Company X) did not take possession of the products in Washington is not determinative. As noted above, the only buyer who took possession or delivery did so from Avnet and in Washington. Under RCW 82.04.270 and WAC Rule 193, that locates the sale in this state.

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[7] Avnet points to a number of e-mails and internal memoranda, obtained from the Department through discovery, concerning proposed amendments to the rule, which documents Avnet asserts show that the Department itself recognized that WAC Rule 193 as written precludes application of the B&O tax to these transactions. At most, these documents show a concern among certain department staff that parties would rely on the disputed language in WAC Rule 193 to make the argument that Avnet makes here. Because such arguments apparently ran counter to the Department's position, the staff members suggested clarifying the rule to preclude parties from making them. Regardless, Avnet points to no authority suggesting that an agency's internal debates concerning possible amendments to a rule bear on a court's interpretation of the rule.

Avnet's approach also elevates form over substance in a way similar to that rejected by the court in *Chicago Bridge & Iron Company v. Department of Revenue*, 98 Wn.2d 814, 824, 659 P.2d 463 (1983):

> [Chicago Bridge & Iron] argues rigorously that it is immune from the B & O tax because the contract "procurement" activities occurred outside Washington, thus leading to the conclusion that no "sales" activities occurred in state. Such an argument ignores the practicalities of modern business practice. As many corporations engage in business and maintain branch offices in numerous foreign jurisdictions, it is not surprising that contracts are negotiated and signed at locations other than the jurisdiction for which the product is intended. Corporate convenience, however, is not controlling in the context of the incidence of a tax. Were it otherwise, substantial taxes could be avoided simply by consummating all contracts outside the borders of the taxing state.

(Internal citations omitted.) As in *Chicago Bridge & Iron*, corporate convenience in negotiating or contracting out of state cannot distract from the central facts establishing the location of sale: where the buyer took delivery and possession.

B. Legal Effect of WAC Rule 193

A more profound infirmity in Avnet's argument, though, lies in the nature of WAC Rule 193 itself. "An 'interpretive rule' is a rule, the violation of which does not subject a person to a penalty or sanction, that sets forth the agency's interpretation of statutory provisions it administers." RCW 34.05.328(5)(c)(ii). WAC Rule 193 does not impose any sanction for noncompliance with its terms: it merely explains the Department's view of when a party must pay the tax. Thus, WAC Rule 193 is an "interpretive" rule. *See also Ass'n of Wash. Bus. v. Dep't of Revenue*, 155 Wn.2d 430, 446-47, 120 P.3d 46 (2005) (discussing the difference between legislative and interpretive agency regulations).

Interpretative rules do not constrain the courts. Our Supreme Court held in *Ass'n of Wash. Bus.*, 155 Wn.2d at 447 (emphasis omitted) that interpretive rules

> are not binding on the courts and are afforded no deference other than the power of persuasion. Accuracy and logic are the only clout interpretive rules wield. If the public violates an interpretive rule that accurately reflects the underlying statute, the public may be sanctioned and punished, not by authority of the rule, but by authority of the statute. This is the nature of interpretive rules.

More specifically, in *Coast Pacific Trading, Inc. v. Department of Revenue*, 105 Wn.2d 912, 917-18, 719 P.2d 541 (1986), our Supreme Court rejected an argument, similar to Avnet's, that the related rule governing international transactions, WAC 458-20-193C, exempted more sales from the B&O tax than the statute or the constitution required. Because the statute clearly aimed to tax imports and exports to the fullest extent constitutionally permissible, the *Coast Pacific Trading* court held that the language of the rule could not provide a broader exemption than the constitution required:

> The Department of Revenue cannot use Rule 193C to expand the tax immunity of exporters beyond the exemptions provided by statute or required by the constitution. The Legislature has allocated to the Department the authority only to establish procedural rules. The Department cannot contradict a substantive legislative enactment by administrative regulation.

105 Wn.2d at 917 (footnote omitted). More recently, we rejected an argument almost indistinguishable from Avnet's that a different example from WAC Rule 193(11) provided a broader exemption than the B&O statute or the dormant commerce clause[8] required. *Space Age Fuels, Inc. v. State*, 178 Wn. App. 756, 764-65, 315 P.3d 604 (2013), *review denied*, 180 Wn.2d 1010 (2014). Under our case law, WAC Rule 193 is an interpretive rule that cannot subtract from the force of the statute or WAC Rule 103, discussed above.

[8] From the federal constitution's grant to Congress of authority to regulate interstate commerce, the United States Supreme Court has implied a "dormant Commerce Clause," which prohibits "certain state taxation even when Congress has failed to legislate on the subject." *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 179, 115 S. Ct. 1331, 131 L. Ed. 2d 261 (1995).

No specific statutory exemption applies to the sales at issue here. Avnet instead relies entirely on its constitutional nexus argument, addressed below, and the plain language of WAC Rule 193. Under the precedents just discussed, however, the language of the rule can provide Avnet no more haven than the B&O statute does. As discussed, the B&O statute aims to tax interstate commerce almost as far as the dormant commerce clause permits: absent a specific statutory exemption, every party with the requisite nexus to Washington must pay it on every transaction occurring here. Former RCW 82.04.220; RCW 82.04.040, .140; *Coast Pac. Trading*, 105 Wn.2d at 917-18. Avnet's argument that the State may not tax the sales because Avnet's customer did not receive the goods in Washington under WAC Rule 193 must fail.

As the analysis above shows, under RCW 82.04.040, .270 and WAC Rule 103, Avnet's proceeds from the drop-shipped sales are subject to the wholesale B&O tax. Neither the terms nor the legal status of WAC Rule 193 call that conclusion into question.

III. AVNET'S CROSS-APPEAL

A. WAC Rule 193

Avnet cross-appeals the order on summary judgment ruling that its national sales are subject to the B&O tax. Avnet first contends that its national sales are exempt under a regulation that purports to exclude from taxation sales "'not significantly associated in any way with'" the taxpayer's activities in Washington.[9] Br. of Resp't/Cross-Appellant at 17-20. This argument relies on WAC Rule 193(7)(c), which warns that

> a seller [who] carries on significant activity in this state and conducts no other business in the state except the business of making sales . . . has the distinct burden of establishing that the instate activities are not significantly associated in any way with the sales into this state.

[9] Avnet advances the same argument as an alternative basis for affirming the summary judgment in its favor regarding its drop-shipped sales. We reject it for the reasons here articulated.

The rule goes on to give a nonexclusive list of circumstances that would establish that the B&O tax applies to certain sales. WAC Rule 193(7)(c)(i)-(vi). Avnet maintains that, with respect to the disputed sales, its Redmond office engages in none of the activities described, and that its "instate activities are [thus] not significantly associated in any way with the sales" at issue. Br. of Resp't/Cross Appellant 19 (quoting WAC Rule 193(7)(c)).

From this, Avnet argues that even if the dormant commerce clause does not exempt the disputed sales from the B&O tax, the plain language of WAC Rule 193 does. This argument fails because, as shown above, the language of this interpretive rule can provide Avnet no more haven than the B&O statute does, and the statute, subject to any express exemptions, aims to tax all sales that the commerce clause allows the State to reach. *Coast Pac. Trading*, 105 Wn.2d at 917-18. Avnet's claims of exemption must therefore succeed or fail on the merits of its constitutional arguments, to which we now turn.

B. Constitutional Limits on the State's Taxing Power

A tax on an out-of-state corporation must satisfy both the requirements of the Fourteenth Amendment's due process clause and the commerce clause. *Quill Corp. v. North Dakota*, 504 U.S. 298, 305, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992). Due process requires only sufficient contacts between the corporation and 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 Office of Unemployment Comp. & Placement*, 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)). Avnet does not expressly argue that the tax at issue offends due process, basing its argument instead on the commerce clause.

The limits imposed by courts under the dormant commerce clause have changed significantly over time. *See Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 179-84, 115 S. Ct. 1331, 131 L. Ed. 2d 261 (1995) *and Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279-88, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977). Modern dormant commerce clause jurisprudence requires only that a state tax imposed on an out-of-state corporation (1) be "applied to an activity with a substantial nexus with the taxing State," (2) be "fairly apportioned," (3) be nondiscriminatory with respect to interstate commerce, and (4) be "fairly related to the services provided by the State." *Complete Auto Transit*, 430 U.S. at 279. The parties' dispute focuses on the substantial nexus requirement. Our Supreme Court has held that, to establish such nexus, the instate activities of an out-of-state company "must be substantial and must be associated with the company's ability to establish and maintain the company's market within the state." *Lamtec*, 170 Wn.2d at 851.

C. Transactional Nexus and Dissociation

Avnet concedes that it has "taxpayer . . . nexus," or connections with Washington sufficient for the state to constitutionally tax its interstate business activities here. Br. of Resp't/Cross-Appellant at 19. The parties' dispute centers on "transactional nexus"; specifically, whether the dormant commerce clause allows Avnet to "dissociate" its Washington-bound national and drop-shipped sales by showing that its instate personnel played no significant role in those transactions. Br. of Appellant/Cross-Resp't at 13-27, 30-46; Br. of Resp't/Cross-Appellant at 2-9, 20-28.

Avnet argues that "states may impose a tax on interstate sales only if there is a substantial nexus between the seller's activities and the state and those activities are significantly associated with the sales at issue." Br. of Resp't/Cross-Appellant at 16 (citing *Allied-Signal, Inc. v. Dir.*,

Div. of Taxation, 504 U.S. 768, 778, 112 S. Ct. 2251, 119 L. Ed. 2d 533 (1992)). However, the authority Avnet cites for this proposition, *Allied-Signal*, does not support it:

> The principle that a State may not tax value earned outside its borders rests on the fundamental requirement of both the Due Process and Commerce Clauses that there be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Brothers Co.*, 347 U.S. at 344-45. The reason the Commerce Clause includes this limit is self-evident: In a Union of 50 States, to permit each State to tax activities outside its borders would have drastic consequences for the national economy, as businesses could be subjected to severe multiple taxation. But the Due Process Clause also underlies our decisions in this area. Although our modern due process jurisprudence rejects a rigid, formalistic definition of minimum connection, we have not abandoned the requirement that, in the case of a tax on an activity, there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax, *see Quill Corp.*, 504 U.S. at 306-08.

Allied-Signal, 504 U.S. at 777-78. This precedent shows that the taxing state must have a sufficient connection both to the taxpayer and the activity taxed, but it does not impose a requirement that the taxpayer's activities creating the requisite connection to the taxing state have some direct connection to the specific sales taxed.

Avnet contends, though, that *Norton Company v. Department of Revenue of State of Illinois*, 340 U.S. 534, 71 S. Ct. 377, 95 L. Ed. 517 (1951) and *B.F. Goodrich Company v. State*, 38 Wn.2d 663, 231 P.2d 325 (1951), control and do impose such a requirement. In *Norton*, a Massachusetts company with a branch office in Chicago challenged Illinois's imposition of a gross receipts tax on all of its Illinois-bound sales. 340 U.S. at 535-37. The *Norton* Court held that, notwithstanding the presence of the Chicago office, Illinois could not tax transactions where Illinois customers placed orders with Norton's Massachusetts office, which office filled them and delivered the goods directly to the buyer via common carrier. 340 U.S. at 539. These sales were "so clearly interstate in character that the State could not reasonably attribute their proceeds to the local business." *Norton* 340 U.S. at 539.

Our Supreme Court followed *Norton* in *B.F. Goodrich*, 38 Wn.2d at 673-76, where a New York corporation that conducted extensive sales activities in Washington challenged B&O tax assessments on various types of transactions, including sales of goods delivered to J. C. Penny stores in Washington. B.F. Goodrich's New York office received the orders directly and shipped the goods from outside Washington, without the Washington sales force's direct participation. *B.F. Goodrich*, 38 Wn.2d at 666. Following *Norton*, the court held that the dormant commerce clause prohibited Washington from taxing these sales. *B.F. Goodrich*, 38 Wn.2d at 674.

The Department does not dispute that this case involves facts "substantially similar" to those in *Norton* and *Goodrich*, and concedes that those cases have not been expressly overruled. Reply Br. of Appellant/Cross-Resp't at 5. Instead, it argues that subsequent dormant commerce clause precedents "have greatly expanded the scope of activities deemed relevant in determining whether an interstate sale is 'dissociated' from a taxpayer's business activities in the taxing state," and that these more recent precedents demonstrate that Avnet's activities in Washington create sufficient nexus for taxation of all its Washington-bound sales. Reply Br. of Appellant/Cross-Resp't at 5-13 (citing *Tyler Pipe Indus., Inc. v. Wash. Dep't of Revenue*, 483 U.S. 232, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987); *Standard Pressed Steel Co. v. Wash. Dep't of Revenue*, 419 U.S. 560, 95 S. Ct. 706, 42 L. Ed. 2d 719 (1975); *Gen. Motors Corp. v. Washington*, 377 U.S. 436, 84 S. Ct. 1564, 12 L. Ed. 2d 430 (1964)).

As an initial matter, we note that *Norton*'s foundations have been eroded by subsequent precedent. For example, the *Norton* Court based its conclusion in part on a then-prevailing view that

> [w]here 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.

340 U.S. at 537. The Court has long since rejected that view. *Scripto, Inc. v. Carson*, 362 U.S. 207, 210-13, 80 S. Ct. 619, 4 L. Ed. 2d 660 (1960). The *Norton* Court's reasoning also relied on the "immunity" from state taxation that interstate commerce then enjoyed. *Norton*, 340 U.S. at 538. The Court soundly rejected this immunity in *Complete Auto Transit*, expressly overruling precedents to the contrary. 430 U.S. at 288-89. Thus, the United States Supreme Court has explicitly removed at least two of *Norton*'s chief doctrinal underpinnings.

More to the point, the Department is correct that subsequent precedents have expanded the range of activities relevant to the substantial nexus analysis. In *General Motors*, the company challenged imposition of the B&O tax on various transactions, including sales of parts to independent dealers in Washington, which orders were placed with and filled from its Portland, Oregon office. 377 U.S. 443-46. The *General Motors* Court declined to look at particular transactions in isolation, instead considering whether General Motors could show that "the bundle of corporate activity" in Washington was not a "decisive factor[] in establishing and holding" the market for its goods here, and concluding that it could not. *Gen. Motors Corp.*, 377 U.S. at 447-48.

In *Tyler Pipe Industries*, the Court found sufficient nexus for imposition of B&O tax on all of Tyler Pipe's sales into Washington even though it

> maintains no office, owns no property, and has no employees residing in the State . . . [and i]ts solicitation of business in Washington is directed by executives who maintain their offices out-of-state and by an independent contractor located in Seattle.

483 U.S. at 249, 251. The Court agreed with our Supreme Court 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.'" *Tyler Pipe*, 483 U.S. at 250 (quoting *Tyler Pipe Indus., Inc. v. Dep't of Revenue*, 105 Wn.2d 318, 323, 715 P.2d 123 (1986)). Significantly, in the portion of its opinion affirmed by the United States Supreme Court, our Supreme Court rejected an argument very similar to Avnet's, that the portion of Tyler Pipe's sales attributable to orders placed directly with its main office were exempt from tax. *Tyler Pipe*, 105 Wn.2d at 326-27; *Tyler Pipe*, 483 U.S. at 250-51.

These precedents show a progressive broadening of the types of activities that may establish substantial nexus for purposes of state taxation of interstate commerce. They show that a state need not demonstrate a direct connection between a taxpayer's nexus-creating activities and particular sales into the state in order to tax those sales.[10]

D. Avnet's Washington Activities and Its Market for the Taxed Sales

Although United States Supreme Court precedent does not require a direct connection between Avnet's activities in Washington and these specific sales, it does require some connection to sustain application of the B&O tax. To find that connection, both *General Motors*, 377 U.S. at 447-48, and *Tyler Pipe*, 483 U.S. at 250-51; looked to whether the taxpayer's instate activities were significant in establishing and maintaining a market for its goods in the state. The *Tyler Pipe* Court quoted with approval our Supreme Court's description of some of the activities, other than building or maintaining direct relationships with customers, held to give rise to sufficient nexus there:

[10] Avnet further asserts that delivery by common carrier into the taxing state does not qualify as in-state activity for purposes of substantial nexus. This argument relies on *Quill Corporation*, 504 U.S. 298, which upheld on stare decisis grounds a rule that states may not impose a use tax collection duty on out-of-state sellers whose only contact with the taxing state is by mail and common carrier. The *Quill* Court, however, limited its holding to sales and use taxes, 504 U.S. at 314-15, robbing it of precedential force in this appeal.

> 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; . . . and other critical information of a local nature concerning Tyler Pipe's Washington market.

483 U.S. at 249-50 (quoting *Tyler Pipe*, 105 Wn.2d at 325).

The taxpayer carries a heavy burden in showing the absence of such a connection. In *American Oil Company v. Neill*, 380 U.S. 451, 458, 85 S. Ct. 1130, 14 L. Ed. 2d 1 (1965), the Court described the burden as follows:

> when a corporation, pursuant to permission given, enters a State and proceeds to do local business the 'link' is strong. In such instances there is a strong inference that it exists between the State and transactions which result in economic benefits obtained from a source within the State's territorial limits. The corporation can, however, exempt itself by a clear showing that there are no in-state activities connected with out-of-state sales.

Employees at Avnet's Redmond office concededly engaged in a wide variety of market research and product development activities aimed at building and maintaining the company's worldwide market. Those activities included the servicing of new and existing accounts by account managers and sales and marketing managers and representatives, the development and implementation of marketing programs, the recruiting of new customers, and extensive engineering support. Avnet's marketing materials give the contact information for the Redmond office. These activities all served the creation and maintenance of Avnet's market in Washington, as well as other locations. These activities lie at the core of the market sustenance which both *General Motors Corporation*, 377 U.S. at 447-48, and *Tyler Pipe*, 483 U.S. at 250-51, found sufficient for constitutional nexus. That nexus is present for both Avnet's national sales and drop-shipped sales into Washington.

CONCLUSION

Under the uncontroverted facts and governing legal standards, both Avnet's national sales and drop-shipped sales here at issue are subject to Washington's B&O tax. We affirm the trial court's grant of summary judgment to the Department as to Avnet's Washington-bound national sales. As to the drop-shipped sales, we reverse the grant of summary judgment to Avnet and remand for entry of judgment in favor of the Department. We otherwise affirm.

Bjorgen, A.C.J.
BJORGEN, A.C.J.

We concur:

Worswick J.
WORSWICK, J.

Melnick, J.
MELNICK, J.

APPENDIX B

WAC 458-20-193 Inbound and outbound interstate sales of tangible personal property. (1) **Introduction.** This section explains Washington's B&O tax and retail sales tax applications to interstate sales of tangible personal property. It covers the outbound sales of goods originating in this state to persons outside this state and of inbound sales of goods originating outside this state to persons in this state. This section does not include import and export transactions.

(2) **Definitions:** For purposes of this section the following terms mean:

(a) "State of origin" means the state or place where a shipment of tangible personal property (goods) originates.

(b) "State of destination" means the state or place where the purchaser/consignee or its agent receives a shipment of goods.

(c) "Delivery" means the act of transferring possession of tangible personal property. It includes among others the transfer of goods from consignor to freight forwarder or for-hire carrier, from freight forwarder to for-hire carrier, one for-hire carrier to another, or for-hire carrier to consignee.

(d) "Receipt" or "received" means the purchaser or its agent first either taking physical possession of the goods or having dominion and control over them.

(e) "Agent" means a person authorized to receive goods with the power to inspect and accept or reject them.

(f) "Nexus" means the activity carried on by the seller in Washington which is significantly associated with the seller's ability to establish or maintain a market for its products in Washington.

(3) **Outbound sales.** Washington state does not assess its taxes on sales of goods which originate in Washington if receipt of the goods occurs outside Washington.

(a) Where tangible personal property is located in Washington at the time of sale and is received by the purchaser or its agent in this state, or the purchaser or its agent exercises ownership over the goods inconsistent with the seller's continued dominion over the goods, the sale is subject to tax under the retailing or wholesaling classification. The tax applies even though the purchaser or its agent intends to and thereafter does transport or send the property out-of-state for use or resale there, or for use in conducting interstate or foreign commerce. It is immaterial that the contract of sale or contract to sell is negotiated and executed outside the state or that the purchaser resides outside the state.

(b) Where the seller delivers the goods to the purchaser who receives them at a point outside Washington neither retailing nor wholesaling business tax is applicable. This exemption applies even in cases where the shipment is arranged through a for-hire carrier or freight consolidator or freight forwarder acting on behalf of either the seller or purchaser. It also applies whether the shipment is arranged on a "freight prepaid" or a "freight collect" basis. The shipment may be made by the seller's own transportation equipment or by a carrier for-hire. For purposes of this section, a for-hire carrier's signature does not constitute receipt upon obtaining the goods for shipment unless the carrier is acting as the purchaser's agent and has express written authority from the purchaser to accept or reject the goods with the right of inspection.

(4) **Proof of exempt outbound sales.**

(a) If either a for-hire carrier or the seller itself carries the goods for receipt at a point outside Washington, the seller is required to retain in its records documentary proof of the sales and delivery transaction and that the purchaser in fact received the goods outside the state in order to prove the sale is tax exempt. Acceptable proofs, among others, will be:

(i) The contract or agreement of sale, if any, **And**

(ii) If shipped by a for-hire carrier, a waybill, bill of lading or other contract of carriage indicating the seller has delivered the goods to the for-hire carrier for transport to the purchaser or the purchaser's agent at a point outside the state with the seller shown on the contract of carriage as the consignor (or other designation of the person sending the goods) and the purchaser or its agent as consignee (or other designation of the person to whom the goods are being sent); or

(iii) If sent by the seller's own transportation equipment, a trip-sheet signed by the person making delivery for the seller and showing:

The seller's name and address,

The purchaser's name and address,

The place of delivery, if different from purchaser's address,

The time of delivery to the purchaser together with the signature of the purchaser or its agent acknowledging receipt of the goods at the place designated outside the state of Washington.

(b) Delivery of the goods to a freight consolidator, freight forwarder or for-hire carrier merely utilized to arrange for and/or transport the goods 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. See also WAC 458-20-174, 458-20-175, 458-20-176, 458-20-177, 458-20-238 and 458-20-239 for certain statutory exemptions.

(5) **Other B&O taxes - outbound and inbound sales.**

(a) **Extracting, manufacturing.** Persons engaged in these activities in Washington and who transfer or make delivery of such produced articles for receipt at points outside the state are subject to business tax under the extracting or manufacturing classification and are not subject to tax under the retailing or wholesaling classification. See also WAC 458-20-135 and 458-20-136. The activities taxed occur entirely within the state, are inherently local, and are conducted prior to the commercial journey. The tax is measured by the value of products as determined by the selling price in the case of articles on which the seller performs no further manufacturing after transfer out of Washington. It is immaterial that the value so determined includes an additional increment of value because the sale occurs outside the state. If the seller performs additional manufacturing on the article after transferring the article out of state, the value should be measured under the principles contained in WAC 458-20-112.

(b) **Extracting or processing for hire, printing and publishing, repair or alteration of property for others.** These activities when performed in Washington are also inherently local and the gross income or total charge for work performed is subject to business tax, since the operating incidence of the tax is upon the business activity performed in this state. No deduction is permitted even though the articles

DATED .....

.....
(Purchaser)
By .....
(Officer or Purchaser's Representative)
Address .....

(v) There is no business and occupation tax deduction of the gross proceeds of sales of goods for use in noncontiguous states unless the goods are received outside Washington.

(d) See WAC 458-20-173 for explanation of sales tax exemption in respect to charges for labor and materials in the repair, cleaning or altering of tangible personal property for nonresidents when the repaired property is delivered to the purchaser at an out-of-state point.

(7) **Inbound sales.** 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.

(a) 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.

(b) When the sales documents indicate the goods are to be shipped to a buyer in Washington, but the seller delivers the goods to the buyer at a location outside this state, the seller may use the proofs of exempt sales contained in subsection 4 to establish the fact of delivery outside Washington.

(c) If a seller carries on significant activity in this state and conducts no other business in the state except the business of making sales, this person has the distinct burden of establishing that the instate activities are not significantly associated in any way with the sales into this state. Once nexus has been established, it will continue throughout the statutory period of RCW 82.32.050 (up to five years), notwithstanding that the instate activity which created the nexus ceased. Persons taxable under the service B&O tax classification should refer to WAC 458-20-194. The following activities are examples of sufficient nexus in Washington for the B&O tax to apply:

(i) The goods are located in Washington at the time of sale and the goods are received by the customer or its agent in this state.

(ii) The seller has a branch office, local outlet or other place of business in this state which is utilized in any way, such as in receiving the order, franchise or credit investigation, or distribution of the goods.

(iii) The order for the goods is solicited in this state by an agent or other representative of the seller.

(iv) The delivery of the goods is made by a local outlet or from a local stock of goods of the seller in this state.

(v) The out-of-state seller, either directly or by an agent or other representative, performs significant services in relation to establishment or maintenance of sales into the state, even though the seller may not have formal sales offices in Washington or the agent or representative may not be formally characterized as a "salesperson".

(vi) The out-of-state seller, either directly or by an agent or other representative in this state, installs its products in this state as a condition of the sale.

(8) **Retail sales tax - inbound sales.** Persons engaged in selling activities in this state are required to be registered with the department of revenue. Sellers who are not required to be registered may voluntarily register for the collection and reporting of the use tax. The retail sales tax must be collected and reported in every case where the retailing B&O tax is due as outlined in subsection 7. If the seller is not required to collect retail sales tax on a particular sale because the transaction is disassociated from the instate activity, it must collect the use tax from the buyer.

(9) **Use tax - inbound sales.** The following sets forth the conditions under which out-of-state sellers are required to collect and remit the use tax on goods received by customers in this state. A seller is required to pay or collect and remit the tax imposed by chapter 82.12 RCW if within this state it directly or by any agent or other representative:

(i) Has or utilizes any office, distribution house, sales house, warehouse, service enterprise or other place of business; or

(ii) Maintains any inventory or stock of goods for sale; or

(iii) Regularly solicits orders whether or not such orders are accepted in this state; or

(iv) Regularly engages in the delivery of property in this state other than by for-hire carrier or U.S. mail; or

(v) Regularly engages in any activity in connection with the leasing or servicing of property located within this state.

(a) The use tax is imposed upon the use, including storage preparatory to use in this state, of all tangible personal property acquired for any use or consumption in this state unless specifically exempt by statute. The out-of-state seller may have nexus to require the collection of use tax without personal contact with the customer if the seller has an extensive, continuous, and intentional solicitation and exploitation of Washington's consumer market. (See WAC 458-20-221).

(b) Every person who engages in this state in the business of acting as an independent selling agent for unregistered principals, and who receives compensation by reason of sales of tangible personal property of such principals for use in this state, is required to collect the use tax from purchasers, and remit the same to the department of revenue, in the manner and to the extent set forth in WAC 458-20-221.

(10) **Examples - outbound sales.** The following examples show how the provisions of this section relating to interstate sales of tangible personal property will apply when the goods originate in Washington (outbound sales). The examples presume the seller has retained the proper proof documents and that the seller did not manufacture the items being sold.

(a) Company A is located in Washington. It sells machine parts at retail and wholesale. Company B is located in California and it purchases machine parts from Company A. Company A carries the parts to California in its own vehicle to make delivery. It is immaterial whether the goods are

former employee. The burden of proof to disassociate is on the seller.

(h) Company X is located in Ohio and has no office, employees, or other agents located in Washington or any other contact which would create nexus. Company X receives by mail an order from Company Y for parts which are to be shipped to a Washington location. Company X purchases the parts from Company Z who is located in Washington and requests that the parts be drop shipped to Company Y. Since Company X has no nexus in Washington, Company X is not subject to B&O tax or required to collect retail sales tax. Company X has not taken possession or dominion or control over the parts in Washington. Company Z may accept a resale certificate from Company X which will bear the registration number issued by the state of Ohio. Company Y is required to pay use tax on the value of the parts.

(i) Company ABC is located in Washington and purchases goods from Company XYZ located in Ohio. Upon receiving the order, Company XYZ ships the goods by a for-hire carrier to a public warehouse in Washington. The goods will be considered as having been received by Company ABC at the time Company ABC is entitled to receive a warehouse receipt for the goods. Company XYZ will be subject to the B&O tax at that time if it had nexus for this sale.

(j) P&S Department Stores has retail stores located in Washington, Oregon, and in several other states. John Doe goes to a P&S store in Portland, Oregon to purchase luggage. John Doe takes physical possession of the luggage at the store and elects to finance the purchase using a credit card issued to him by P&S. John Doe is a Washington resident and the credit card billings are sent to him at his Washington address. P&S does not have any responsibility for collection of retail sales or use tax on this transaction because receipt of the luggage by the customer occurred outside Washington.

(k) JET Company is located in the state of Kansas where it manufactures specialty parts. One of JET's customers is AIR who purchases these parts as components of the product which AIR assembles in Washington. AIR has an employee at the JET manufacturing site who reviews quality control of the product during fabrication. He also inspects the product and gives his approval for shipment to Washington. JET is not subject to B&O tax on the sales to AIR. AIR receives the parts in Kansas irrespective that JET may be shown as the shipper on bills of lading or that some parts eventually may be returned after shipment to Washington because of hidden defects.

[Statutory Authority: RCW 82.32.300. 91-24-020, § 458-20-193, filed 11/22/91, effective 1/1/92. Formerly WAC 458-20-193A and 458-20-193B.]

APPENDIX C

$2.00

State of Washington

Excise Tax Rules

- Retail Sales and Use
- Business and Occupation
- Public Utility
- Cigarette
- Tobacco Products
- Conveyance

Department of Revenue

GEORGE KINNEAR, *Director*

Published January 1, 1974

WAC 458-20-193B (Rule 193 – Part B) SALES OF GOODS ORIGINATING IN OTHER STATES TO PERSONS IN WASHINGTON

Rule 193 deals with interstate and foreign commerce and is published in four separate parts:

Part A. Sales of Goods Originating in Washington to Persons in Other States.
Part B. Sales of Goods Originating in Other States to Persons in Washington.
Part C. Imports and Exports: Sales of Goods from or to Persons in Foreign Countries.
Part D. Transportation, Communication, Public Utility Activities, or Other Services in Interstate or Foreign Commerce.

PART B.

BUSINESS AND OCCUPATION TAX

RETAILING, WHOLESALING. Sales to persons in this state are taxable when the property is shipped from points outside this state to the buyer in this state and the seller carries on or has carried on in this state any local activity which is significantly associated with the seller's ability to establish and maintain a market in this state for the sales. If a person carries on significant activity in this state and conducts no other business in this state except the business of making sales, this person has the distinct burden of establishing that the instate activities are not significantly associated in any way with the sales into this state. The characterization or nature of the activity performed in this state is immaterial so long as it is significantly associated in any way with the seller's ability to establish and maintain a market for its products in this state. The essential question is whether the instate services enable the seller to make the sales.

Applying the foregoing principles to sales of property shipped from a point outside this state to the purchaser in this state, the following activities are examples of sufficient local nexus for application of the business and occupation tax:

1. The seller's branch office, local outlet or other place of business in this state is utilized in any way, such as in receiving the order, franchise or credit investigation, or distribution of the goods.
2. The order for the goods is given in this state to an agent or other representative connected with the seller's branch office, local outlet, or other place of business.
3. The order for the goods is solicited in this state by an agent or other representative of the seller.
4. The delivery of the goods is made by a local outlet or from a local stock of goods of the seller in this state.
5. Where an out-of-state seller, either directly or by an agent or other representative, performs significant services in relation to establishment and maintenance of sales into the state, the business tax is applicable, even though (a) the seller may not have formal sales offices in Washington or (b) the agent or representative may not be formally characterized as a "salesman."
6. Where an out-of-state seller either directly or by an agent or other representative in this state installs its products in this state as a condition of the sale, the installation services shall be deemed significant services for establishing and maintaining a market in this state for such installed products and the gross proceeds from the sale and installation are subject to business tax.

Under the foregoing principles, sales transactions in which the property is shipped directly from a point outside the state to the purchaser in this state are exempt only if there is and there has been no participation whatsoever in this state by the seller's branch office, local outlet, or other local place of business, or by an agent or other representative of the seller. A franchise or credit investigation of a prospective purchaser and/or recommendation or approval by a local office upon which subsequent transactions are based is such a utilization of the local office as to render such subsequent transactions taxable.

road construction, repair of tangible personal property and similar contracts performed in this state are inherently local business activities subject to tax even though materials involved may have been delivered from outside the state or the contracts may have been negotiated outside the state and notwithstanding the fact that the work may be done by foreign vendors who performed preliminary services outside the state with respect thereto.

RENTING OR LEASING OF TANGIBLE PERSONAL PROPERTY. Persons outside this state who rent or lease tangible personal property for use in this state are subject to tax upon their gross proceeds from such rentals, irrespective of the fact that possession to the property leased may have passed to the lessee outside the state or that the lease agreement may have been consummated outside the state.

SALES AND USE TAX

Retail sales tax must be collected and accounted for in every case where business and occupation tax is due as outlined above.

The following sets forth the conditions under which out-of-state vendors are required to collect and remit the retail sales tax or use tax on deliveries to customers in this state. It conforms to the recommended jurisdiction standards of the Multistate Tax Commission.

JURISDICTION STANDARD. A vendor is required to pay or collect and remit the tax imposed by Ch. 82.08 RCW or Ch. 82.12 RCW if within this state he directly or by any agent or other representative:

1. Has or utilizes an office, distribution house, sales house, warehouse, service enterprise or other place of business; or
2. Maintains a stock of goods; or
3. Regularly solicits orders whether or not such orders are accepted in this state, unless the activity in this state consists solely of advertising or of solicitation by direct mail; or
4. Regularly engages in the delivery of property in this state other than by common carrier or U.S. mail; or
5. Regularly engages in any activity in connection with the leasing or servicing of property located within this state.

All vendors who are registered with the Department of Revenue are required to collect use tax or sales tax from all persons to whom goods are sold for use in this state irrespective of the absence of local activity on any given sale.

Every person who engages in this state in the business of acting as an independent selling agent for unregistered principals, and who receives compensation by reason of sales of tangible personal property of such principals for use in this state, is required to collect the use tax from purchasers, and remit the same to the Department of Revenue, in the manner and to the extent set forth in Rule 221.

The use tax is imposed upon the use, including storage, of all tangible personal property acquired for any use or consumption in this state unless specifically exempt by statute.

Revised May 3, 1974.

APPENDIX D

RULES
Relating to the
REVENUE ACT OF 1935

COVERING

- RETAIL SALES TAX
- COMPENSATING (USE) TAX
- BUSINESS & OCCUPATION TAX
- PUBLIC UTILITY TAX
- MECHANICAL DEVICES TAX
- CONVEYANCE TAX
- CIGARETTE TAX
- TOBACCO PRODUCTS TAX

WASHINGTON STATE TAX COMMISSION

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Revised January 1, 1960

Compensating Tax

Indians are not subject to the Compensating Tax upon the use of tangible personal property in an Indian reservation. However, Indians will become liable for the Compensating Tax when any such property is placed into actual use outside the reservation, irrespective of the fact that the first use of the property may have been within the reservation.

Special Application of Retail Sales Tax and Compensating Tax With Respect to Sales of Motor Vehicles and Trailers to Indians—When motor vehicles and trailers sold to Indians are licensed by the State of Washington at the time of sale, or at any time thereafter, a presumption is raised that such motor vehicles and trailers are for use on the highways of the State of Washington. When motor vehicles or trailers are licensed prior to delivery, dealers are required to collect the Retail Sales Tax in every instance where delivery is made outside an Indian reservation, and to collect the Compensating Tax in every instance where delivery is made by the dealer within an Indian reservation. County Auditors must collect the Compensating Tax when Indians apply for a license or transfer of registration unless the applicant can show that Retail Sales Tax or Compensating Tax has previously been paid on the sale or use of the vehicle by the applicant.

Revised March 1, 1954.

INTERSTATE AND FOREIGN COMMERCE

Rule 193.

I. PREFACE

The provisions of chapter 82.04 RCW—Business and Occupation Tax; 82.08 RCW—Sales Tax; 82.12 RCW—Compensating Tax; 82.16 RCW—Public Utility Tax; and 82.28 RCW—Cigarette Tax, do not apply to income derived from businesses, or to sales or uses which the State of Washington is prohibited from taxing under the Constitution or laws of the United States. Such taxes do apply in all other instances except where statutory exemptions exist. Where the taxpayer engages in both taxable and exempt activities, the burden is upon him to segregate properly and establish his exemptions.

The Federal Constitution provides that

> "no state shall * * * lay any imposts or duties on imports or exports" (Art. I, sec. 10, subsection 2)

and it confers power upon the Federal Congress

> "to regulate commerce with foreign nations and among the several states" (Art. I, sec. 8, subsection 3).

These provisions restrict the power of a state to tax transactions made in interstate commerce and foreign commerce.

The interstate commerce clause, although prohibiting imposition of undue or discriminatory taxes, or taxes susceptible of multiple state imposition, permits state taxes fairly designed to require interstate commerce to "pay its own way." Fairness between local and out-of-state businesses is an important element. The export-import clause, on the other hand, serves a different national policy and prohibits any state tax on imports or exports

> "except what may be absolutely necessary for executing its inspection laws." (Art. I, sec. 10, subsection 2.)

"Interstate Commerce" generally means that commerce, commercial intercourse, traffic or trade which involves the purchase, sale or exchange of property and its transportation, or the transportation of persons or the transmission of communications or electrical energy from one state or territory of the United States to another.

The controlling principles in this field are: (1) Interstate commerce must pay its own way, i.e., interstate commerce is not completely "exempt" from state taxation; (2) a state tax may neither discriminate against interstate commerce nor expose it to the risk of a similar tax by some other state with respect to the same transaction, thus a "multiple burden" upon interstate commerce is prohibited; and (3) a state may not carve out a local incident from an interstate transaction as the taxable event as this carries a similar multiple tax threat. However, where the local incident is sufficiently substantive and disjoined, and is sufficiently local in nature so that it is not repeated in each taxing unit (such as delivery) the tax is valid.

The locus of a tax is determined as to persons by its "legal incidence" that is, upon whom is the tax imposed—who is the primary obligor. The locus of a tax as to events or incidents is tested by its "operating incidence," that is, by the occurrence of what event does tax liability arise, and what is its operative effect.

Scope of this Rule: This rule governs all matters relating to interstate and foreign commerce. The diversity of problems involved limits the rule to a statement of general principles and the Tax Commission reserves the right to rule upon each question as it arises. The Commission will not state its position upon hypothetical questions but it will rule on specific problems provided that all the pertinent facts surrounding the transaction, copies of pertinent contracts of sale and other relevant data are submitted.

II. DEFINITIONS

"Bona fide private carrier" means every carrier other than a common carrier regularly engaged in transporting the property of another for hire;

"Local vendor" means every person engaged in the business of selling tangible personal property, and who either

(a) Maintains a stock of goods within this state;

(b) Maintains a sales office in this state for other than limited promotional activities; or

(c) Maintains a salesman employee, or agent resident in this state for other than limited promotional activities. The term "agent" includes *del credere* agents.

"Foreign vendor" means every person engaged in selling tangible personal property to persons in this state, and who is not a "local vendor."

The terms "foreign vendor" and "local vendor" do not include persons who merely act as independent selling agents in procuring, promoting, or making sales for a principal.

"Promotional activities" mean the attempt to stimulate sales. It includes general correspondence, the distribution of catalogs or similar sales literature, radio, newspaper, magazine and similar general advertising, good will calls, etc. It includes the solicitation of sales where the solicitor may not and does not accept an order or execute a contract and is in no way connected

with a local office. It does not include the receiving of orders, the making of contracts, nor the making by a local office of complete and unconditional offers to sell to specific customers who may accept such offers so as to create contracts.

"Maintaining a stock of goods" means having a stock of merchandise held for sale. It includes goods held in a warehouse or store of the vendor, or held in the public or private warehouse of another, or held by an agent, consignee, or bailee of the vendor. It also includes goods incidentally brought into this state prior to sale and sold from vehicles. It is immaterial that the stock of goods does not include the whole line of merchandise dealt in by the seller. It does not include sample stock when such samples are not held for sale.

"Sale" is any transfer of ownership of, or title to, or possession of property for a valuable consideration, see RCW 82.04.040 and 82.04.050. It is the transfer of the "property in the goods," RCW chap. 63.04. Except where bare legal title is retained for security purposes, delivery of the goods and passage of title occur simultaneously and are governed by the same legal principles.

"Property in the goods" means ownership of, title to, or possession of the goods, except where title (or possession) is retained for bare security purposes (conditional sales contracts, etc.). The question is "When did the buyer become the owner of the goods as that term is normally understood?"

III. BUSINESS AND OCCUPATION TAX

(RCW Chap. 82.04)

Extracting, Manufacturing, Processing for Hire, Printing and Publishing—Interstate and Foreign Commerce: (See also Rules 135, 136 and 144)

The foregoing activities occur entirely within this state. They are inherently local and occur prior to the commercial journey. Therefore no deduction is permitted even though the articles produced may be sold or delivered to persons at points outside this state. The tax is measured by the value of the products as determined by the sales price, see Rule 112. It is immaterial that value so determined includes an additional increment of value resulting from the fact that the sale occurs out-of-state.

Wholesaling and Retailing:

Interstate Commerce

Preface—This tax is imposed upon the privilege of engaging in business in this state measured by gross proceeds of sales. Whether a person engaging in business in this state is taxable depends upon the extent of his activities here. A simple sales transaction is generally divisible into the following elements:

(1) solicitation;
(2) negotiation;
(3) offer;
(4) acceptance;
(5) credit investigation;
(6) credit approval;
(7) transportation of the goods;
(8) delivery or perfomance of the service;
(9) passage of title;
(10) servicing of the contract;
(11) payment (payment of the purchase price is complete performance on the part of one party to the contract).

The performance of the above activities is "engaging in business." The following factors relate more to the element "within this state." It is important to note whether the taxpayer either:

(1) Has a local sales office; or
(2) Has a local agent; or
(3) Has a local warehouse or stock of goods; or
(4) Is a local corporation or a foreign corporation which has (and which must) qualify to do business in this state.

Where a vendor maintains a local outlet which performs substantive services necessary or helpful to its competition for local trade, he is subject to a business tax and other liabilities like any other vendor. He may not channel business through a local outlet to gain the advantage of a local business and yet hold the immunities of an interstate business.

Except as to processors for hire, in computing tax under these classifications there may be deducted from the gross proceeds of sales so much thereof as is derived from nontaxable interstate commerce.

The diversity of situations involving sales of property transported across state lines limits the principles herein set forth to general statements only. These are as follows:

A Sales—Property Originating in Washington

Sales by Local Vendors to Persons in Washington:

No deduction will be allowed with respect to any such sale.

Sales by Local Vendors — Delivery in Washington for Use Outside Washington:

Where tangible personal property is located in Washington at the time of its sale or is subsequently produced here and then delivered to the purchaser in Washington, the sale is taxable, notwithstanding the fact that the purchaser may, after receiving the goods, transport or send the property out of state for use or resale outside of Washington or for use in the conduct of interstate commerce such as ships stores, etc. It is immaterial that the contract of sale or contract to sell is negotiated and executed outside Washington; that the purchaser resides outside of Washington, or the purchaser is a carrier.

Sales by Local Vendors to Persons in Other States:

(1) Exempt Sales—Delivery to Purchaser:

The tax does not apply to gross receipts from sales in which the seller agrees to, and does, deliver the goods to the purchaser at a point outside this state.

(2) Exempt Sales—Delivery to Carrier:

The tax does not apply to gross receipts from sales in which the seller agrees to, and does, deliver the goods to a common or *bona fide* private carrier, consigned to the purchaser at a point outside this state. The facts must disclose that the carrier is the agent of the seller and the property in the goods does not pass to the buyer until a point outside the State of Washington.

(3) Proof of Exempt Sales:

To establish that the gross receipts from any given sale are exempt because the property is delivered by the seller to a point outside

Washington, the seller will be required to retain in his records satisfactory proof (1) that there was such an agreement; and (2) a *bona fide* delivery was in fact made outside this state. The most acceptable proof will be

(a) the contract or other documents, and any of the following:

(b) if shipped by common or *bona fide* private carrier, a waybill or bill of lading naming the vendor as the consignor, and by which the carrier agrees with the seller to transport the goods to the buyer at a point outside the state;

(c) if sent by the seller's own transportation equipment, a trip sheet signed by the person making delivery for the seller and showing the (a) name, (b) address, (c) time of delivery together with (d) the signature of the buyer or his representative to whom the the goods were delivered outside Washington.

When the buyer is also the carrier, a deduction will be allowed only when the agreement between the parties obligates the seller to make delivery to a point outside of Washington. The seller must obtain and keep a *bona fide* bill of lading in which he is the consignor by which the carrier agrees to transport the goods sold, as agent of the seller, to a point outside this state.

B Sales—Property Originating in Other States

Sales by Local Vendors:

Sales by local vendors to persons in this state are taxable when the subject matter of the sale is shipped from points outside this state to the buyer here and a local outlet performs or has previously performed a service essential to the completion of the sale to the purchaser in Washington. In determining tax liability it is immaterial that the goods may be shipped f.o.b. at a point outside this state, or that the order is accepted outside this state, or that a stock of similar goods is not maintained in this state.

Applying the foregoing principle, the following types of sales transactions, in which the property is shipped from a point outside this state to the purchaser in this state, are taxable:

(1) The seller's branch office, local outlet or other place of business in this state is utilized in any way, such as in receiving the order, franchise or credit investigation, distribution of the goods, etc.; or

(2) The order for the goods is given in this state to an agent connected with the seller's branch office, local outlet, or other place of business; or

(3) The order for the goods is accepted in such a manner by a resident agent of the seller in this state so as to create a binding contract in this state; or

(4) The delivery of the goods is made by a local outlet of the seller in this state.

Under the foregoing principle, the following types of sales transactions in which the property is shipped directly from a point outside the state to the purchaser in this state are exempt:

(1) When the order is sent by an out of state office of the purchaser directly to the seller at a point outside this state; or

(2) When the order is sent by the Washington customer directly to the seller at a point outside this state; or

(3) When the order is solicited in this state by an agent of the seller and forwarded to the seller for acceptance at a point outside this state

provided, there is and there has been no participation whatsoever in the transaction by the seller's branch office, local outlet, or other local place of business; or by an agent of the seller having or having had any connection with any branch office, local outlet or other place of business of the seller. A franchise or credit investigation of a prospective purchaser and/or recommendation or approval by such a local office upon which subsequent transactions are based is such a utilization of the local office as to render such subsequent transactions taxable.

Sales by Foreign Vendors:

Sales by foreign vendors are not taxable.

Special—Sale and Installation Contracts:

Normally installation contracts are taxable, see Rule 137. However, if a contract of sale, exempt under the above principles, involves (1) a product so intricate and complicated that a purchaser would reasonably desire a technician of the seller to install the product, and (2) this is made a part of the contract, and (3) the technician is in no way connected with the seller's branch office, local outlet, or other place of business in this state, the installation is an inherent part of the contract and exempt.

If installation is pursuant to a separate contract, it cannot be an inherent part of the contract of sale. Then, since installation is essentially a local activity, it is taxable.

However, even if the product is complicated and installation is required by the interstate contract, if the installation operation itself is of such magnitude (hiring local labor, pouring concrete, opening a local office, etc.) the seller is then engaged in primarily local rather than interstate business and the gross income therefrom is taxable.

Processing for Hire or Installing, Cleaning, Repairing, or Otherwise Altering Personal Property for Others:

Persons residing outside this state may ship personal property into this state for processing (see Rule 136) or having the same repaired or otherwise altered (see Rule 173). The entire amount charged therefor is taxable since the operating incidence of the tax is upon a business activity wholly performed within this state. This is true even though new parts are involved. The local office or other place of business of the taxpayer is clearly substantively involved.

Foreign Commerce

A Special Definitions

Foreign Commerce: Means that commerce, commercial intercourse, traffic or trade which involves the purchase, sale or exchange of property and its transportation, or the transportation of persons, or the transportation of communications or electrical energy, from a state or territory of the United States to a foreign country, or from a foreign

country to a state or territory of the United States. It includes the sale by the importer of goods in the original unbroken package or container in which they were imported. Such goods remain imports when all of these following factors exist: The goods remain (1) in the original unbroken package or container, (2) the property of the importer, and (3) are not put to the use for which they were imported, or (4) commingled with the general mass of property in this state.

Imports: An import is an article which comes from a foreign country (not from a state, territory or possession of the United States) for the first time into the taxing jurisdiction of a state. It also includes fish, sea food or other products originating on the high seas beyond the territorial limits of the state; however, such products lose their distinctive character as imports when they are processed, handled or sold within this state. Such products then become commingled with the general mass of property in this state and the sale thereof is taxable.

Exports: An export is an article which originates within the taxing jurisdiction of the state destined for a purchaser in a foreign country. Thus ships stores and supplies are not exports.

B Wholesaling and Retailing

Imports: Sales of imports by an importer or his agent are not taxable and a deduction will be allowed with respect to the sales of such goods, if, at the time of sale such goods are in the original and unbroken package or container in which the same are imported even though the goods were located in this state at the time of the sale and the transfer of title and possession occur in this state. Immunity from tax does not extend: (1) to the sale of imports by the importer thereof or his agent if such goods are sold other than in the original unbroken package or container; nor (2) to the sale in this state of imports by any person other than the importer or his agent whether or not in the original unbroken package or container; nor (3) to the sale of imports subsequent to the time they have been placed in use in this state for the purpose for which they were imported; nor (4) to sales of products which, although imports, have been processed or handled within this state or its territorial waters.

Exports: A deduction will be allowed with respect to export sales when as a necessary incident to the contract of sale the seller agrees to, and does deliver the goods (1) to the buyer at a foreign destination; or (2) to a carrier consigned to and for transportation to a foreign destination; or (3) to the buyer at shipside or aboard the buyer's vessel or other vehicle of transportation under circumstances where it is clear the goods will be taken to a foreign destination.

In all circumstances there must be (a) a certainty of export and (b) the process of export must have started.

As proof of export the seller must obtain and keep in his files a *bona fide* bill of lading, in which he is the consignor and by which the carrier agrees to transport the goods sold to a foreign destination; or obtain and keep documentary proof of export duly certified to by the Collector of Customs, showing export of the goods sold.

It is of no importance that title and/or possession pass in this state or pass through an intermediate purchaser so long as delivery is made directly to the export channel as above set forth.

Sales of tangible personal property, of ships stores, and supplies to operators of steamships, etc., are not deductive irrespective of the fact that the property will be consumed on the high seas, or outside the territorial jurisdiction of this state, or, by a vessel engaged in carrying foreign commerce.

Service and Other Business Activities:

Interstate and Foreign Commerce

In computing tax under this classification there may be deducted from the gross income of the business the amount thereof derived as compensation for performance of services which in themselves constitute interstate or foreign commerce to the extent that a tax measured thereby constitutes a direct burden upon such commerce. Engaging in interstate or foreign commerce is exempt, while supplying others, with facilities, etc., by which they engage in such commerce is taxable.

Types of Exempt Income:

(1) Those activities which involve the actual transportation of goods or commodities in interstate or foreign commerce;
(2) Solicitation of freight for interstate or foreign shipment;
(3) Selling of tickets for interstate or foreign passage accommodations;
(4) The compensation derived by contracting, stevedoring or loading companies for loading and unloading cargo from vessels or vehicles where such cargo is actually moving in interstate or foreign commerce and where the work is actually directed and controlled by the stevedoring or loading company;
(5) Those portions of commissions received by local brokers or commission merchants for interstate or foreign sales which were paid to out-of-state independent agents; or
(6) So much thereof as is derived from services rendered by an out-of-state agent, branch, office or employee of the taxpayer regularly maintained outside the state.

Types of Taxable Income:

(1) Compensation received by persons engaged in business within this state for performances of business activities which are only incidentally related to interstate or foreign commerce;
(2) Compensation received by merchandise brokers or commission merchants for services rendered within this state to principals engaged in interstate or foreign commerce;
(3) Compensation received by stevedoring or loading companies for supplying longshoremen or others to a ship owner or master, or to another, for the latter's use in loading or unloading, that is, when the work of unloading is not directed and controlled by the stevedoring or loading company.

The mere ownership or operation of facilities used by others in interstate or foreign commerce is incidental to that commerce and income received therefrom is taxable.

IV. RETAIL SALES TAX
(RCW Chap. 82.08)

Interstate Commerce

Preface: The Retail Sales Tax is imposed upon all retail sales made within this state. The legal incidence of the tax is upon the buyer and the seller is obligated to collect and remit the tax to the state upon civil and criminal penalties.

Application of Tax: The Retail Sales Tax applies to all sales by local vendors to consumers when delivery is made in Washington, irrespective of the fact that the gross proceeds of such sales may not be subject to tax under the Business and Occupation Tax (RCW 82.04). However, see Rule 174, 175, 176 and 177 for certain statutory exemptions.

The Retail Sales Tax does not apply when, as a necessary incident to the contract of sale, the seller agrees to, and does, deliver the subject matter of the sale to the buyer at a point outside the state, or delivers the same to a common carrier or to a *bona fide* private carrier consigned to the purchaser outside the state. The facts must disclose that the carrier is the agent of the seller and the property in the goods does not pass to the buyer until a point outside the State of Washington.

For proof of exempt sales see under Retailing and Wholesaling, Business and Occupation Tax, Part I, Section 3(c).

For tax liability of foreign vendors see section pertaining to Compensating Tax.

Foreign Commerce

The same principles apply to the Retail Sales Tax as are set forth under the foreign commerce section of the Business and Occupation Tax. Certain statutory exemptions are applicable, see Rules 174, 175, 176 and 177.

V. COMPENSATING TAX
(RCW Chap. 82.12)

Interstate and Foreign Commerce

The Compensating or "use" Tax is imposed upon the use, including storage, of all tangible personal property acquired for any use or consumption in this state unless specifically exempt by statute (see Rules 174, 175, 176, 177 and 178).

Effective July 1, 1956, for purposes of the Compensating Tax, all foreign vendors who make sales of tangible personal property to persons in this state which are solicited through resident sales agents or traveling representatives are construed to be maintaining a place of business in this state and are required to obtain a Compensating Tax Certificate of Registration. All foreign vendors who have been granted a Compensating Tax Certificate of Registration are required to collect the tax from all persons to whom goods are sold at retail for use in this state.

Every person who engages in this state in the business of acting as an independent selling agent for foreign vendors who do not hold such a valid certificate of registration, and who has received compensation by reason of sales of tangible personal property of his principals for use in this state, is also required to collect the Compensating Tax from purchasers, and to remit the same to the Tax Commission, in the manner and to the extent set forth in Rule 221.

VI. PUBLIC UTILITY TAX
(RCW Chap. 82.16)

Interstate and Foreign Commerce

In computing Public Utility Tax, there may be deducted from gross income so much thereof as is derived from actually transporting persons or property or transmitting communications or electrical energy, from this state to another state or territory or to a foreign country and vice versa. Likewise, a dock company or a wharfage company is permitted a like deduction of gross income derived from the handling of cargo or freight which is moving in interstate or foreign commerce.

However, no deduction is permitted with respect to gross income derived from activities which are incidentally related to interstate commerce. For example, no deduction is permitted a wharf company or warehouse company with respect to gross income received for the storage of goods remaining on the wharf or pier for a time prolonged beyond the stage of transportation and its reasonable incidents. In such cases, it will be presumed that all revenue received for storage constitutes taxable gross income unless the taxpayer can show in each individual case that the particular article stored, with respect to which exemption is claimed, was actually shipped to the point of destination on the first available carrier. The fact that the shipment of the particular article stored was delayed for the purpose of accumulating other articles to complete a lot or cargo will not be sufficient to entitle the taxpayer to deduct the income received for the storage thereof. The mere ownership or operation of facilities by means of which others engage in foreign or interstate commerce is merely incidental to such commerce and any income received therefrom is taxable.

In so far as the transportation of goods is concerned, the interstate movement of cargo or freight ceases when the goods have arrived at the destination to which it was billed by the out-of-state shipper, and no deduction is permitted of the gross income derived from transporting the same from such point of destination in this state to another point within this state. Thus, freight is billed from San Francisco, or a foreign point, to Seattle. After arrival in Seattle it is transported to Spokane. No deduction is permitted of the gross income received for the transportation from Seattle to Spokane. Again, freight is billed from San Francisco, or a foreign point, to line carrier's terminal, or a public warehouse in Seattle. After arrival in Seattle it is transported from line carrier's terminal or public warehouse to place of business of buyer in Seattle. No deduction is permitted of the gross income received as carrying charges for transportation from line carrier's terminal or public warehouse to place of business of buyer in Seattle.

Furthermore, the interstate movement of goods, destined for delivery to a point outside this state, does not begin until the goods have been delivered to the carrier which will issue its bill of lading agreeing to transport the goods to a point outside this state, and no deduction is permitted of the gross income received as carrying charges for transportation from a point in this state to the billing carrier. (See RCW 82.16.050(8)) for special provisions relating to the transportation of commodities into export elevators, etc.)

WASHINGTON STATE ATTORNEY GENERAL

May 08, 2015 - 2:01 PM

Transmittal Letter

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Court of Appeals Case Number: 46939-1

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