No. 92080-0

No. 45108-5-II

DIVISION II, COURT OF APPEALS
OF THE STATE OF WASHINGTON

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Appellant/Cross-Respondent

v.

AVNET, INC.,

Respondent/Cross-Appellant

ON APPEAL FROM THURSTON COUNTY SUPERIOR COURT
(Hon. Christine Schaller)

OPENING BRIEF OF RESPONDENT/CROSS-APPELLANT AVNET, INC.

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I. INTRODUCTION

This case involves the Department of Revenue's ("DOR") erroneous assessment of B&O tax on Avnet's Third Party Drop Ship and National Sales. The trial court correctly held that the Third Party Drop Ship Sales are not taxable because the goods were not "received by the purchaser" in Washington as required by WAC 458-20-193 ("Rule 193"). DOR's argument that Rule 193 allows tax when there is "physical delivery" to the purchaser's customer in Washington, but no receipt by the purchaser itself, is contrary to the plain language of the rule, DOR's own published determinations, and the cases DOR cites in defense of its erroneous "interpretation" of the rule. Indeed, DOR has acknowledged that it would need to amend Rule 193 to "change the determining factor ... from 'receipt' to 'delivery'" in order to tax sales of this kind. CP 544.

The trial court erred, however, when it ruled that DOR could tax Avnet's National Sales because they were not "dissociated" from its Washington activities. Rule 193 provides that B&O tax does not apply to sales that are "not significantly associated in any way" with the seller's Washington activities. The rule reflects controlling U.S. and Washington Supreme Court decisions, which hold that the Commerce Clause of the U.S. Constitution forbids a state from imposing tax on interstate sales dissociated from the seller's instate activities. The evidence is undisputed

in this case that Avnet engaged in no activities in Washington associated in any way with either the National Sales or Third Party Drop Ship Sales – those sales are dissociated from Avnet's Washington activities.

II. ASSIGNMENT OF ERROR ON CROSS-APPEAL

The trial court erred in refusing to apply Rule 193 and controlling Supreme Court precedent when it concluded that Avnet's National Sales were not dissociated from its Washington activities.

III. ISSUES PRESENTED

Issue Raised by DOR's Appeal

Whether the trial court correctly ruled that, with respect to Third Party Drop Ship Sales, Avnet's purchasers did not receive the goods in Washington as required by WAC 458-20-193.

Issue Raised by Avnet's Cross-Appeal

Whether the trial court erred in concluding that Avnet's National Sales were not dissociated from its Washington activities when:

(a) Rule 193(7)(c) provides that B&O tax does not apply when the seller establishes that its "instate activities are not significantly associated in any way with the sales into this state"; and

(b) The U.S. Supreme Court in *Norton* and the Washington Supreme Court in *Goodrich* held that the Commerce Clause of the U.S.

Constitution prohibits states from taxing sales that are dissociated from the seller's instate activities; and

(c) The evidence is undisputed that Avnet's Washington activities were not associated in any way with the National Sales and Third Party Drop Ship Sales.

IV. COUNTERSTATEMENT OF THE CASE

A. Avnet's business.

Avnet is a leading business-to-business distributor of electronic components and computer parts, whose wholesale customers are primarily manufacturers and value added resellers. CP 194. Avnet is a New York corporation with its worldwide headquarters and principal place of business in Phoenix, Arizona. *Id.* Avnet ships products to customers in all 50 states and throughout the world. Avnet does not maintain any warehouse or stock of goods in Washington; products are shipped into Washington from Avnet distribution centers in Arizona or Texas. CP 195. One of Avnet's 35 U.S. sales offices is located in Redmond, Washington. CP 10, 195.

Employees in Avnet's Washington office perform a variety of sales related functions for Washington customers, including soliciting orders from Washington customers, receiving and responding to requests for quotes from Washington customers, receiving orders placed by

Washington customers, responding to questions asked by Washington customers, and otherwise meeting the needs of Avnet's Washington customers. CP 9. Avnet reports and pays Washington wholesaling B&O tax on: (i) all sales to Washington customers; and (ii) all sales shipped into Washington in which the Washington office is associated in any way. CP 195. During the period January 2003 to December 2005, Avnet paid $565,295 of wholesaling B&O tax with its regularly filed Washington tax returns on sales involving the Washington office. *Id.* The tax Avnet paid with its tax returns was properly due and is not at issue in this litigation.

B. The sales at issue; Third Party Drop Ship Sales and National Sales.

The two categories of sales on which tax was improperly assessed are referred to by the parties as Third Party Drop Ship Sales and National Sales. Avnet did not engage in any activities in Washington associated in any way with either the Third Party Drop Ship or National Sales.

"Third Party Drop Ship Sales" are sales in which (1) an Avnet customer based *outside* Washington (2) served by an Avnet office located *outside* Washington (3) placed an order from *outside* Washington with (4) an Avnet office *outside* Washington and (5) asked Avnet to ship all or part of the order to a third party (presumably a customer of the purchaser) at a

Washington address, and (6) Avnet's Washington office was not associated in any way with the transaction. CP 198-99.

Examples of Third Party Drop Ship Sales are sales of electronic components to Solutions II, Inc. ("Solutions-II"), a value-added reseller who designs, installs, and maintains technology solutions for businesses. Solutions-II placed orders from its Littleton, Colorado office with an Avnet sales office located in Phoenix, Arizona, and instructed Avnet to ship the products to various third parties in Washington—including, among others, Advanced Integration Technology, Inland Northwest Health Systems, and Deaconess Medical Center. Avnet shipped the products from distribution centers in Arizona and invoiced Solutions-II from Avnet's Chandler, Arizona office. CP 199, 250-59. Advanced Integration Technology, Inland Northwest Health Systems, and Deaconess Medical Center are not Avnet customers and had no contact with any Avnet office. CP 199. The amount of B&O tax improperly assessed on Third Party Drop Ship Sales during the Audit Period was $371,042. CP 111.

"National Sales" are sales in which (1) an Avnet customer based *outside* Washington (2) served by an Avnet office located *outside* Washington (3) placed an order from *outside* Washington with (4) an Avnet office *outside* Washington and (5) asked Avnet to ship all or part of the order to one or more of the customer's own locations in Washington,

where (6) Avnet's Washington office was not associated in any way with the sales. CP 196.

One example of a National Sale is the sale of electronic components to Intel Corporation ("Intel"). Intel, based in Santa Clara, California with offices throughout the United States, designs and manufactures integrated digital technology platforms—i.e., microprocessors and computer chipsets that are often enhanced by additional hardware, software, or services. During the Audit Period, Intel's Hillsboro, Oregon office placed orders with Avnet's Phoenix, Arizona office for products that Intel requested be shipped to various Intel facilities, including an Intel facility in DuPont, Washington. Avnet shipped the products from a distribution center in Arizona and invoiced Intel from Avnet's Chandler, Arizona office. CP 196, 228-231. The amount of B&O tax improperly assessed on National Sales during the Audit Period was $15,137. CP 111.

The distinguishing characteristic between National Sales and Third Party Drop Ship Sales is the party to whom Avnet's buyer asked Avnet to ship the goods. In Third Party Drop Ship Sales, Avnet's buyer asks Avnet to ship the goods to a different person, a third party (presumably a customer of the buyer). In National Sales, the buyer asks Avnet to ship the goods to one or more of the buyer's own facilities, including a buyer

facility in Washington. In both instances, however, Avnet engaged in ***no activity*** in Washington associated in any way with the transaction. It is undisputed that:

- *None* of the Avnet sales representatives in the Washington office were associated with any of the National Sales or Third Party Drop Ship Sales.
- Avnet did *not* receive, review, acknowledge, or accept orders in Washington for any of the National Sales or Third Party Drop Ship Sales.
- Avnet did *not* provide any engineering or technical advice in Washington for any of the National Sales or Third Party Drop Ship Sales.
- Avnet did *not* investigate the credit of any of the National Sales customers or Third Party Drop Ship Sales customers in Washington.
- Avnet's Washington office did *not* participate in the distribution of goods for any of the National Sales or Third Party Drop Ship Sales.
- Avnet did *not* maintain a stock of goods in Washington from which any of the Nationals Sales or Third Party Drop Ship Sales were filled.
- Avnet did *not* perform any other role in Washington in connection with Avnet's National Sales or Third Party Drop Ship Sales.

CP 10-11, 198-200

C. Procedural history.

Following an audit of Avnet's Washington tax returns, DOR assessed wholesaling B&O tax on Avnet's Third Party Drop Ship Sales

and National Sales. CP 205. Avnet appealed the assessment and DOR denied the appeal. As required by statute, Avnet then paid the assessment and filed this refund suit. CP 4. On cross-motions for summary judgment, the trial court ordered a refund of tax assessed on the Third Party Drop Ship Sales because the goods were not received by the purchaser in Washington as required by Rule 193, but denied a refund of tax assessed on the National Sales, ruling that the sales were not dissociated from Avnet's Washington activities. CP 700, 6/7/13 Tr. at 30-31. DOR appealed the trial court's ruling on the Third Party Drop Ship Sales, CP 694, and Avnet cross-appealed the trial court's dissociation ruling. CP 705.

V. ARGUMENT

A. The Third Party Drop Ship Sales are not subject to B&O tax because Avnet's purchasers did not receive the goods in Washington.

Rule 193 addresses "Washington's B&O tax and retail sales tax applications to interstate sales of tangible personal property." WAC 458-20-193(1). Rule 193 provides that B&O tax does not apply to "sales of goods which originate outside this state ***unless*** the goods are ***received by the purchaser*** in this state." WAC 458-20-193(7) (emphasis added).

1. The purchasers did not receive the goods in Washington as required by Rule 193.

Rule 193 expressly defines "receipt" as the purchaser "first either taking physical possession of the goods or having dominion and control over them." WAC 458-20-193(2)(d). Rule 193 also specifically addresses the receipt of goods by the wholesale purchaser in a third party drop ship sale. The rule states that when (1) a wholesale purchaser ("Company X" in the rule, Avnet's customer here), (2) places an order with a wholesale seller ("Company Z" in the rule, Avnet here); and (3) "requests that the parts be drop shipped to Company Y" (the third parties listed in CP 261); then "Company X [Avnet's customer] has ***not*** taken possession or dominion or control over the parts in Washington." WAC 458-20-193(11)(h) (emphasis added). Since receipt is expressly defined as the purchaser taking possession, dominion, or control over the goods in Washington, Third Party Drop Ship Sales are not "received by the purchaser" under the rule and, therefore, are not subject to B&O tax. WAC 458-20-193(2)(d), (7), (11)(h).

DOR expressly acknowledged this clear reading of the rule's plain language in an internal memorandum addressing potential amendments to the rule. Specifically, DOR acknowledged that goods sold to an out-of-state buyer and drop shipped to a third party in Washington from out-of-

state are not "received by the purchaser" in Washington and, therefore, are not subject to B&O tax under the plain language of Rule 193:

> WAC 458-20-193(11)(h) is the only example of a drop shipment transaction. In it, it concludes that "Company X has not taken possession or dominion or control over the parts in Washington."
>
> If under the Department's regulation, the purchaser of drop shipped goods does not take possession, dominion or control, then ***there is no receipt***. If there is no receipt, ***the sale is not taxable***.

CP 562 (emphasis added). DOR has repeatedly considered amending Rule 193 to "change[] the determining factor for where a sale of tangible personal property takes place from 'receipt' to 'delivery.'" CP 544, 546. DOR expressly recognized that the proposed amendment, if adopted, would "change ... prior practice" regarding the taxation of drop shipped sales, acknowledging that "for many years" prior to proposing the amendment, DOR had "consistently" advised "that tax would not apply in that situation." CP 578-9. Although DOR considered replacing Rule 193's "received by the purchaser" requirement with a "delivery" requirement in 2004, 2005, 2006, 2007, 2008, and 2010, it never has. CP 544, 546, 548, 552, 556, and 562. The trial court correctly ruled that Avnet's Third Party Drop Ship sales were not received by the purchaser under the plain, unamended language of Rule 193.

2. The trial court properly rejected DOR's proposed "delivery" standard because the plain language of Rule 193 requires "receipt" by the purchaser.

Completely ignoring Rule 193's express definition of "'receipt' and 'received,'" DOR argues that, instead of the purchaser's receipt, "*physical delivery* determines where" the sale is taxable. DOR Br. at 1 (emphasis added). Thus, DOR contends, without citation to authority, that "a wholesale sale indisputably occurs and it is consummated by the *physical delivery* of the goods to the shipping destination." DOR Br. at 16 (emphasis added). And again, DOR suggests that the rule should be "interpreted" as "locating an interstate sale at the place where the goods are *physically delivered.*" DOR Br. at 17 (emphasis added). DOR's argument is contrary to and in disregard of the plain language of Rule 193.

It is well settled that "rules of statutory construction apply to administrative rules and regulations." *Dep't of Licensing v. Cannon,* 147 Wn.2d 41, 56, 50 P.3d 627 (2002). "It is an axiom of statutory construction that where a term is defined we will use that definition." *U.S. v. Hoffman*, 154 Wn.2d 730, 741, 116 P.3d 999 (2005). It is also an "elementary rule" of construction that the use of different terms in different parts of a statute or rule reflects different meanings. *United Parcel Serv. v. Dep't of Revenue*, 102 Wn.2d 355, 362, 687 P.2d 186 (1984). Here, Rule 193 expressly defines both "receipt" and "delivery"

and then establishes "receipt" by the purchaser, not "delivery," as the determining factor for imposing B&O tax. WAC 458-20-193(2)(c), (2)(d), and (7). Under the plain, unambiguous language of Rule 193, where the goods are "received by the purchaser" as defined by the rule, not where "delivery" of the goods (separately defined) may occur, determines whether the sale is subject to B&O tax.[1]

3. The third parties to whom the goods are shipped are not agents of Avnet's purchasers under Rule 193.

Completely ignoring Rule 193's express definition of "receipt," WAC 458-20-193(2)(d), its establishment of receipt by the purchaser as the determining factor for imposing B&O tax, WAC 458-20-193(7), and the rule's statement that the purchaser in a drop ship sale does not receive the goods in Washington as defined by the rule, WAC 458-20-193(11)(h), DOR argues for a delivery standard as follows:

> [Rule 193 does not] address how the B&O tax applies to the wholesale sales made when a supplier ***delivers*** goods directly to the customer of the wholesale buyer. ... Thus, it is appropriate to fill in the gap left by the Department's rule by applying both the common law and common sense in deciding whether receipt by the person designated by the wholesale buyer is receipt by the buyer for purposes of determining the place of sale.

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[1] DOR's contention that it should be permitted to disregard Rule 193's receipt standard because "45 other states ... attribute sales receipts to the destination state" is equally misplaced. DOR Br. at 15, n2. DOR's cited authority was discussing the receipts factor for apportionment of state income taxes. W. Hellerstein, State Taxation ¶9.18 (3d ed 2002).

DOR Mot at 21.[2] DOR's argument is wrong for multiple reasons. First, as discussed above, Rule 193 does address the application of B&O tax to drop ship sales and specifically provides that the wholesale purchaser in a drop ship transaction does not receive the goods in Washington, as receipt is defined in Rule 193.

Second, DOR completely ignores Rule 193's very strict limitations on a purchaser's ability to designate an agent to receive goods on the purchaser's behalf. While Rule 193 does permit a purchaser to receive goods through an "agent," it expressly defines such a receiving agent as a person "authorized to receive goods with the power to inspect and accept or reject them," WAC 458-20-1932(2)(e).[3] Rule 193 also expressly requires that a grant of authority to be a receiving agent must be "express written authority to accept or reject the goods for the purchaser with the

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[2] Separately, DOR argues that "case law" supports its "interpretation" of Rule 193 with a lengthy discussion of *Time Oil v. Dep't of Revenue*, 79 Wn.2d 143, 483 P.2d 628 (1971). DOR Br. at 24-29. This argument is also wrong. First, *Time Oil* was decided twenty years before Rule 193 was even adopted. Second, *Time Oil* did not consider or discuss where receipt by the purchaser occurs. Rather, as DOR acknowledges, *Time Oil* addressed whether a taxpayer's barter transactions were "sales" under the statute. 79 Wn.2d at 146-47; DOR Br. at 24-25. The parties here do not dispute that the Third Party Drop Ship Sales are "sales."

[3] Rule 193's express provision for receipt by "the purchaser or its agent," WAC 458-20-193(7) is directly contrary to DOR's argument that the rule would lead to absurd results "unless the phrase, receipt 'by the purchaser' means receipt by the purchaser *or the purchaser's designee*." DOR Br. at 29 (emphasis by DOR). The rule specifically requires any person receiving the goods on behalf of the purchaser to qualify as an "agent" as defined in the rule.

right of inspection." WAC 458-20-193(4)(b). Moreover, DOR has clarified that an agent cannot receive goods on behalf of a purchaser for purposes of determining whether a sale is subject to B&O tax under Rule 193 unless the agent: (i) has "written authority to accept or reject goods for the buyer"; (ii) "takes those actions that would generally be taken by a prudent buyer to assure that the goods conform to the purchase order or contract," which "requires at a minimum that the goods be physically examined by the receiving agent"; and (iii) "provide[s] documentation ... to the seller" of the agent's acceptance or rejection of the goods. Excise Tax Advisory 561.041.193 (1993) (reissued as ETA 3091.2009). Thus, "the mere grant of authority" to an agent "is not sufficient to constitute receipt by the purchaser ... there must be evidence that the [agent] actually inspected and accepted the goods and documented that acceptance to the seller." Det. No. 06-0028, 26 WTD 97 (2007) (*citing* Excise Tax Advisory 561.04.193).

DOR does not allege, and there is absolutely no evidence in the record, that any of the wholesale purchasers of the Third Party Drop Ship Sales authorized their customers in writing to be receiving agents with authority to inspect and accept the goods on the purchaser's behalf, let alone that any third party fulfilled and documented its receipt of the goods as agent of the purchaser as required by Rule 193. To the contrary, the

record affirmatively shows that a search for such documentation found none. CP 660.

Third, DOR's plea to "fill in" a non-existent gap in the rule with "common law" is not supported by the cases it cites. DOR Br. at 21-22. Those out-of-state cases from the 1920s and 1930s are not tax cases and do not address receipt by the purchaser at all. In fact, none of them discuss, let alone determine, where the purchaser received the goods. Rather, they are general commercial law cases cited by DOR for the proposition that "delivery to the buyer's customers ... is delivery to the buyer." DOR Br. at 20, citing *Williamsburgh Stopper Co. v. Bickart*, 134 A. 233 (Conn. 1926); DOR Br. at 21-22 ("delivery to ... any third person at the buyer's request or with his consent is sufficient delivery to the buyer") (quoting *Middleton v. Evans*, 45 P.2d 570 (Utah 1935)). Moreover, these "common law" cases apply those other states' commercial law statutes. *Williamsburgh Stopper Co.*, 134 A. at 235 (delivery controlled by Connecticut's "Sales Act, §§ 48, 49, 63; G. S. §§ 4714, 4715, 4729); *Middleton*, 45 P.2d at 572 (applying "Section 81-2-3" Utah Revised Statutes (1933)).

Fourth, DOR has expressly rejected the argument that "common law or commercial law" are even relevant to determining where a sale occurs for B&O tax purposes, emphasizing that, "[i]nstead, a Washington

sale takes place when the goods are received by the buyer or its agent in this state." Det. No. 99-216E, 18 WTD 264 (1999) (*citing* Rule 193). *Accord*, Det. No. 98-298, 20 WTD 197 (2001) (following Det. No. 99-216E "because, under RCW 82.32.410, it is precedential").

B. The Third Party Drop Ship Sales and National Sales Are Not Subject To B&O Tax Because They Are Dissociated From Avnet's Unrelated Business Activities In Washington.

Under the Commerce Clause, 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. *Allied-Signal, Inc. v. Director, Div. of Tax'n*, 504 U.S. 768, 778 (1992). Thus, even if the seller does business or maintains an office in Washington, the state cannot tax an interstate sale that is "disassociated" from the seller's instate activities. *Norton Co. v. Dep't of Revenue of Ill.*, 340 U.S. 534, 537 (1951); *B.F. Goodrich Co. v. State*, 38 Wn.2d 663, 671-72, 231 P.2d 325 (1951). This doctrine of dissociation—*i.e.*, no taxation in the absence of a transactional nexus—is not only a constitutional imperative, it is expressly codified in Rule 193, which provides that B&O tax does not apply where "the instate activities are not significantly associated in any way with the sales into this state." WAC 458-20-193(7)(c). Consistent with Rule 193, WAC 458-20-101 ("Rule 101") expressly instructs that businesses with out-of-state locations "should not

include income that is disassociated from their instate activities" in calculating gross income for certain tax registration thresholds. WAC 458-20-101(5)(a).

The trial court did not reach the issue of dissociation when granting summary judgment to Avnet on the Third Party Drop Ship Sales, but rejected it when granting summary judgment to DOR on the National Sales. CP 700. The trial court's refusal to apply the doctrine of dissociation, as required by Rule 193 and controlling Supreme Court precedent, was erroneous as a matter of law. This Court can invoke the doctrine of dissociation as an alternative ground to affirm the trial court's ruling on the Third Party Drop Ship Sales and must apply the doctrine to reverse the ruling on the National Sales. The undisputed facts demonstrate that both the Third Party Drop Ship Sales and National Sales were wholly dissociated from Avnet's Washington activities.

1. Rule 193 provides that B&O tax is not imposed on interstate sales that are disassociated from the seller's instate activities.

DOR argues that case law has eroded the constitutional foundation of the dissociation doctrine set forth in the *Norton* and *Goodrich* cases. DOR Br. at 36-46. For all the reasons explained below, DOR's analysis is wrong, but this Court does not need to decide the constitutional issue in order to reverse the trial court based on the plain language of the

Department's own rule. *See State v. Hall*, 95 Wn.2d 536, 539, 627 P.2d 101 (1981) ("A reviewing court should not pass on constitutional issues unless absolutely necessary to the determination of the case."). As DOR itself has correctly recognized in the past, regardless of the constitutional status of dissociation, Rule 193(7)(c) requires a transactional nexus as a matter of Washington law, and it forbids imposition of B&O tax where, as here, dissociation is proven.

DOR concedes that Rule 193 was adopted to reflect the dissociation doctrine following the *Norton* and *Goodrich* decisions. DOR Br. at 46.[4] The relevant portion of the rule reads in relevant part:

> (7) **Inbound sales.** ... There must be both the receipt of goods in Washington by the purchaser and the seller must have nexus for B&O tax to apply to a particular sale. The B&O will not apply if one of these elements is missing. ...
>
> > (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

[4] The Department dissembles Rule 193's various iterations to suggest that the current version, despite its clear codification of *Norton*'s dissociation doctrine, should be construed (ignored, actually) to reflect a "modern understanding" of nexus analysis. DOR Br. at 46-48. Nonsense. The Department does not argue ambiguity nor dispute the rule's plain meaning and, indeed, the Department conceded below "that when Rule 193(7)(c) was issued in 1991 it was meant to explain the dissociation concept." CP 132 (DOR Mot. for Summ. Judg. at 21). Regardless, the prior version, like the present version, contained identical language clearly invoking the dissociation doctrine: "If a person 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." CP 637 (Former WAC 458-20-193B).

> burden of establishing that the instate activities are not significantly associated in any way with the sales into this state. ...

WAC 458-20-193(7)(c). The rule makes clear that for B&O tax to apply, consistent with the constitutional principles discussed below, there must be both taxpayer <u>and</u> transactional nexus, and the existence of the former does not automatically establish the latter. Even if a seller has a substantial nexus with Washington, *i.e.*, the "seller carries on significant activity in this state," the seller can avoid B&O tax for a "particular sale" if it successfully proves dissociation, *i.e.*, "the instate activities are not significantly associated in any way with the sales into this state." *Id.*

Rule 193(7)(c) is plain and unambiguous, and must be followed. "Administrative agencies are bound by their own rules." *Skamania Cty. v. Woodall*, 104 Wn. App. 525, 539, 16 P.3d 701 (2001). So are the courts. *Overlake Hosp. Ass'n v. Dep't of Health*, 170 Wn.2d 43, 52, 239 P.3d 1095 (2010) ("If the meaning of a rule is plain and unambiguous on its face, then we are to give effect to that plain meaning."). This is true even if the case law origins of a rule may have changed. At least until now, DOR recognized this itself; in the very same decisions in which it questioned the viability of *Norton* and dissociation as a constitutional requirement, DOR concluded it still must apply Rule 193(7)(c) as written. Det. No. 00-098, 22 WTD 151, 154 (2003); Det. No. 04-0208, 24 WTD

217, 224 (2005); *also Maxwell Corp. v. Dep't of Revenue*, 2006 WL 4059847, *4 (Wash. Bd. Tax. App. 2006) ("The Board does not need to rule on the continued validity of the *Norton* case because the Department admits its regulation allows dissociation.").

DOR's efforts to amend Rule 193 likewise confirm that, whatever the status of *Norton*, the rule still requires dissociation. DOR recognized that "Rule 193, not *Norton*, permits taxpayers to dissociate." CP 561. So, in 2005, DOR initiated rulemaking to "eliminate" dissociation from the rule. CP 544, 546. DOR internally conceded that amendment was necessary because, "as long as dissociation remains in the rule, the Department cannot test the continued validity of *Norton*." CP 574. DOR abandoned the rulemaking, but considered it again the next year—for the same reason. CP 554 ("the A.G.'s can't litigate the *Norton* issue with Rule [193] being out there."). DOR considered removing dissociation from the rule in 2006, 2007, 2008 and 2010—but it never did. CP 548-66. Nothing has changed. So long as Rule 193(7)(c) remains on the books, and it does, DOR must apply dissociation a matter of Washington law.

2. The constitution forbids states from taxing sales that are dissociated from the seller's in-state activities; *Norton* and *Goodrich* remain good law.

Rule 193(7)(c) is not an artifact of outdated case law; it reflects current constitutional law. Even the trial court recognized this. 6/7/13 Tr.

at 31 ("The case from the Supreme Court from 1951 is still good law."). Indeed, DOR could not amend the rule to eliminate dissociation, nor can it ignore the plain meaning of the rule now, without violating the Commerce Clause and controlling Supreme Court precedent. This Court does not need to reach the constitutional issue, but if it does, it should confirm that *Norton* and *Goodrich* remain good law. DOR's argument that later opinions reject dissociation is not supported by case law or its own actions, and is premised on a faulty analysis that ignores the enduring principle that there must be a "transactional nexus" between the taxpayer's instate activities and the sales at issue.

a. *Norton* permits sellers to prove the absence of a transactional nexus through dissociation.

Under the Commerce Clause, a state may only impose taxes on activities with a "substantial nexus" to the state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). The Supreme Court has long held that, for this nexus to exist, "there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax." *Allied-Signal*, 504 U.S. at 778. Thus, "the nexus inquiry does not always end with ... an entity's physical presence within a state. The Commerce Clause contains another nexus requirement, the transactional nexus requirement. This second nexus principle is not directed at the connection

between the taxpayer and the taxing jurisdiction, but between the taxpayer's *transaction* and the taxing jurisdiction." J. Friedman & K. Houghton, *The Other Nexus: Transactional Nexus and the Commerce Clause*, 4 St. & Loc. Tax Lawyer 19, 20 (1999) (emphasis in original).

A seller, in turn, may use "the concept of dissociation to show that transactional nexus does not exist" between the seller's instate activities and the particular sales at issue. M. Bowen, *Sales and Use Taxes*, 20 J. Multistate Tax'n & Incentives 16 (July 2010). The concept of dissociation was established in *Norton*. There, the seller had an office and warehouse in Illinois, but also accepted mail orders at its Massachusetts headquarters. Illinois sought to tax sales on orders that Illinois buyers placed directly with the seller's Massachusetts office and which the seller filled by shipping the goods directly from Massachusetts. 340 U.S. at 536. The seller's Illinois offices were not involved in the sales. *Id.* The Court held that Illinois could not constitutionally tax the sales because they were "dissociated" from the seller's Illinois offices and activities. *Id.* at 539.

The Washington Supreme Court followed *Norton* in *Goodrich*. There, the seller had multiple offices in Washington, but also accepted and filled orders from offices in other states. Like *Norton*, Washington sought to tax sales on orders that Washington buyers placed directly with the seller's offices in California or Massachusetts, and which the seller filled by

shipping the goods directly from those out-of-state locations. Again, the seller's local offices were not involved with the sales. *Id.* at 664-66. Applying *Norton*, the Court held that the sales were dissociated from the seller's Washington activities because the sales were made "without intervention on the part of the local office" and therefore were "separate and distinct from [the seller's] local business." *Id.* at 672, 674. This case is indistinguishable from *Norton* and *Goodrich*.

b. *Norton* and *Goodrich* have not been overruled.

DOR argues that subsequent U.S. Supreme Court cases, primarily *Complete Auto* and *Tyler Pipe Indus., Inc. v. Dep't of Revenue*, 483 U.S. 232 (1987), overruled *Norton*, and that Avnet can no longer avoid B&O tax by proving that its instate activities were dissociated from the sales at issue. DOR Br. at 36-45. Not so. On matters of constitutional law, only the U.S. Supreme Court can overrule its own opinions, and until it "specifically" does so, they remain binding on Washington courts. *State v. Smith*, 150 Wn.2d 135, 141-42, 75 P.3d 934 (2003). The U.S. Supreme Court has never overruled *Norton* (nor has our Supreme Court overruled *Goodrich*); neither *Complete Auto* nor *Tyler Pipe* cited to *Norton*, much less disavowed the doctrine of dissociation.[5] In fact, based on Avnet's

[5] Equally fanciful is DOR's claim that *Standard Pressed Steel v. Dep't of Revenue*, 419 U.S. 560 (1975) and other cases "firmly embraced" the opinion of the *Norton* dissenters that nexus exists if the seller engages in any instate market-

research, no federal or state case has ever concluded that *Norton* was overruled by *Complete Auto* or any other opinion.

Moreover, the notion that *Complete Auto* implicitly undermined *Norton* is contradicted by the continued citation to *Norton* and dissociation doctrine by the U.S. and Washington Supreme Courts, after *Complete Auto* was decided in 1977. *See Mobil Oil Corp. v. Comm'r of Taxes of Vermont*, 445 U.S. 425, 442 (1980); *Nat. Geographic v. Cal. Equalization Bd.*, 430 U.S. 551, 560-61 (1977); *Chicago Bridge & Iron Co. v. Dep't of Revenue*, 98 Wn.2d 814, 821, 827, 833, 659 P.2d 463 (1983); *Dep't of Revenue v. J. C. Penney Co., Inc.*, 96 Wn.2d 38, 47-48, 633 P.2d 870 (1981); *also Dep't of Revenue v. Sears, Roebuck and Co.*, 660 P.2d 1188, 1190-91 & n. 4 (Alaska 1983) ("we find no basis to conclude that [*Norton*] has been overruled, and we regard it as binding precedent on this court"). Just four years ago, in *Lamtec*, this Court applied *Complete Auto*'s four-

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making activities. DOR Br. at 40-42. First, the *Norton* minority said no such thing. As the *Standard Pressed Steel* court noted, the *Norton* dissent did not dispute the dissociation doctrine; it disputed the taxpayer's proof. 419 U.S. at 563. The *Norton* dissent believed there was no dissociation because there was evidence that the instate office handled customer and technical service on the goods subject to the tax. *Norton*, 340 U.S. at 541. Second, *Standard Pressed Steel* likewise says nothing about market-making activities; it too turned on the seller's failure to prove that its instate activities were unrelated to the sales at issue. There, unlike here, the evidence showed that the seller's instate employee consulted with the buyer to determine what products it should order and to provide engineering services after delivery. 419 U.S. at 561.

part test for nexus and *Norton*'s test for dissociation. *Lamtec Corp. v. Dep't of Revenue*, 151 Wn. App. 451, 467-68, 215 P.3d 968 (2009).[6]

Finally, DOR's current argument is flatly inconsistent with decades of its own published decisions, which uniformly accepted the viability of *Norton* and *Goodrich*, both before and after the current version of Rule 193(7)(c) was adopted in 1991.[7] Indeed, if *Complete Auto* and *Tyler Pipe* overruled *Norton* decades earlier, the 1991 version of the rule (the first since those cases were decided) would not, of all things, continue to codify *Norton*'s dissociation test. But it does. Despite no developments in the law, and in spite of its own precedent, it wasn't until 2003 that DOR discovered, without citing any authority, that "[t]he premise in *Norton* ... was overruled in *Complete Auto*"—although it at least conceded that dissociation was still required by Rule 193(7)(c). Det. No. 00-098, 22 WTD 151 (2003). This case is simply DOR's latest assault on

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[6] The appellant in *Lamtec* did not challenge this Court's ruling on dissociation when seeking review in the Supreme Court. *See* Petition for Review, www.courts.wa.gov/content/Briefs/A08/835799%20prv.pdf. The Supreme Court did not, therefore, consider dissociation in its opinion. *Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 246 P.3d 788 (2011).

[7] The examples are legion. *See, e.g.*, Det. No. 86-295, 2 WTD 11 (1986); Det. No. 87-68, 2 WTD 347 (1987); Det. No. 87-18, 2 WTD 173 (1987); Det. No. 86-29A, 6 WTD 217 (1988); Det. No. 91-213, 11 WTD 239 (1991); Det. No. 91-279, 11 WTD 273 (1991); Det. No. 93-155, 13 WTD 297 (1994); Det. No. 93-283, 14 WTD 041 (1994); Det. No. 94-209, 15 WTD 96 (1996); Det. No. 96-144, 16 WTD 201 (1996); Det. No. 97-235, 17 WTD 107 (1998); Det. No. 97-061, 18 WTD 211 (1999).

dissociation; it asks the Court to ignore both the continued viability of *Norton* and the plain the meaning of the rule. This Court can do neither.

c. *Complete Auto* and *Tyler Pipe* did not abrogate the transactional nexus requirement.

DOR's entire analysis is based on a flawed reading of *Complete Auto* and *Tyler Pipe*. Those cases did not reject dissociation; they confirmed the principle that there must be a nexus between the taxing state and the activity being taxed, *i.e.*, a transactional nexus with the particular sales at issue; a nexus with the taxpayer alone is not enough. *Complete Auto*, 430 U.S. at 279 (tax may be applied only "to an activity with a substantial nexus with the taxing State"); *Tyler Pipe*, 483 U. S. at 250 ("activities performed in this state" must be "significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales") (citation and internal quotation omitted) (emphasis added). The Supreme Court's position has not waivered since. *See Allied-Signal*, 504 U.S. at 778 ("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").[8]

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[8] There is one exception; transactional nexus is not a requirement in the unique context of a use-tax collection duty. *Nat. Geographic*, 430 U.S. at 560. Critically, however, *National Geographic*, which was decided in the same term as *Complete Auto*, expressly affirmed *Norton*'s dissociation principle in the context of a direct tax. *Id.* ("However fatal to a direct tax a 'showing that particular transactions are dissociated from the local business ...,' such

DOR suggests that these cases hold that nexus exists so long as the seller conducts any kind of "market-creating activities in the state." DOR Br. at 33. Not quite. Activities that establish or maintain a market can establish nexus, but only if those activities relate to the sales at issue—either procuring or consummating the sales, or providing support after the sales. Every single case cited by DOR had such a nexus. *Tyler Pipe*, 483 U.S. at 249 ("sales representatives acted daily on behalf of Tyler Pipe in calling on its customers and soliciting orders"); *Standard Pressed Steel*, 419 U.S. at 561 (employee "was to consult with Boeing regarding its anticipated needs ... and to follow up any difficulties in the use of appellant's product after delivery"); *Lamtec*, 170 Wn.2d at 841 ("sales employees visited major customers in Washington" and "answered questions and provided information about Lamtec products"); *Chicago Bridge*, 98 Wn.2d at 821 ("CBI employs ... individuals in Washington who supervise the site preparation and installation of its products, and who are available if problems arise"). This case does not.

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dissociation does not bar the imposition of the use tax collection duty") (citations omitted; quoting *Norton*, 340 U.S. at 537). The Department recognizes this too and, predictably, suggests that *National Geographic* has been implicitly overruled on this point as well. DOR Br. at 43 n. 11. Of course, the Department cannot cite any authority for this claim either.

C. The evidence is undisputed that Avnet's Washington activities were not associated in any way with the Third Party Drop Ship and National Sales.

There is a reason why DOR asks this Court to ignore both the plain meaning of Rule 193(7)(c) and controlling Supreme Court precedent: it cannot defend the trial court's ruling on the facts. Although the court recognized that dissociation remains "good law," it concluded that Avnet did not meet its burden. 6/7/13 Tr. at 31-33. That was error. The test under Rule 193(7)(c) is whether Avnet's "instate activities are not significantly associated in any way with the sales into this state." The constitutional analysis is the same. *Amer. Oil Co. v. Neill*, 380 U.S. 451, 458 (1965) (seller must make "clear showing that there are no in-state activities connected to the out-of-state sales"); *Goodrich*, 38 Wn.2d at 672 (seller must show "sales separate and distinct from its local business").

Simply put, if Rule 193 means what it says, and/or *Norton* and *Goodrich* control, and both are true, this Court must conclude that Avnet proved the Third Party Drop Ship and National Sales were dissociated from Avnet's Washington activities. The facts are undisputed. Avnet's Washington employees played no role in the sales whatsoever: Avnet's customers were located outside Washington; the customers placed orders with Avnet at offices located outside Washington; and the products were shipped by Avnet distribution sites located outside Washington. CP 194-

201 (Wine Decl.); CP 9-12 (Piergossi Decl.). This dissociation was not limited to taking orders, shipping, and billing, but extended to all facets of the relationship: Avnet's Washington employees provided no technical or engineering advice or post-sale support either. *Id.*[9]

DOR presented no contrary evidence below, and can point to none on appeal. The best DOR can do is cite to a roster of Avnet's Washington employees and their generic job descriptions, *see* CP 59-64, 474-95, but it cannot cite to any document, declaration, or deposition testimony rebutting Avnet's proof that these employees were responsible for sales and support to Washington customers only, and did "not perform activities in support of sales made to customers located outside Washington, including specifically National Sales and Third Party Drop Shipped Sales[.]" CP 9-10; CP 50. Avnet's in-state and out-of-state sales derived from completely separate markets, comprised of completely separate customers, served by completely different employees. There was no overlap. The sales were dissociated. Not only does Rule 193 apply by its plain terms, this case is indistinguishable from *Norton* and *Goodrich*.

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[9] Avnet does not dispute that it has a nexus with Washington by virtue of its instate business activities. And where its sales in Washington are associated with those instate activities, *i.e.*, where there is a transactional nexus, Avnet duly reports and pays B&O tax. For example, from the period from January 2003 to December 2005, Avnet paid $565,295 in B&O taxes for its Washington sales. CP 195.

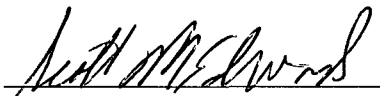
Lastly, the fact that the Third Party Drop Ship and National Sales were physically delivered into Washington does not constitute associated "instate activity" for purposes of nexus. In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the U.S. Supreme Court reaffirmed the rule that delivery by mail or common carrier does not create a "substantial nexus." *Id.* at 311 (citing *Nat'l Bellas Hess, Inc. v. Dep't of Revenue*, 386 U.S. 753 (1967)). Here too, it is undisputed that the Third Party Drop Ship and National Sales were delivered by common carrier from Avnet's out-of-state distribution centers. *See* CP 229-39, 247-59. There simply is no Washington nexus to these interstate sales.

VI. CONCLUSION

For the reasons discussed above, the trial court (1) correctly ruled that Avnet's Third Party Drop Ship Sales were not subject to B&O tax because the goods were not received by the purchaser in Washington as required by WAC 458-20-193 and (2) erred in ruling that Avnet's National Sales were not dissociated from Avnet's Washington Activities. Accordingly, Avnet requests the court to (1) affirm the trial court's order refunding B&O taxes and interest assessed on Third Party Drop Ship Sales and (2) reverse the trial court's order dismissing Avnet's refund claim for National Sales and instruct the trial court to enter judgment awarding a refund of tax and interest assessed on the National Sales.

RESPECTFULLY SUBMITTED this 18th day of February, 2014.

LANE POWELL PC

By 

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CERTIFICATE OF SERVICE

I hereby certify under penalty of perjury of the laws of the State of Washington, that on February 18, 2014, I caused to be served a copy of the foregoing **Brief of Respondent/Cross-Appellant** on the following persons in the manner indicated below at the following addresses:

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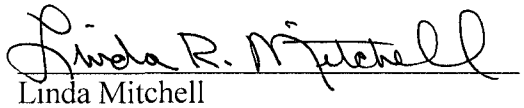

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