NO. 96137-9

SUPREME COURT OF THE STATE OF WASHINGTON

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Appellant,

v.

WAREHOUSE DEMO SERVICES, INC.,

Respondent.

ANSWER TO PETITION FOR REVIEW

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I. INTRODUCTION

This case involves a little known tax exemption enacted in 1963 when it was common for a salesperson, carrying a sample case of demonstration products and supplies, to solicit sales through face-to-face contact with prospective buyers. The exemption, codified at RCW 82.04.290(2)(b), is narrowly tailored. It provides that the value of promotional supplies and materials furnished to an agent by his or her principal to be used for informational, educational, or promotional purposes is not to be included as part of the agent's remuneration or commission for purposes of the state's business and occupation (B&O) tax.

The Board of Tax Appeals broadly construed the exemption statute, allowing Warehouse Demo Services, Inc. (Warehouse Demo) to claim the exemption with respect to *cash payments* the company received from product manufacturers as reimbursement for demonstration products that Warehouse Demo *purchased* and used in its product demonstration business. Moreover, the Board concluded that Warehouse Demo was acting as an agent as required by the statute even though (1) the company admitted that it was not an agent, (2) its "Agreement for Demonstration Services" specified that it was not an agent, and (3) no evidence was presented to the Board contradicting Warehouse Demo's admission that it was not an agent or the terms of its Demonstration Services agreement.

The Court of Appeals reversed the Board's broad and unprincipled application of the tax exemption statute, holding that Warehouse Demo was not an agent as expressly required by the statute. Nothing in the Court of Appeals' unpublished opinion requires review by this Court.

II. COUNTERSTATEMENT OF ISSUE PRESENTED FOR REVIEW

If the Court were to accept review, the sole issue would be whether the Board of Tax Appeals erred when it concluded that cash payments Warehouse Demo received as reimbursement for the cost of consumer products it purchased from Costco and gave away to Costco members were exempt from the B&O tax under RCW 82.04.290(2)(b).

III. COUNTERSTATEMENT OF THE CASE

A. Warehouse Demo's Product Demonstration Services

During the periods at issue, Warehouse Demo provided product demonstration service at Costco Wholesale Corporation (Costco) stores in the Pacific Northwest and parts of California. AR 623.[1] Warehouse Demo marketed its services to companies that sell products at Costco stores, such as General Mills, Heinz, Foster Farms, and Nestlé. AR 629. These Costco vendors would employ Warehouse Demo to offer free trial samples of food products and to demonstrate and promote the benefits of other

[1] Warehouse Demo was acquired by Club Demonstration Services in 2013. BTA Hearing Transcript ("Tr.") at 60. This appeal involves the December 2006 through September 2011 tax periods when Warehouse Demo was still in existence.

consumer products to Costco members. AR 623. According to Warehouse Demo's marketing materials, these product demonstrations allowed Costco members to experience the Costco vendors' products before purchase and "learn their most compelling benefits first hand." *Id.*

Warehouse Demo would provide demonstration services for a particular Costco vendor at several Costco stores on the same date. AR 684. It billed the Costco vendor shortly after completing the demonstration services. *Id.* Although Warehouse Demo provided services to Costco vendors, and was paid by the Costco vendors, it had no written agreement with the vendors it served. AR 014 (FOF 4). Instead, the terms governing Warehouse Demo's activities were set out in the "Agreement for Demonstration Services" it entered into with Costco. AR 673-83. As relevant in this appeal, the agreement specified that Warehouse Demo was an independent contractor and was "solely responsible for the direction of persons conducting Demos under [the] Agreement." AR 675.

Neither Costco nor the Costco vendors who paid for demonstration services furnished the products Warehouse Demo gave away to Costco members as free samples. Instead, Warehouse Demo purchased the products at the Costco store where the demonstration was scheduled to take place. AR 015 (FOF 7). There were sound business reasons for this practice, including logistical issues involving the possible spoilage of the

sample products and to ensure that Costco members were sampling the same products that they could purchase from that particular Costco store. *Id.*

Warehouse Demo charged its customers a "demonstration fee" for its services, and also charged for the costs it incurred in purchasing demonstration products from Costco. AR 633. Warehouse Demo recorded as gross income on its accounting records all of the amounts it charged and received from its customers, including the amount charged for the cost of products it purchased from Costco. AR 016 (FOF 10.1 and 10.2).

B. Warehouse Demo's Refund Claims

Warehouse Demo timely reported and paid Washington B&O tax on the full amount of gross income it received from its Washington business activities, including the cash payments it received as reimbursement for the cost of the products it purchased and gave away to Costco members. AR 486-544. However, in December 2011 the company submitted a tax refund claim to the Department, seeking a refund of over $700,000 plus interest for the December 2006 through September 2011 tax periods. AR 645-46. The refund claim asserted that the cash payments Warehouse Demo received from Costco vendors as reimbursement for the products it demonstrated should not have been included as "gross income of the business" as that term is defined in RCW 82.04.080. AR 647. Roughly one

year later the company filed an alternative refund claim, arguing that if B&O tax was owed on the cash payments at issue, it should be computed under the retailing B&O tax rate, not the higher service rate. AR 657.[2] Neither refund claim mentioned RCW 82.04.290(2)(b), and neither refund claim asserted that the cash payments at issue were exempt from tax as demonstration materials furnished to an agent. To the contrary, Warehouse Demo explained that it was not an agent for any of the Costco venders it served. *See* AR 579 ("WDS is not an agent of, nor do they have a contract with, the product vendors").

The Department reviewed and rejected Warehouse Demo's initial and alternative refund claims. AR 692. Warehouse Demo then sought de novo review by the Board of Tax Appeals. AR 723. Its appeal petition raised the same two issues the Department had rejected. *Id.* The petition did not mention RCW 82.04.290(2)(b).

The matter was set for a formal APA hearing. AR 711. Roughly three weeks before the hearing, Warehouse Demo asserted for the first time that the cash payments it received as reimbursement for the cost of products given away as free samples were exempt from B&O tax under RCW 82.04.290(2)(b). *See* AR 132 (Warehouse Demo's hearing brief).

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[2] Gross income from retail sales is taxed at the rate of 0.471 percent, while the gross income from service activities is taxed at the rate of 1.5 percent. *See* RCW 82.04.250(1) (imposing B&O tax on retailers); .290(2)(a) (imposing B&O tax on service and other business activities).

RCW 82.04.290(2)(b) provides that the value of "advertising, demonstration, and promotional supplies and materials furnished to an agent by his or her principal or supplier to be used for informational, educational, or promotional purposes is not considered a part of the agent's remuneration or commission and is not subject to taxation under this section." Citing no evidence, Warehouse Demo asserted in its hearing brief that it "acted as the agent of the vendors" when promoting the vendors' products at the in-store demonstrations. AR 132. The assertion was a reversal from its earlier admission to the Department of Revenue that "WDS is not an agent of, nor [does it] have a contract with, the products vendors" it represents. AR 579.

C. The Board of Tax Appeals' Decision and Subsequent Judicial Review

The Board held an evidentiary hearing in November 2015. The sole witness was the company's part-owner and Chief Financial Officer, Brent Ellis. Mr. Ellis explained that Warehouse Demo had contracted with Costco "to run [Costco's] demo business" by "promoting products to Costco's members." Tr. at 20, 19. Warehouse Demo "supplied the labor and the marketing know-how to execute those product demonstrations." Tr. at 19. To help manage the business, Warehouse Demo hired "full-time salaried demo managers" who oversaw the product demonstrations at each

Costco location. Tr. at 29. Demo managers hired and trained demonstrators and purchased from Costco the specific products necessary to "execute a demo." *Id.*

Mr. Ellis also confirmed that Warehouse Demo had almost no direct contact with any of the Costco vendors it served. Tr. at 23. Rather, Costco dictated the terms and conditions of its demonstration service activities. Tr. 19-21. Consistent with that testimony, Mr. Ellis never asserted that Warehouse Demo acted as the agent for any of the Costco vendors. Nor did he offer any testimony contradicting Warehouse Demo's earlier admission that it was "not an agent of . . . the products vendors." AR 579.

Following the hearing, Warehouse Demo voluntarily withdrew its alternative refund claim regarding the proper B&O tax rate. AR 037. Consequently, the Board did not address that issue, and it is not part of this appeal.

When the Board of Tax Appeals issued its written decision, it rejected Warehouse Demo's argument that the reimbursement payments it received from the Costco vendors should be excluded from its gross income. AR 013 ("Brief Answer" to issue # 1); AR 018 (COL 6). Warehouse Demo did not appeal that ruling.

Although the Board rejected Warehouse Demo's primary argument concerning the definition of "gross income," it did accept the company's claim that the cash payments it received as reimbursement for the cost of the products given away to Costco members were exempt from the B&O tax under RCW 82.04.290(2)(b). AR 013 ("Brief Answer" to issue # 2). In reaching its decision, the Board concluded that the products Warehouse Demo purchased from Costco and gave away to Costco members had been "furnished" to Warehouse Demo by the Costco vendors who paid Warehouse Demo for its services. AR 019 (COL 13). The Board also concluded that Warehouse Demo was the agent of the Costco vendors that paid for its services, and concluded that the exemption applied to payments received as reimbursement from the Costco vendors after the demonstration service activity took place. AR 020-21 (COL 14-16).

The Department timely appealed to the Thurston County Superior Court. CP 4. The Superior Court affirmed the Board of Tax Appeals, CP 208, which prompted the Department to appeal to the Court of Appeals.

The Court of Appeals reversed the Board of Tax Appeals, holding that Warehouse Demo had failed to establish that it was an agent of any of the Costco vendors that paid it for its demonstration services. Slip op. at

8.[3] The Court of Appeals explained that the Board had made no express finding of an agency relationship. *Id.* at 5-6. Moreover, the findings it did make (relating to mostly undisputed aspects of Warehouse Demo's business operations) did not support a conclusion of law that an agency relationship existed. *Id.* at 6, 8. As a result, the Court reversed the Board's final decision granting Warehouse Demo's tax refund claim. *Id.* at 8. The Court also denied Warehouse Demo's motion for reconsideration, and its motion to publish. *See* Order denying motions issued 6/27/2018.

IV. REASONS WHY THE COURT SHOULD DENY REVIEW

RAP 13.4(b) sets out the criteria used in determining whether a petition for discretionary review will be accepted. Warehouse Demo mentions only RAP 13.4(b)(4), which permits review by this Court if the petition raises an issue of substantial public interest. Pet. at 3.

Warehouse Demo's petition should be denied. The Court of Appeals' unpublished opinion raises no issue of substantial public interest. Rather, the opinion merely applied well-established law of agency in holding that Warehouse Demo was not entitled to claim the B&O tax exemption for promotional supplies and materials furnished to an agent.

[3] Because the Court found that there was no agency relationship between Warehouse Demo and the Costco vendors, it did not address the other arguments advanced by the Department. Slip. op. at 4 n.1.

Application of settled law to the facts of this appeal has substantial interest only to Warehouse Demo.

A. This Appeal Presents No Issue of Substantial Public Interest

Although Warehouse Demo cites RAP 13.4(b)(4) at page 3 of its Petition, the company offers no argument suggesting that this appeal presents an issue of substantial public interest. *See* Pet. at 8-20 (no argument concerning any issue of substantial public interest). Rather, Warehouse Demo simply disagrees with the Court of Appeals' decision. Specifically, Warehouse Demo contends that the Court of Appeals "erred when it found . . . no evidence" to support the Board of Tax Appeals' conclusion of law regarding agency and when it "failed to follow" WAC 458-20-193 to determine whether an agency relationship existed between Warehouse Demo and the vendors that pay for its services. Pet. at 8, 13.

Warehouse Demo's disagreement with the Court of Appeals' analysis is not an issue of substantial public interest warranting review under RAP 13.4(b)(4) or otherwise.

B. The Court of Appeals Correctly Applied the Law of Agency in Deciding That Warehouse Demo Did Not Qualify for the Exemption in RCW 82.04.290(2)(b)

Warehouse Demo's disagreement with the Court of Appeals' opinion is unfounded. The Court of Appeals correctly applied well-established law pertaining to the creation of an agency relationship, and

Warehouse Demo's arguments concerning an unrelated Department administrative rule, WAC 458-20-193, are totally without merit.

1. The Court of Appeals correctly applied the law of agency

The Court of Appeals correctly applied the law of agency, as well as the standard of judicial review outlined in the Administrative Procedure Act, when it held that the Board of Tax Appeals erred in concluding that Warehouse Demo was acting as an agent.

As this Court has explained in several cases, an agency relationship "generally arises when two parties consent that one shall act under the control of the other." *Washington Imaging Servs., LLC v. Dep't of Revenue*, 171 Wn.2d 548, 562, 252 P.3d 885 (2011) (quoting *Rho Co., Inc. v. Dep't of Revenue*, 113 Wn.2d 561, 570, 782 P.2d 986 (1989)). "The two elements of an agency are mutual consent and control by the principal of the agent." *Uni-Com Northwest, Ltd. v. Argus Publishing Co.*, 47 Wn. App. 787, 796, 737 P.2d 304 (1987). The element of control is crucial. *Id.* Absent evidence of control, the relationship is one of a buyer and seller, for example, not a principal and agent. *Id.* at 797. The burden of establishing a principal-agency relationship falls to the party asserting its existence. *Hewson Constr., Inc. v. Reintree Corp.*, 101 Wn.2d 819, 823,

685 P.2d 1062 (1984). The Court of Appeals correctly summarized and correctly applied this established law. Slip op. at 6-7.

The facts of this case establish that Warehouse Demo was hired to do a job—to demonstrate consumer products at Costco stores. Warehouse Demo sold its services to Costco vendors under the terms of an agreement it entered into with Costco. AR 673. Paragraph 2(E) of that agreement expressly provided that no agency relationship was being created, that Warehouse Demo was an independent contractor, and that the "mode, manner, methods and means used by [Warehouse Demo] or its Demonstrators in the performance of Demos shall be under the control and direction of" Warehouse Demo. AR 675. That paragraph also specified that Warehouse Demo was "solely responsible for the direction of persons conducting Demos under [the] Agreement." *Id.* Likewise, paragraph 3(A) of the agreement stipulated that Warehouse Demo "will be fully responsible" for all "acts, omissions, statements and representations made by any . . . persons or entities acting on [its] behalf." AR 676. Consistent with the terms of its agreement with Costco, Warehouse Demo admitted that it was not an agent for any of the Costco vendors it served. AR 579.

The testimony offered at the BTA hearing was entirely consistent with the express agreement between Costco and Warehouse Demo, and with Warehouse Demo's admission that it was not an agent. Brent Ellis,

part-owner and CFO of Warehouse Demo, explained to the Board that the terms of the agreement "fairly describe[d] WDS's actions as it relates to vendors." Tr. at 22. He also explained that Warehouse Demo hired full-time "demo managers" to oversee the in-store demonstrations. Tr. at 29. The demo managers, not the Costco vendors, hired and trained demonstrators and decided how much of a vendor's product should be purchased from Costco in order to "execute the demo." *Id.* Just as important, Mr. Ellis offered no testimony regarding any alleged oral agreement between Warehouse Demo and the Costco vendors, and he offered no testimony suggesting that the vendors exercised some degree of control over Warehouse Demo's business activities. Instead, he consistently explained that Warehouse Demo was in control of the demonstrations. *See, e.g.*, Tr. at 19 (The company "supplied the labor and the marketing know-how to execute [the] product demonstrations").

Because evidence of control was lacking, the relationship between the Costco vendors and Warehouse Demo was that of buyer and seller of demonstration services, not a principal and agent. The Board of Tax Appeals erred as a matter of law when it concluded otherwise, as the Court of Appeals correctly held. Slip. op. at 8. Simply put, the Board made no finding that "any of the [Costco] vendors controlled the manner in which Warehouse Demo conducted its demonstrations, or managed and

supervised the product information shared by Warehouse Demo, or otherwise exhibited control over the demonstrations." *Id.* The Board made no "agency" finding because evidence of control was totally lacking. *See* AR 675 (Warehouse Demo was "solely responsible for the direction of persons conducting Demos under [the] Agreement").

In its petition for review, Warehouse Demo points only to findings of fact that are consistent with a typical buyer-seller arrangement. Pet. at 11. It can point to no evidence that Costco vendors exercised control over its demonstration activities and no evidence undercutting the express language of the Costco agreement or its own admission of no agency relationship.[4] Given the lack of evidence supporting Warehouse Demo's claim of agency, this case does not merit further review.

2. The Court's opinion does not conflict with WAC 458-20-193 or Department determinations applying that administrative rule

Warehouse Demo next argues that evidence of control is either not necessary or has been rendered unimportant in excise tax cases because of language it believes is contained in WAC 458-20-193 (Rule 193). Pet. at 13-20. The argument is entirely without merit.

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[4] The parties agree that, in some cases, the Costco vendor would pick the product to be demonstrated and the location of the demonstrations. But the same is true in many buyer-seller relationships. A homeowner who hires a contractor to paint her home will typically tell the contractor the location of the home, the date the work should start, and the color of the paint to use. Providing instruction on these logistical details does not convert the relationship into an agency.

Rule 193 is an interpretive rule that explains how Washington's tax statutes and federal constitutional law apply to interstate sales of goods. *See* WAC 458-20-193 (copy provided as Appendix 1); *Avnet, Inc. v. Dep't of Revenue*, 187 Wn.2d 44, 52-53, 384 P.3d 571 (2016) (discussing prior version of Rule 193). Among other things, Rule 193 explains that sales of goods may be subject to B&O tax and retail sales tax "if the seller has nexus with Washington and the sale occurs in Washington." WAC 458-20-193(2).

Rule 193 is not applicable to this case. There is no dispute that Warehouse Demo had nexus with Washington and that its service activities occurred in this state. AR 013. Nevertheless, the company contends that the unpublished Court of Appeals' opinion—which had nothing to do with Rule 193 or nexus—"conflicts with the Department's administration of Rule 193(102)(a)(iii)." Pet. at 20.

The portion of Rule 193 Warehouse Demo cites deals with the "physical presence nexus standard." *See* WAC 458-20-193(102)(a). The Rule points out that an in-state physical presence can be established in a number of ways, including through the activities of employees, agents, or independent representatives. *Id.* at (102)(a)(ii), (iii); *see generally, Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue*, 483 U.S. 232, 250, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987) (nexus established by activities of

independent sales representative); *Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 246 P.3d 788 (2011) (nexus established by in-state activities of employees). The employment status of the person acting on behalf of the taxpayer is not important. Rather, as Rule 193 explains, the key to establishing nexus is whether the person acting on behalf of the taxpayer "engages in activities in this state that are significantly associated with [the taxpayer's] ability to establish or maintain a market for its products in Washington." WAC 458-20-193(102)(d).

Because there is no statutory or constitutional distinction between nexus-creating activity performed by an agent of a taxpayer and nexus-creating activity performed by a non-agent, Rule 193 provides no discussion of the law of agency. The actor's status as an agent of the taxpayer is simply not a relevant consideration. Under Rule 193 and the law it applies, activities of agents and non-agents are treated alike.

Warehouse Demo misses this nuance in its reading of Rule 193. It somehow arrives at the conclusion that Rule 193 makes the in-state actor an "agent" of the taxpayer if that actor performs nexus-creating activity. *See* Pet. at 13 ("under Rule 193, if [a person] helps the out-of-state vendor establish or maintain a Washington market for vendors, then [that actor] *would be an agent*"). But Rule 193 says no such thing. In fact, the Rule is clear that nexus can be established through in-state activity directly

engaged in by the taxpayer or "though an agent or *other representative*." WAC 458-20-193(102)(d) (emphasis added). Warehouse Demo simply misreads or misunderstands the Rule.

Additionally, the Court of Appeals' opinion is not in "conflict" with any of the Department determinations discussed in Warehouse Demo's petition for review. *See* Pet. at 14-20 (discussing five published tax determinations involving whether an out-of-state seller had nexus with Washington and alleging that the opinion of the Court of Appeals conflicts with those determinations). When the Department decides a tax dispute through the process of issuing a written tax determination, it is acting in a quasi-judicial role. It hears and weighs evidences, makes findings of fact, and applies those findings to legal principles to arrive at a conclusion. The fact that the Department may have found an agency relationship with respect to a particular taxpayer based on particular facts does not mean that Warehouse Demo is an agent based on the facts here. Nor does it mean that the Court of Appeals should have overlooked the particular facts of this case and, instead, treated Warehouse Demo as an agent because a Department determination in an entirely unrelated matter concluded that an agency relationship existed between an in-state actor and an out-of-state seller. Any difference in the outcome of these unrelated

cases simply underscores that when a legal standard is applied to different facts, different results may be reached.

Moreover, as discussed above, nexus can be established in many ways, including through the actions of non-agents. *See Tyler Pipe*, 483 U.S. at 250; *Scripto, Inc. v. Carson*, 362 U.S. 207, 211, 80 S. Ct. 619, 4 L. Ed. 2d 660 (1960) (in-state activities of independent contractors were sufficient to establish nexus). As this Court pointed out more than thirty years ago, "the characterization of an in-state sales representative as an 'independent contractor' is without constitutional significance with regard to . . . nexus." *Tyler Pipe Indus., Inc. v. Dep't of Revenue*, 105 Wn.2d 318, 324, 715 P.2d 123 (1986) (citing *Scripto*), *vacated in part on other grounds*, 483 U.S. 232, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987). Thus, it has long been settled that an agency relationship is not required to establish nexus.[5]

The Court of Appeals' opinion does not "conflict with the Department's administration of Rule 193" as Warehouse Demo alleges. Pet. at 20. Rather, Warehouse Demo simply failed to prove an agency relationship with any of its customers under the facts presented at the

[5] By contrast, an agency relationship is necessary to qualify for the tax exemption allowed by RCW 82.04.290(2)(b). The term "agent" appears twice in the statute, first to identify the person who is furnished with the supplies and materials, and again to emphasize that the exemption applies to the "agent's remuneration or commission." A non-agent is not entitled to the tax preference.

Board of Tax Appeals proceeding. Consequently, it does not meet one of the requirements for claiming the "promotional supplies and materials furnished to an agent" tax exemption set out in RCW 82.04.290(2)(b). The Board of Tax Appeals erred when it concluded otherwise.

The unpublished opinion of the Court of Appeals resolves this dispute. And while Warehouse Demo may be unhappy with the final outcome, its fanciful argument alleging a "conflict" with the Department's application of Rule 193 to nexus claims based on different facts does not raise an issue warranting this Court's attention.

V. CONCLUSION

For the foregoing reasons, the decision of the Court of Appeals does not merit this Court's review. Warehouse Demo's petition should be denied.

RESPECTFULLY SUBMITTED this 27th day of August, 2018.

ROBERT W. FERGUSON
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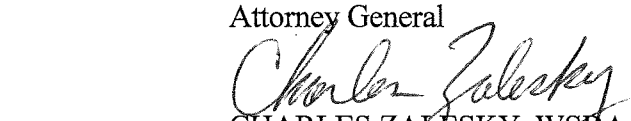

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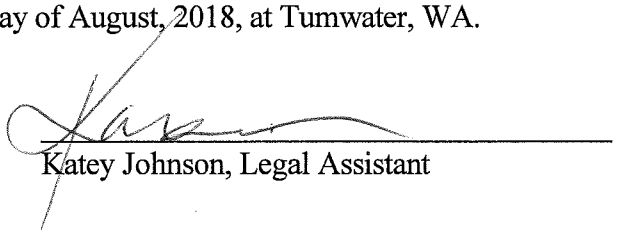
I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 27th day of August, 2018, at Tumwater, WA.



Katey Johnson, Legal Assistant

APPENDIX 1

WAC 458-20-193

Interstate sales of tangible personal property.

(1) **Introduction.** This rule explains the application of the business and occupation (B&O) and retail sales taxes to interstate sales of tangible personal property.

(a) The following rules may also be helpful:

(i) WAC **458-20-178** Use tax and the use of tangible personal property.

(ii) WAC **458-20-193C** Imports and exports—Sales of goods from or to persons in foreign countries.

(iii) WAC **458-20-193D** Transportation, communication, public utility activities, or other services in interstate or foreign commerce.

(iv) WAC **458-20-19401** Minimum nexus threshold for apportionable receipts.

(b) This rule contains examples that identify a number of facts and then state a conclusion. These examples should be used only as a general guide. The tax results of all situations must be determined after a review of all the facts and circumstances.

(c) **Tangible personal property.** For purposes of this rule, the term "tangible personal property" means personal property that can be seen, weighed, measured, felt, or touched or that is in any other manner perceptible to the senses, but does not include steam, electricity, or electrical energy. It includes prewritten computer software (as such term is defined in RCW **82.04.215**) in tangible form. However, this rule does not address electronically delivered prewritten computer software or remote access software.

(2) **Scope of rule.** In general, Washington imposes its B&O and retail sales taxes on sales of tangible personal property if the seller has nexus with Washington and the sale occurs in Washington. This rule explains the applicable nexus and place of sale requirements with respect to sales of tangible personal property. This rule does not cover sales of intangibles or services and does not address the use tax obligation of a purchaser of goods in Washington. For information on payment responsibilities for use tax see WAC **458-20-178**.

(3) **Organization of rule.** This rule is divided into three parts:

(a) Part I – Nexus standards for sales of tangible personal property;

(b) Part II – Sourcing sales of tangible personal property; and

(c) Part III – Drop shipment sales.

Part I – Nexus Standards for Sales of Tangible Personal Property

(101) **Introduction.** A seller is subject to the state's B&O tax and retail sales tax with respect to sales of tangible personal property, if that seller has nexus. Washington applies specific nexus standards and thresholds that are used to determine whether a seller of tangible personal property has nexus. The nexus standards and thresholds described in this rule pertain only to sellers of tangible personal property. The remainder of Part 1 of this rule describes these nexus standards and thresholds and how they apply in the context of Washington's wholesaling and retailing B&O classifications and the retail sales tax.

(102) **Physical presence nexus standard.** A person who sells tangible personal property in a retail sale is deemed to have nexus with Washington if the person has a physical presence in this state, which need only be demonstrably more than the slightest presence. RCW **82.04.067**(6). This standard applies to retail sales both in the retail sales tax and retailing B&O tax context.

(a) **Physical presence.** A person is physically present in this state if:

(i) The person has property in this state;

(ii) The person has one or more employees in this state;

(iii) The person, either directly or through an agent or other representative, engages in activities in this state that are significantly associated with the person's ability to establish or maintain a market for its products in Washington; or

(iv) The person is a remote seller as defined in RCW **82.08.052** and is unable to rebut the substantial nexus presumption for remote sellers set out in RCW **82.04.067** (6)(c)(ii).

(b) **Property.** A person has property in this state if the person owns, leases, or otherwise has a legal or beneficial interest in real or personal property in Washington.

(c) **Employees.** A person has employees in this state if the person is required to report its employees for Washington unemployment insurance tax purposes, or the facts and circumstances otherwise indicate that the person has employees in the state.

(d) **In-state activities.** Even if a person does not have property or employees in Washington, the person is physically present in Washington when the person, either directly or through an agent or other representative, engages in activities in this state that are significantly associated with the person's ability to establish or maintain a market for its products in Washington. It is immaterial that the activities that establish nexus are not significantly associated with a particular sale into this state.

For purposes of this rule, the term "agent or other representative" includes an employee, independent contractor, commissioned sales representative, or other person acting either at the direction of or on behalf of another.

A person performing the following nonexclusive list of activities, directly or through an agent or other representative, generally is performing activities that are significantly associated with establishing or maintaining a market for a person's products in this state:

(i) Soliciting sales of goods in Washington;

(ii) Installing, assembling, or repairing goods in Washington;

(iii) Constructing, installing, repairing, or maintaining real property or tangible personal property in Washington;

(iv) Delivering products into Washington other than by mail or common carrier;

(v) Having an exhibit at a trade show to maintain or establish a market for one's products in the state, except as described in subsection (102)(f) of this rule;

(vi) An online seller having a brick-and-mortar store in this state accepting returns on its behalf;

(vii) Performing activities designed to establish or maintain customer relationships including, but not limited to:

(A) Meeting with customers in Washington to gather or provide product or marketing information, evaluate customer needs, or generate goodwill; or

(B) Being available to provide services associated with the product sold (such as warranty repairs, installation assistance or guidance, and training on the use of the product), if the availability of such services is referenced by the seller in its marketing materials, communications, or other information accessible to customers.

(e) **Remote sellers – Click-through nexus.** Effective September 1, 2015, a remote seller as defined in RCW **82.08.052** is presumed to meet the physical presence nexus standard described in this subsection for purposes of the retail sales tax if the remote seller enters into an agreement with a resident of this state under which the resident, for a commission or other consideration, refers potential customers to the remote seller, whether by link on an internet web site or otherwise, but only if the cumulative gross receipts from sales by the remote seller to customers in this state who are referred to the remote seller through such agreements exceeds ten thousand dollars during the preceding calendar year. For more information related to the presumption and how to rebut the presumption, see RCW **82.08.052** and **82.04.067** (6)(c)(ii).

(f) **Trade convention exception.** For the physical presence nexus standard described in this subsection, the department may not make a determination of nexus based solely on the attendance

or participation of one or more representatives of a person at a single trade convention per calendar year in Washington state in determining if such person is physically present in this state for the purposes of establishing substantial nexus with this state. This does not apply to persons making retail sales at a trade convention in this state, including persons taking orders for products or services where receipt will occur at a later time in Washington state. RCW **82.32.531**.

Definitions. The following definitions apply only to (f) of this subsection:

(i) "Not marketed to the general public" means that the sponsor of a trade convention limits its marketing efforts for the trade convention to its members and specific invited guests of the sponsoring organization.

(ii) "Physically present in this state" and "substantial nexus with this state" have the same meaning as provided in RCW **82.04.067**.

(iii) "Trade convention" means an exhibition for a specific industry or profession, which is not marketed to the general public, for the purposes of:

(A) Exhibiting, demonstrating, and explaining services, products, or equipment to potential customers; or

(B) The exchange of information, ideas, and attitudes in regards to that industry or profession.

(103) **Economic nexus thresholds.** RCW **82.04.067** establishes substantial nexus thresholds that apply to persons who sell tangible personal property. For more information on the economic nexus thresholds, see WAC **458-20-19401**.

Application to retail sales. Effective July 1, 2017, for B&O tax purposes, a person making retail sales taxable under RCW **82.04.250**(1) or **82.04.257**(1) is deemed to have substantial nexus with Washington if the person's receipts meet the economic nexus thresholds under RCW **82.04.067** (1)(c)(iii) and (iv). The receipts threshold is met if the person has more than two hundred sixty-seven thousand dollars of receipts (as adjusted by RCW **82.04.067**(5)) from this state or at least twenty-five percent of the person's total receipts are in this state. For more information, see WAC **458-20-19401**.

(104) **Application of standards and thresholds to wholesale sales.** The physical presence nexus standard described in subsection (102) of this rule, applies to wholesale sales for periods prior to September 1, 2015. Effective September 1, 2015, wholesale sales taxable under RCW **82.04.257** (1) and **82.04.270** are subject to the RCW **82.04.067** (1) through (5) economic nexus thresholds. Wholesaling activities not taxable under RCW **82.04.257**(1) and **82.04.270** remain subject to the physical presence nexus standard. For more information, see WAC **458-20-19401**.

(105) **Effect of having nexus.**

(a) **Retail sales.** A person that makes retail sales of tangible personal property and meets either the physical presence nexus standard or whose receipts meet the economic nexus thresholds described in RCW **82.04.067** (1)(c)(iii) or (iv) is subject to B&O tax on that person's retail sales received in the state. In addition, a person that makes retail sales of tangible personal property and meets the physical presence nexus standard, including as described in subsection (102)(e) of this rule, is also responsible for collecting and remitting retail sales tax on that person's sales of tangible personal property sourced to Washington, unless a specific exemption applies.

(b) **Wholesale sales.** A person that makes wholesale sales of tangible personal property and has nexus with Washington (as described in subsection (104) of this rule) is subject to B&O tax on that person's wholesale sales sourced to Washington.

(106) **Trailing nexus.** Effective July 1, 2017, for B&O tax purposes, a person is deemed to have substantial nexus with Washington for the current year if that person meets any of the requirements in RCW **82.04.067** in either the current or immediately preceding calendar year. Thus, a person who stops the business activity that created nexus in Washington continues to have nexus in the calendar year following any calendar year in which the person met any of the requirements in RCW **82.04.067** (also known as "trailing nexus").

Prior to July 1, 2017, RCW **82.04.220** provided that for B&O tax purposes a person who stopped the business activity that created nexus in Washington continued to have nexus for the remainder of that calendar year, plus one additional calendar year.

The department of revenue applies the same trailing nexus period for retail sales tax and other taxes reported on the excise tax return.

(107) **Public Law 86-272.** Public Law 86-272 (15 U.S.C. Sec. 381 et. seq.) applies only to taxes on or measured by net income. Washington's B&O tax is measured by gross receipts. Consequently, Public Law 86-272 does not apply.

Part II – Sourcing Sales of Tangible Personal Property

(201) **Introduction.** RCW **82.32.730** explains how to determine where a sale of tangible personal property occurs based on "sourcing rules" established under the streamlined sales and use tax agreement. Sourcing rules for the lease or rental of tangible personal property are beyond the scope of this rule, as are the sourcing rules for "direct mail," "advertising and promotional direct mail," or "other direct mail" as such terms are defined in RCW **82.32.730**. See RCW **82.32.730** for further explanation of the sourcing rules for those particular transactions.

(202) **Receive and receipt.**

(a) **Definition.** "Receive" and "receipt" mean the purchaser first either taking physical possession of, or having dominion and control over, tangible personal property.

(b) Receipt by a shipping company.

(i) "Receive" and "receipt" do not include possession by a shipping company on behalf of the purchaser, regardless of whether the shipping company has the authority to accept and inspect the goods on behalf of the purchaser.

(ii) A "shipping company" for purposes of this rule means a separate legal entity that ships, transports, or delivers tangible personal property on behalf of another, such as a common carrier, contract carrier, or private carrier either affiliated (e.g., an entity wholly owned by the seller or purchaser) or unaffiliated (e.g., third-party carrier) with the seller or purchaser. A shipping company is not a division or branch of a seller or purchaser that carries out shipping duties for the seller or purchaser, respectively. Whether an entity is a "shipping company" for purposes of this rule applies only to sourcing sales of tangible personal property and does not apply to whether a "shipping company" can create nexus for a seller.

(203) **Sourcing sales of tangible personal property – In general.** The following provisions in this subsection apply to sourcing sales of most items of tangible personal property.

(a) **Business location.** When tangible personal property is received by the purchaser at a business location of the seller, the sale is sourced to that business location.

Example 1. Jane is an Idaho resident who purchases tangible personal property at a retailer's physical store location in Washington. Even though Jane takes the property back to Idaho for her use, the sale is sourced to Washington because Jane received the property at the seller's business location in Washington.

Example 2. Department Store has retail stores located in Washington, Oregon, and in several other states. John, a Washington resident, goes to Department Store's store in Portland, Oregon to purchase luggage. John takes possession of the luggage at the store. Although Department Store has nexus with Washington through its Washington store locations, Department Store is not liable for B&O tax and does not have any responsibility to collect Washington retail sales tax on this transaction because the purchaser, John, took possession of the luggage at the seller's business location outside of Washington.

Example 3. An out-of-state purchaser sends its own trucks to Washington to receive goods at a Washington-based seller and to immediately transport the goods to the purchaser's out-of-state

location. The sale occurs in Washington because the purchaser receives the goods in Washington. The sale is subject to B&O and retail sales tax.

Example 4. The same purchaser in Example 3 uses a wholly owned affiliated shipping company (a legal entity separate from the purchaser) to pick up the goods in Washington and deliver them to the purchaser's out-of-state location. Because "receive" and "receipt" do not include possession by the shipping company, the purchaser receives the goods when the goods arrive at the purchaser's out-of-state location and not when the shipping company takes possession of the goods in Washington. The sale is not subject to B&O tax or retail sales tax.

(b) **Place of receipt.** If the sourcing rule explained in (a) of this subsection does not apply, the sale is sourced to the location where receipt by the purchaser or purchaser's donee, designated as such by the purchaser, occurs, including the location indicated by instructions for delivery to the purchaser or purchaser's donee, as known to the seller.

(i) The term "purchaser" includes the purchaser's agent or designee.

(ii) The term "purchaser's donee" means a person to whom the purchaser directs shipment of goods in a gratuitous transfer (e.g., a gift recipient).

(iii) Commercial law delivery terms, and the Uniform Commercial Code's provisions defining sale or where risk of loss passes, do not determine where the place of receipt occurs.

(iv) The seller must retain in its records documents used in the ordinary course of the seller's business to show how the seller knows the location of where the purchaser or purchaser's donee received the goods. Acceptable proof includes, but is not limited to, the following documents:

(A) Instructions for delivery to the seller indicating where the purchaser wants the goods delivered, provided on a sales contract, sales invoice, or any other document used in the seller's ordinary course of business showing the instructions for delivery;

(B) If shipped by a shipping company, a waybill, bill of lading or other contract of carriage indicating where delivery occurs; or

(C) If shipped by the seller using 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 the purchaser's address; and
- 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 by the purchaser.

Example 5. John buys luggage from a Department Store that has nexus with Washington (as in Example 2), but has the store ship the luggage to John in Washington. Department Store has nexus with Washington, and receipt of the luggage by John occurred in Washington. Department Store owes Washington retailing B&O tax and must collect Washington retail sales tax on this sale.

Example 6. Parts Store is located in Washington. It sells machine parts at retail and wholesale. Parts Collector is located in California and buys machine parts from Parts Store. Parts Store ships the parts directly to Parts Collector in California, and Parts Collector takes possession of the machine parts in California. The sale is not subject to B&O or retail sales taxes in this state because Parts Collector did not receive the parts in Washington.

Example 7. An out-of-state seller with nexus in Washington uses a third-party shipping company to ship goods to a customer located in Washington. The seller first delivers the goods to the shipping company outside Washington using its own transportation equipment. Even though the shipping company took possession of the goods outside of Washington, possession by the shipping company is not receipt by the purchaser for Washington tax purposes. The sale is subject to B&O and retail sales tax in this state because the purchaser has taken possession of the goods in Washington.

Example 8. A Washington purchaser's affiliated shipping company arranges to pick up goods from an out-of-state seller at its out-of-state location, and deliver those goods to the Washington purchaser's Yakima facility. The affiliated shipping company has the authority to accept and inspect the goods prior to transport on behalf of the buyer. When the affiliated shipping company takes possession of the goods out-of-state, the Washington purchaser has not received the goods out-of-state. Possession by a shipping company on behalf of a purchaser is not receipt for purposes of this rule, regardless of whether the shipping company has the authority to accept and inspect the goods on behalf of the buyer. Receipt occurs when the buyer takes possession of the goods in Washington. The sale is subject to B&O and retail sales tax in this state.

Example 9. An instate seller arranges for shipping its goods to an out-of-state purchaser by first delivering its goods to a Washington-based shipping company at its Washington location for further transport to the out-of-state customer's location. Possession of the goods by the shipping company in Washington is not receipt by the purchaser for Washington tax purposes, and the sale is not subject to B&O and retail sales tax in Washington.

Example 10. An out-of-state manufacturer/seller of a bulk good with nexus in Washington sells the good to a Washington-based purchaser in the business of selling small quantities of the good under its own label in its own packaging. The purchaser directs the seller to deliver the goods to a third-party packaging plant located out-of-state for repackaging of the goods in the purchaser's own packaging. The purchaser then has a third-party shipping company pick up the goods at the packaging plant. The Washington purchaser takes constructive possession of the goods outside of Washington because it has exercised dominion and control over the goods by having them repackaged at an out-of-state packaging facility before shipment to Washington. The sale is not subject to B&O and retail sales tax in this state because the purchaser received the goods outside of Washington.

Example 11. Company ABC is located in Washington and purchases goods from Company XYZ located in Ohio. Company ABC directs Company XYZ to ship the goods by a for-hire carrier to a commercial storage warehouse in Washington. The goods will be considered as having been received by Company ABC when the goods are delivered at the commercial storage warehouse. Assuming Company XYZ has nexus, Company XYZ is subject to B&O tax and must collect retail sales tax on the sale.

(c) **Other sourcing rules.** There may be unique situations where the sourcing rules provided in (a) and (b) of this subsection do not apply. In those cases, please refer to the provisions of RCW **82.32.730** (1)(c) through (e).

(204) **Sourcing sales of certain types of property.**

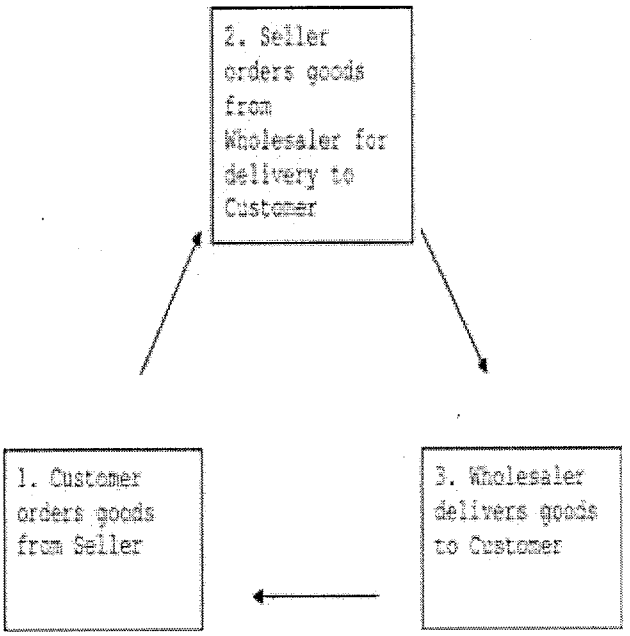
(a) **Sales of commercial aircraft parts.** As more particularly provided in RCW **82.04.627**, the sale of certain parts to the manufacturer of a commercial airplane in Washington is deemed to take place at the site of the final testing or inspection.

(b) **Sales of motor vehicles, watercraft, airplanes, manufactured homes, etc.** Sales of the following types of property are sourced to the location at or from which the property is delivered in accordance with RCW **82.32.730** (7)(a) through (c): Watercraft; modular, manufactured, or mobile homes; and motor vehicles, trailers, semi-trailers, or aircraft that do not qualify as "transportation equipment" as defined in RCW **82.32.730**. See WAC **458-20-145** (2)(b) for further information regarding the sourcing of these sales.

(c) **Sales of flowers and related goods by florists.** Sales by a "florist" are subject to a special origin sourcing rule. For specific information concerning "florist sales," who qualifies as a "florist," and the related sourcing rules, see RCW **82.32.730** (7)(d) and (9)(e) and WAC **458-20-158**.

Part III – Drop Shipments

(301) **Introduction.** A drop shipment generally involves two separate sales. A person (the seller) contracts to sell tangible personal property to a customer. The seller then contracts to purchase that property from a wholesaler and instructs that wholesaler to deliver the property directly to the seller's customer. The place of receipt in a drop shipment transaction is where the property is delivered (i.e., the seller's customer's location). Below is a diagram of a basic drop shipment transaction:



The following subsections discuss the taxability of drop shipments in Washington when:

(a) The seller and wholesaler do not have nexus;

(b) The seller has nexus and the wholesaler does not;

(c) The wholesaler has nexus and the seller does not; and

(d) The seller and wholesaler both have nexus. In each of the following scenarios, the customer receives the property in Washington and the sale is sourced to Washington. Further, in each of the following scenarios, a reseller permit or other approved exemption certificate has been acquired to document any wholesale sales in Washington. For information about reseller permits issued by the department, see WAC **458-20-102**.

(302) **Seller and wholesaler do not have nexus.** Where the seller and the wholesaler do not have nexus with Washington, sales of tangible personal property by the seller to the customer and the wholesaler to the seller are not subject to B&O tax. In addition, neither the seller nor the wholesaler is required to collect retail sales tax on the sale.

(303) **Seller has nexus but wholesaler does not.** Where the seller has nexus with Washington but the wholesaler does not have nexus with Washington, the wholesaler's sale of tangible personal property to the seller is not subject to B&O tax and the wholesaler is not required to collect retail sales tax on the sale. The sale by the seller to the customer is subject to wholesaling or retailing B&O tax, as the case may be. The seller must collect retail sales tax from the customer unless specifically exempt by law.

(304) **Wholesaler has nexus but seller does not.** Where the wholesaler has nexus with Washington but the seller does not have nexus with Washington, wholesaling B&O tax applies to the sale of tangible personal property by the wholesaler to the seller for shipment to the seller's customer. The sale from the seller to its Washington customer is not subject to B&O tax, and the seller is not required to collect retail sales tax on the sale.

Example 12. Seller is located in Ohio and does not have nexus with Washington. Seller receives an order from Customer, located in Washington, for parts that are to be shipped to Customer

in Washington for its own use as a consumer. Seller buys the parts from Wholesaler, which has nexus with Washington, and requests that the parts be shipped directly to Customer. Seller is not subject to B&O tax and is not required to collect retail sales tax on its sale to Customer because Seller does not have nexus with Washington. The sale by Wholesaler to Seller is subject to wholesaling B&O tax because Wholesaler has nexus with Washington and Customer receives the parts (i.e., the parts are delivered to Customer) in Washington.

(305) **Seller and wholesaler have nexus with Washington.** Where the seller and wholesaler have nexus with Washington, wholesaling B&O tax applies to the wholesaler's sale of tangible personal property to the seller. The sale from the seller to the customer is subject to wholesaling or retailing B&O tax as the case may be. The seller must collect retail sales tax from the customer unless the sale is specifically exempt by law.

[Statutory Authority: RCW **82.32.300** and **82.01.060**(2). WSR 18-06-078, § 458-20-193, filed 3/6/18, effective 4/6/18; WSR 17-09-087, § 458-20-193, filed 4/19/17, effective 5/20/17; WSR 16-12-083, § 458-20-193, filed 5/31/16, effective 7/1/16. Statutory Authority: RCW **82.32.300**, **82.01.060**(2), **82.24.550**(2), and **82.26.220**(2). WSR 15-15-025, § 458-20-193, filed 7/7/15, effective 8/7/15. Statutory Authority: RCW **82.32.300**, **82.01.060**(2), chapters **82.04**, 82.08, 82.12 and **82.32** RCW. WSR 10-06-070, § 458-20-193, filed 2/25/10, effective 3/28/10. Statutory Authority: RCW **82.32.300**. WSR 91-24-020, § 458-20-193, filed 11/22/91, effective 1/1/92. Formerly WAC 458-20-193A and 458-20-193B.]

ATTORNEY GENERAL'S OFFICE - REVENUE & FINANCE DIVISION

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