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SUPREME COURT OF THE STATE OF WASHINGTON

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent,

v.

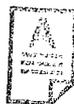
AVNET, INC.,

Petitioner.

**RESPONDENT DEPARTMENT OF REVENUE'S
SUPPLEMENTAL BRIEF**

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I. INTRODUCTION

Over the past sixty years, the United States Supreme Court has repeatedly sustained gross receipts taxes on interstate sales imposed by the state to which the goods were shipped. The state has constitutional nexus over the inbound sale of goods when the seller, or someone acting on the seller's behalf, engages in activity "significantly associated with the taxpayer's ability to establish and maintain a market in [the] state for the sales." *Tyler Pipe Indus., Inc. v. Dep't of Revenue*, 483 U.S. 232, 250, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987). Avnet meets this nexus standard, as the Court of Appeals correctly held, through its varied and substantial in-state activities, which "all served the creation and maintenance of Avnet's market in Washington." *Avnet, Inc. v. Dep't of Revenue*, 187 Wn. App. 427, 448, 348 P.3d 1273 (2015).

In addition, the Court of Appeals' opinion is faithful to the Washington B&O tax system, which taxes virtually all business activity within the state to the fullest extent constitutionally permissible, to this Court's decisions addressing the scope of the State's authority to tax inbound sales, and to Department interpretive rules pertaining to inbound sales. The opinion also reflects sound tax policy by embracing the "destination rule," which assigns taxing jurisdiction to the state where the goods are delivered. The decision should be affirmed.

II. STATEMENT OF THE CASE

Avnet describes itself as one of the world's largest distributors of electronic components and computer equipment. CP 194, 500. Based in Arizona, Avnet conducts business throughout the United States. CP 5. The company maintains an office in Redmond, Washington, with over forty employees. CP 5, 59-64. Employees stationed at the Redmond office include account managers, sales and marketing representatives, engineers, and technology consultants. CP 59-64. Acting through its Washington employees, Avnet markets and sells products, establishes and improves customer relations, provides design services to help its suppliers make new and improved products, and provides technical and engineering support to its Washington and Idaho customers. CP 474-95.

A substantial and growing proportion of Avnet's Washington sales, described by Avnet as "national sales" and "drop-shipped sales," result from orders placed with Avnet sales offices outside Washington and shipped into Washington from warehouses located outside the state. CP 5-6. In a drop-shipped sale, the wholesale buyer that purchases the goods from Avnet directs Avnet to ship the goods directly to a third party in Washington, usually a customer of the wholesale buyer. CP 5. In a "national sale," the wholesale buyer directs Avnet to ship the goods to one of the buyer's facilities in Washington. CP 6.

Avnet contends that its drop-shipped sales and national sales are exempt from B&O tax as a result of a Department administrative rule and the Commerce Clause limits expressed in two 1951 court decisions. CP 6 at ¶¶ 10 & 11 (citing former WAC 458-20-193, *B.F. Goodrich v. State*, 38 Wn.2d 663, 231 P.2d 325 (1951), and *Norton Co. v. Illinois Dep't of Revenue*, 340 U.S. 534, 71 S. Ct. 377, 95 L. Ed. 517 (1951)). The Court of Appeals rejected both claims. The Court explained that the Department's administrative rules did not create the tax exemption Avnet was claiming, and that contemporary dormant Commerce Clause case law permits Washington to tax all of Avnet's inbound sales.

III. STATEMENT OF THE ISSUE

The dormant Commerce Clause limits that apply to state taxing authority have evolved over time, as reflected in decisions of this Court and the United States Supreme Court. Under contemporary dormant Commerce Clause standards, the "balance tips against the [state] tax only when it unfairly burdens commerce by exacting more than a just share from the interstate activity." *Department of Revenue v. Ass'n of Wash. Stevedoring Cos.*, 435 U.S. 734, 748, 98 S. Ct. 1388, 55 L. Ed. 2d 682 (1978). Under this minimal standard, did the Court of Appeals correctly hold that Washington may impose its fairly apportioned B&O tax on all of Avnet's Washington sales when: (a) Avnet has nexus with Washington as

a result of its significant and varied in-state activities, and (b) the sales at issue were shipped into the State by common carrier and physically delivered to the person designated by the purchaser?

IV. ARGUMENT

The Washington business and occupation (B&O) tax system is “extremely broad” and “leave[s] practically no business and commerce free of . . . tax.” *Steven Klein, Inc. v. Dep’t of Revenue*, 183 Wn.2d 889, 896, 357 P.3d 59 (2015); *Budget Rent-A-Car of Wash.-Or., Inc. v. Dep’t of Revenue*, 81 Wn.2d 171, 175, 500 P.2d 764 (1972). The Legislature intended “to tax all business activities not expressly excluded.” *Coast Pac. Trading, Inc. v. Dep’t of Revenue*, 105 Wn.2d 912, 917-18, 719 P.2d 541 (1986). Hence, the tax is presumed valid and the taxpayer has the burden to prove its entitlement to tax immunity, including cases involving the Commerce Clause. *Lamtec Corp. v. Dep’t of Revenue*, 170 Wn.2d 838, 843, 246 P.3d 788 (2011) (citing *General Motors Corp. v. Washington*, 377 U.S. 436, 441, 84 S. Ct. 1564, 12 L. Ed. 2d 430 (1964)); *Space Age Fuels, Inc. v. State*, 178 Wn. App. 756, 762, 315 P.3d 604 (2013).

The B&O tax is imposed on, among other activities, engaging in the business of making wholesale sales in this state. RCW 82.04.270. Washington follows the “destination rule” for determining where an interstate sale of goods is deemed to occur. WAC 458-20-103 (Rule 103).

“For the purpose of determining tax liability of persons selling tangible personal property, a sale takes place in this state when the goods sold are delivered to the buyer in this state” *Id.*

The destination rule supports a number of important policy objectives. Key among those is that the destination rule ensures that the state imposing the tax (i.e., the state in which the goods are delivered) has sufficient nexus with the transaction under established Commerce Clause constraints. *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 184, 115 S. Ct. 1331, 131 L. Ed. 2d 261 (1995). Thus, “transactional nexus” exists with respect to all Avnet’s inbound sales, as the delivery of goods into Washington satisfies that requirement. *Id.*¹

Although the B&O tax applies broadly, Avnet asserts that its drop-shipped sales and national sale are exempt under the dormant Commerce Clause. Brf. of Resp./Cross-App. at 16 (citing *Norton* and *B.F. Goodrich*). Alternatively, Avnet argues that its sales are exempt under a Department administrative rule pertaining to the interstate sale of goods, former WAC

¹ See also *International Harvester Co. v. Indiana Dep't of Treasury*, 322 U.S. 340, 345, 64 S. Ct. 1019, 88 L. Ed. 1313 (1944) (“delivery of the goods . . . is an adequate taxable event” because the state is “asserting authority over the fruits of a transaction consummated within its borders”); *Ford Motor Co. v. City of Seattle*, 160 Wn.2d 32, 54, 156 P.3d 185 (2007) (“[A] long line of precedent sanctions using the gross proceeds from wholesale sales delivered into a jurisdiction as the measure of a B&O tax when the taxpayer is engaged in the business of fostering wholesale sales within the taxing jurisdiction.”).

458-20-193 (2010) (former Rule 193).² Brf. of Resp./Cross-App. at 9-10.

Avnet misreads both the current dormant Commerce Clause case law and former Rule 193. The Commerce Clause does not exempt Avnet's Washington sales from tax because Avnet's in-state activities were more than sufficient to establish nexus with all its inbound sales of goods, as the Court of Appeals correctly concluded. *Avnet*, 187 Wn. App. at 446-48. In addition, under former Rule 193, the B&O tax applies to all of the contested sale transactions because Avnet has nexus with the state, and the goods it sold were physically delivered in Washington. Avnet cannot meet its burden of proving that any of its Washington bound sales are exempt from tax.

A. Avnet Misreads Dormant Commerce Clause Cases, Which Permit The Destination State To Tax The Inbound Sale Of Goods Under The *Tyler Pipe* Nexus Standard.

The central issue in this case concerns Washington's authority to tax an out-of-state business on the sale of goods delivered into the state. Although the question concerns both due process and Commerce Clause limits, Avnet relies solely on the dormant Commerce Clause.

The Commerce Clause grants Congress the power to regulate interstate commerce. U.S. Const. art. I, § 8, cl. 3. "Implicit in this grant of power is the 'dormant' commerce clause, i.e., the premise that a state

² Rule 193 was amended in 2015. Copies of the current and former versions of Rule 193 are attached hereto as Appendices A and B, respectively.

intrudes on this power if it enacts a law that unduly burdens interstate commerce.” *Bostain v. Food Exp., Inc.*, 159 Wn.2d 700, 717-18, 153 P.3d 846 (2007). The limits imposed by the dormant Commerce Clause “have changed significantly over time.” *Avnet*, 187 Wn. App. at 442 (citing *Jefferson Lines*, 514 U.S. at 179-84; *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279-88, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977)).

In *Complete Auto*, the Supreme Court renounced much of its prior dormant commerce clause jurisprudence concerning state taxation of interstate commerce. The Court specifically rejected the notion that the Commerce Clause created a “free trade” immunity from state taxation and held that those engaged in interstate commerce must pay their “just share of [the] state tax burden.” 430 U.S. at 278, 288-89.

Following *Complete Auto*, a state tax imposed on an out-of-state business will be sustained if the tax (1) applies to an activity with a substantial nexus with the state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) fairly relates to the services and protections provided by the state. *Lamtec*, 170 Wn.2d at 844 (citing *Complete Auto*, 430 U.S. at 279). *Avnet* does not dispute that the B&O tax is fairly apportioned, nondiscriminatory, and fairly related to the services and protections provided by the State, as applied to all of *Avnet*’s

wholesale sales of goods shipped into Washington. Thus, only the first prong of the *Complete Auto* test is at issue here.

Courts applying the substantial nexus prong of *Complete Auto* look at the entire bundle of in-state corporate activity to determine whether a state can fairly tax inbound sales. *General Motors*, 377 U.S. at 447-48. The “crucial factor” in determining whether Washington has sufficient connection with an out-of-state taxpayer making sales into the state is “whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer’s ability to establish and maintain a market in this state for the sales.” *Tyler Pipe*, 483 U.S. at 250.

Avnet engages in substantial in-state business activities, which clearly establish nexus under the *Tyler Pipe* standard. Avnet’s Redmond office is staffed with over forty employees dedicated to a variety of sales, marketing, engineering, and managerial activities. CP 59-64, 474-95. These activities support Avnet’s ability to establish and maintain a market for its goods in Washington and “lie at the core of the market sustenance [concept] which both *General Motors Corporation* . . . and *Tyler Pipe* . . . found sufficient for constitutional nexus.” *Avnet*, 187 Wn. App. at 448.

Notwithstanding its obvious nexus with Washington, Avnet asserts that it can “dissociate” its drop-shipped and national sales from its in-state nexus creating activities. Avnet relies on *Norton* and *B.F. Goodrich*.

However, neither case is controlling, and Avnet ignores subsequent cases that flatly reject the premise that the substantial nexus prong of *Complete Auto* requires a direct connection between a taxpayer's nexus creating activities and specific sales.

Norton and *B.F. Goodrich* were decided during a period when the Supreme Court interpreted the Commerce Clause as prohibiting state taxation that directly burdened interstate commerce, while allowing states to tax "local" activity that only indirectly affected interstate commerce. See Jerome R. Hellerstein and Walter Hellerstein, 1 *State Taxation* ¶¶ 4.07, 4.09 (3d ed. 1998).³ The "direct-indirect burdens approach" was often condemned as "formulistic," and it led to a number of inconsistent United States Supreme Court decisions. *Id.* at ¶ 4.11[1], CP 178; see also *B.F. Goodrich*, 38 Wn.2d at 669 (noting in 1951 that the "nature and extent" of the dormant Commerce Clause limits "remain matters of great uncertainty," and that the Supreme Court "has not always been doctrinally consistent" in its approach).

The Supreme Court largely renounced the direct-indirect burdens approach in 1959 when it upheld Minnesota's fairly apportioned net income tax as applied to an out-of-state business making sales into the taxing state. *Northwestern States Portland Cement Co. v. Minnesota*, 358

³ Relevant portions of the Hellerstein treatise are in the record at CP 153-180.

U.S. 450, 79 S. Ct. 357, 3 L. Ed. 2d 421 (1959). And the test was completely repudiated in *Complete Auto*, where the Supreme Court upheld a nondiscriminatory gross receipts tax imposed on goods shipped into Mississippi. *Complete Auto*, 430 U.S. at 288-89. The Court in *Complete Auto* recognized that the States have a significant interest in exacting from those engaged in interstate commerce a fair share of the cost of state government. *Wash. Stevedoring*, 435 U.S. at 748. A state tax violates Commerce Clause limits “only when it unfairly burdens commerce by exacting more than a just share from the interstate activity.” *Id.*

Although the underlying philosophy that guided the Supreme Court in 1951 when it decided *Norton* was rejected in *Complete Auto*, one component of *Norton* has endured. The Court in *Norton* established that an out-of-state seller that elects to conduct business in the state has the distinct burden of proving that its in-state activities “were not decisive factors in establishing and holding [its] market” for its in-state sales. *Norton*, 340 U.S. at 538. This principle is still cited in post-*Complete Auto* cases. See, e.g., *Mobil Oil Corp. v. Comm’r of Taxes of Vermont*, 445 U.S. 425, 442, 100 S. Ct. 1223, 63 L. Ed. 2d 510 (1980) (taxpayer did not meet burden of establishing that its dividend income lacked sufficient nexus with its in-state business activities, citing *Norton*); *Lamtec*, 170 Wn.2d at 843 (burden is on taxpayer to establish exemption from tax,

citing *Norton*). Thus, *Norton* remains the law with respect to a taxpayer's burden of proving that its inbound sales are immune from state tax, and there is no reason for the Supreme Court to overrule the case.

What has *not* endured from *Norton*, however, is the notion that a business can avoid state tax on interstate sales that bypass the taxpayer's "local" branch office. The divided Court in *Norton* held that Illinois was prohibited from taxing sales transactions in which an Illinois customer ordered the goods directly from Norton's out-of-state office, with no direct involvement by the local branch office. *Norton*, 340 U.S. at 539. That narrow view of the constitutional connection required for a state to tax inbound sales did not last. In the years following *Norton*, the Supreme Court has broadened the scope of activities deemed sufficient to support the imposition of tax on sales shipped directly to in-state buyers. The decisive factor under current law is whether the seller has engaged in activity designed to maintain a market for its sales into the taxing state.

Post-*Norton* cases demonstrating this expanded analysis include *General Motors, Standard Pressed Steel Co. v. Dep't of Revenue*, 419 U.S. 560, 95 S. Ct. 706, 42 L. Ed. 2d 719 (1975), and *Tyler Pipe*. In each case the Supreme Court upheld the Washington B&O tax as applied to proceeds from inbound sales where the taxpayer used its employees or independent representatives to help establish a market presence. Thus, the

current test for evaluating a taxpayer's claim of dissociation is whether "the bundle of corporate activity" carried on within the state generally supports the taxpayer's ability to establish and hold a market for its inbound sales. *General Motors Corp.*, 377 U.S. at 447-48. And, as the Court of Appeals correctly concluded, this analysis "does not require a direct connection between Avnet's activities in Washington and [the] specific sales" it claims are exempt from tax. *Avnet*, 187 Wn. App. at 447.

None of the foregoing analysis is new. This Court discussed and applied post-*Norton* cases in *Chicago Bridge & Iron Company v. Dep't of Revenue*, 98 Wn.2d 814, 659 P.2d 463 (1983), rejecting the taxpayer's dissociation claim with respect to in-state sales that did not involve the taxpayer's Seattle sales office. Citing *Standard Pressed Steel* and *General Motors*, this Court explained how these cases "reveal that the presence and participation of a sales office in [the] state is not decisive in determining the existence of nexus." *Id.* at 820. Instead, for a business to "exempt itself from the local tax by showing no in-state activities were associated with the interstate business," it must show that "its in-state services were not decisive in *establishing and holding the market.*" *Id.* at 822 (emphasis added) (citing *General Motors* and *Norton*). The proper focus is on the bundle of corporate activities a company undertakes to establish and create

a market in the state for its sales, not on whether particular sales are channeled through a local sales office.

Avnet contends that the Court of Appeals decision below was based on “speculation” that *Norton* had been “overruled by implication.” Pet. for Review at 2, 9. Avnet mischaracterizes the Court’s holding. The Court of Appeals did not disregard *Norton* or “speculate” that the case has been overruled. Instead, the Court correctly held that subsequent cases (which Avnet ignores) have “expanded the range of activities relevant to the substantial nexus analysis.” *Avnet*, 187 Wn. App. at 446. Thus, it is simply no longer the case, as Avnet suggests, that a local office must be involved with a particular sale in order to tax that interstate sale.

Norton remains the law with respect to the taxpayer’s burden when seeking to claim Commerce Clause immunity from state taxation. But Avnet does not meet that burden under the holdings of *General Motors*, *Tyler Pipe*, and numerous other post-*Norton* cases (including this Court’s decisions in *Chicago Bridge* and *Lamtec*) that have altered the test for evaluating dissociation claims.⁴

⁴ Avnet argues at pages 8 and 9 of its Petition for Review that recent cases have “applied *Norton*’s dissociation rule numerous times.” But none of the cases Avnet cites applied *Norton* in the way that Avnet seeks to use it here. In each cited case the court actually *rejected* the taxpayer’s claim that it could “dissociate” certain sales. As explained in *Chicago Bridge*, the modern concept of dissociation requires a taxpayer to prove that none of its in-state activities were associated with “establishing and holding the market.” *Chicago Bridge*, 98 Wn.2d at 822. The “participation of a sales office in [the] state is not decisive,” *Id.* at 820.

The Court of Appeals correctly analyzed and applied the governing standard set out by this Court and the United States Supreme Court for establishing nexus with interstate sales delivered into Washington. And it correctly rejected Avnet's dissociation claim and held that the company's national sales and drop-shipped sales were properly subject to B&O tax. *Avnet*, 187 Wn. App. at 448-49. This Court should affirm.

B. Avnet Misreads Former Rule 193, Which Does Not Exempt Any Of Avnet's Inbound Sales.

No statutory or constitutional exemption applies to Avnet's inbound Washington sales. Avnet argues, however, that its national sales and drop-shipped sales are exempt under a Department interpretive rule, former Rule 193. Brf. of Resp./Cross-App. at 9, 16. According to Avnet, the rule (1) "codified" the *Norton* concept of dissociation and (2) precludes the imposition of B&O tax on goods that are delivered within the state to someone other than the buyer of the goods. The Court of Appeals correctly rejected both arguments.

1. Former Rule 193 did not "codify" the *Norton* concept of dissociation.

Rule 193 is the Department's interpretive rule that explains the application of the state's B&O tax and retail sales tax on interstate sales of goods. The Rule has been updated and modified many times since 1935, most recently in 2015. *See* WSR 15-15-025 (filed 7/7/15); *see generally*

App. Brf. at 46-48 (discussing different iterations of Rule 193). Avnet claims that Rule 193 “codifies” *Norton*’s dissociation analysis. Pet. for Review at 11. But an examination of the history of that Rule shows that the version in effect during the tax periods at issue correctly reflected contemporary commerce clause law and did not “codify” *Norton*.

The 1960 version of Rule 193 contained language based on the then-prevailing direct-indirect burdens approach to state taxation of interstate commerce. It explained that “[s]ales by foreign vendors are not taxable” by the state, and sales by “local vendors” are taxable only if “a local outlet performs or has performed a service essential to the completion of the sale to the purchaser in Washington.” CP 647. The Rule was revised in 1970 to delete the statement that sale by “foreign vendors are not taxable,” but still interpreted constitutional law as limiting the B&O tax to inbound sales where “the seller performs or has previously performed a local service essential to completion of the sales to the purchaser in Washington.” CP 641. Thus, in the 1960s and early 1970s, Rule 193 acknowledged the holdings in *Norton* and other Supreme Court cases that, at the time, imposed formulative limits on taxing inbound sales.

In 1974 the Department revised Rule 193 to reflect more recent dormant Commerce Clause case law including *General Motors*. The revised version explained that inbound sales are taxable if “the seller

carries on or has carried on . . . any local activity which is *significantly associated with the seller's ability to establish and maintain a market in this state for the sales.*" CP 637 (emphasis added). Thus, the 1974 version of Rule 193 recognized the "market sustenance" concept embodied in *General Motors* and expressly adopted a few years later in *Tyler Pipe*. The Rule did not rely on *Norton* or the underlying philosophy that guided the Supreme Court in 1951 when it decided *Norton*. To the contrary, post-1974 versions of Rule 193 explain that a taxpayer can "dissociate" inbound sales of goods only if it can establish that the sales are not associated in any way with "in-state activities that establish or maintain a market for its product." DOR Det. No. 04-0208, 24 WTD 217, 226 (2005).⁵ A centralized, functionally integrated business like Avnet with a physical office and over forty full-time employees in the state cannot possibly meet its burden of proving that particular sales transactions are "dissociated" from its market sustaining in-state activities.

Former Rule 193 and the relevant Department determinations applying that Rule are consistent with contemporary Commerce Clause case law and do not support Avnet's dissociation claim. During the periods at issue, Avnet engaged in varied in-state activities which "all served the creation and maintenance of [its] market in Washington."

⁵ Det. No. 04-0208 is a published determination that is available on-line at <http://taxpedia.dor.wa.gov/documents/current%20wtds/24-wtd217.doc>.

Avnet, 187 Wn. App. at 448. Consequently, none of the inbound sales at issue are “dissociated” from Avnet’s in-state market creating activities.

2. Former Rule 193 did not exempt drop-shipped sales from B&O tax.

Like most states, Washington follows the “destination rule” to determine where an interstate sale of goods occurs. Under the destination rule, an interstate sale is deemed to occur in Washington for tax purposes “when the goods sold are delivered to the buyer in this state, irrespective of whether title to the goods passes to the buyer at a point within or without the state.” Rule 103. When properly applied to drop-shipped goods, the sale is deemed to occur in Washington when goods are physically delivered in this state to the buyer or its designee.

Prior to the 2015 amendment to Rule 193, the Department’s administrative rules did not specifically address the wholesale B&O tax treatment of drop-shipped sales.⁶ The former Rule did, however, treat the sale of inbound goods as occurring in Washington if the purchaser or its agent received the goods in this State. *See* Former Rule 193(2)(d) (defining “receipt” to mean “the purchaser or its agent first either taking physical possession of the goods or having dominion and control over

⁶ Former Rule 193(11)(h), which Avnet may incorrectly rely on as it did below, did provide an example pertaining to the retail sale of drop-shipped goods. That example did not address the wholesale sale of goods by a business such as Avnet that has nexus with the state. *See Avnet*, 187 Wn. App. at 437-38 (rejecting Avnet’s contention that the example in former Rule 193(11)(h) applies here).

them”). An “agent” is defined as “a person *authorized to receive goods* with the power to inspect or reject them.” Former Rule 193(2)(e) (emphasis added). Thus, in a drop-shipped sale, the wholesale sale is located in Washington for B&O tax purposes when the goods are delivered to the person designated by the wholesale buyer to receive the goods. The person receiving the goods—typically the retail buyer—is the person “authorized to receive the goods” on behalf of Avnet’s wholesale buyer. This is the whole point of a drop shipment: to combine two sale transactions into a single shipment and delivery.

Avnet argues that none of its drop-shipped sales occurs in Washington because *its* customer (the wholesale buyer) never takes physical possession of the goods. Brf. of Resp./Cross-App. at 8-10. In effect, Avnet reads the former Rule as establishing a category of “nowhere sales” that, because the item is not ever physically received by the purchaser, are neither inbound sales (sales received by the purchaser in Washington) nor outbound sales (sales received by the purchaser outside Washington). This is not a reasonable reading of the administrative rule, and it ignores the language and intent of the B&O tax code by exempting from taxation a category of sales the state constitutionally may tax. Properly interpreted, Rule 193 ensures that the B&O tax avoids both multiple taxation and nowhere taxation.

Avnet's approach also "elevates form over substance in a way similar to that rejected" in *Chicago Bridge*. *Avnet*, 187 Wn. App. at 438. In *Chicago Bridge*, this Court soundly rejected the assertion that B&O tax could be avoided through an overly technical reading of the law or by easily manipulated business practices. *Chicago Bridge*, 98 Wn.2d at 824. Consistent with *Chicago Bridge*, the Court of Appeals correctly rejected Avnet's interpretation of former Rule 193, which would have allowed wholesalers to avoid B&O tax simply by assigning someone other than the wholesale buyer to take receipt of the goods in the state.

All of the drop-shipped sales at issue in this case are "sales" as defined by RCW 82.04.040(1). Those sales occurred in Washington under the destination principle embodied in Rule 103 and former Rule 193, and no statutory or constitutional exemption applies. Consequently, the Court of Appeals correctly rejected Avnet's efforts to avoid B&O tax on its Washington-bound drop-shipped sales. This Court should affirm.

C. The Department Has Not "Disavowed" Former Rule 193; It Simply Disagrees With Avnet's Interpretation.

Avnet and amici curiae contend that former Rule 193 supports Avnet's arguments in this case and that the Department is impermissibly "disavowing" or "repudiating" the former Rule. Pet. for Review at 12; Brf. of Council on State Taxation at 4; Brf. of AWB at 6. The argument is

meritless. Pointing out flaws in Avnet's interpretation of Rule 193 is not "disavowing" the Rule. To the contrary, the Department is advancing what it believes is the proper interpretation of the Rule. Unlike Avnet's interpretation, the Department's interpretation is consistent with the B&O tax statutory scheme and with decisions of this Court and the Supreme Court addressing the scope of the State's authority to tax inbound sales.

Avnet is not entitled to force its preferred interpretation of former Rule 193 onto the Department or onto the courts, particularly when that interpretation would provide a broader tax exemption than statutorily or constitutionally authorized. *Coast Pac.*, 105 Wn.2d at 916. The Court of Appeals did not err when it rejected Avnet's interpretation of the rule.

V. CONCLUSION

For the foregoing reasons, the Department requests that this Court affirm the Court of Appeals.

RESPECTFULLY SUBMITTED this 19th day of February, 2016.

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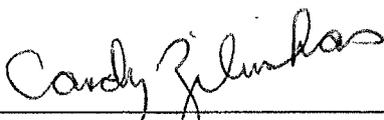
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Washington that the foregoing is true and correct.

DATED this 19th day of February, 2016, at Tumwater, WA.



Candy Zilinskas, Legal Assistant

APPENDIX A

WAC 458-20-193**Interstate sales of tangible personal property.****(1) Introduction.**

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

(b) 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 458-20-221 Collection of use tax by retailers and selling agents.

(c) Examples included in this rule identify a number of facts and then state a conclusion; they 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.

(d) 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 (see WAC 458-20-178) or the use tax collection obligation of out-of-state sellers of goods to Washington customers when sellers are not otherwise liable to collect and remit retail sales tax (see WAC 458-20-221).

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

(a) Part I – Nexus standard 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 Standard for Sales of Tangible Personal Property

(101) Introduction. The nexus standard described here is provided in RCW 82.04.067(6) and is used to determine whether a person who sells tangible personal property has nexus with Washington for B&O and retail sales tax purposes. The economic nexus standard under RCW 82.04.067 (1) through (5) (as further described in WAC 458-20-19401) does not apply to the activity of selling tangible personal property and is, therefore, not addressed in this rule. Further, 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.

(102) Nexus. A person who sells tangible personal property 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).

(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; or

(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.

(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 (but not merely attending a trade show);
- (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.

(103) **Effect of having nexus.** A person selling tangible personal property that has nexus with Washington is subject to B&O tax on that person's retail and wholesale sales, and is 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.

(104) **Trailing nexus.** RCW 82.04.220 provides that for B&O tax purposes a person who stops the business activity that created nexus in Washington continues to have nexus for the remainder of that calendar year, plus one additional calendar year (also known as "trailing nexus"). The department applies the same trailing nexus period for retail sales tax and other taxes reported on the excise tax return.

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 and 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 in-state 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.**

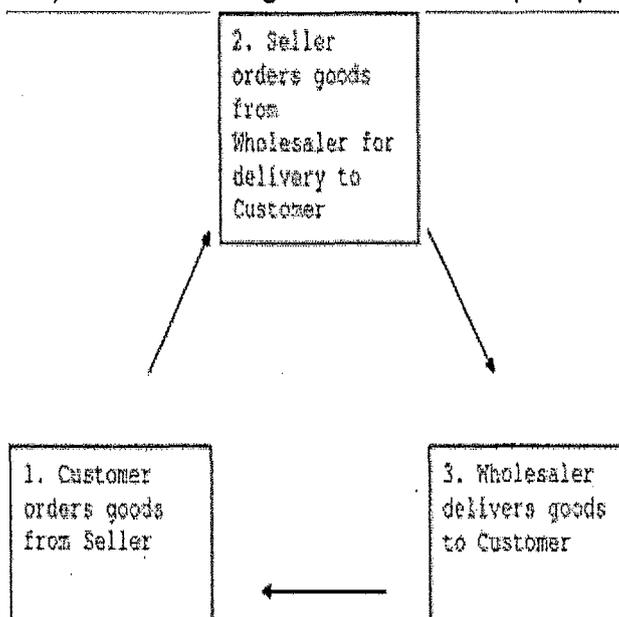
(a) **Sales of commercial aircraft parts.** As more particularly provided in RCW 82.04.627, the sale of certain parts to the manufacturer of a commercial airplane in Washington is deemed to take place at the site of the final testing or inspection.

(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 sections 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. See WAC 458-20-102, Reseller permits.

(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, 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.]

APPENDIX B

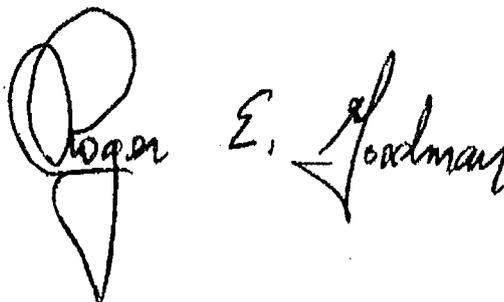
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A handwritten signature in black ink that reads "Roger E. Goodman". The signature is written in a cursive style with a large initial "R" and "G".

ROGER E. GOODMAN, Chair
STATUTE LAW COMMITTEE

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The seller's name and address,

The purchaser's name and address,

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

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

(b) Delivery of the goods to a freight consolidator, freight forwarder or for-hire carrier merely utilized to arrange for and/or transport the goods is not receipt of the goods by the purchaser or its agent unless the consolidator, forwarder or for-hire carrier has express written authority to accept or reject the goods for the purchaser with the right of inspection. See also WAC 458-20-174, 458-20-17401, 458-20-175, 458-20-176, 458-20-177, 458-20-238 and 458-20-239 for certain statutory exemptions.

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

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

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

produced, imprinted, repaired or altered are delivered to persons outside the state. It is immaterial that the customers are located outside the state, that the work was negotiated or contracted for outside the state, or that the property was shipped in from outside the state for such work.

(c) **Construction, repair.** Construction or repair of buildings or other structures, public road construction and similar contracts performed in this state are inherently local business activities subject to B&O tax in this state. This is so even though materials involved may have been delivered from outside this state or the contracts may have been negotiated outside this state. It is immaterial that the work may be performed in this state by foreign sellers who performed preliminary services outside this state.

(d) **Renting or leasing of tangible personal property.** Lessors who rent or lease tangible personal property for use in this state are subject to B&O tax upon their gross proceeds from such rentals for periods of use in this state. Proration of tax liability based on the degree of use in Washington of leased property is required.

It is immaterial that possession of the property leased may have passed to the lessee outside the state or that the lease agreement may have been consummated outside the state. Lessors will not be subject to B&O tax if all of the following conditions are present:

(i) The equipment is not located in Washington at the time the lessee first takes possession of the leased property; and

(ii) The lessor has no reason to know that the equipment will be used by the lessee in Washington; and

(iii) The lease agreement does not require the lessee to notify the lessor of subsequent movement of the property into Washington and the lessor has no reason to know that the equipment may have been moved to Washington.

(6) **Retail sales tax - Outbound sales.** The retail sales tax generally applies to all retail sales made within this state. The legal incidence of the tax is upon the purchaser, but the seller is obligated to collect and remit the tax to the state. The retail sales tax applies to all sales to consumers of goods located in the state when goods are received in Washington by the purchaser or its agent, irrespective of the fact that the purchaser may use the property elsewhere. However, as indicated in subsection (4)(b), delivery of the goods to a freight consolidator, freight forwarder or for-hire carrier arranged either by the seller or the purchaser, merely utilized to arrange for and/or transport the goods out-of-state is not receipt of the goods by the purchaser or its agent in this state, unless the consolidator, forwarder or for-hire carrier has express written authority to accept or reject the goods for the purchaser with the right of inspection.

(a) The retail sales tax does not apply when the seller delivers the goods to the purchaser who receives them at a point outside the state, or delivers the same to a for-hire carrier consigned to the purchaser outside the state. This exemption applies even in cases where the shipment is arranged through a for-hire carrier or freight consolidator or freight forwarder acting on behalf of either the seller or the purchaser. It also applies regardless of whether the shipment is arranged on a "freight prepaid" or a "freight collect" basis and regardless of who bears the risk of loss. The seller must retain proof of exemption as outlined in subsection (4), above.

(12/12/13)

(b) RCW 82.08.0273 provides an exemption from the retail sales tax to certain nonresidents of Washington for purchases of tangible personal property for use outside this state when the nonresident purchaser provides proper documentation to the seller. This statutory exemption is available only to residents of states and possessions or Province of Canada other than Washington when the jurisdiction does not impose a retail sales tax of three percent or more. These sales are subject to B&O tax.

(c) A statutory exemption (RCW 82.08.0269) is allowed for sales of goods for use in states, territories and possessions of the United States which are not contiguous to any other state (Alaska, Hawaii, etc.), but only when, as a necessary incident to the contract of sale, the seller delivers the property to the purchaser or its designated agent at the usual receiving terminal of the for-hire carrier selected to transport the goods, under such circumstance that it is reasonably certain that the goods will be transported directly to a destination in such noncontiguous states, territories and possessions. As proof of exemption, the seller must retain the following as part of its sales records:

(i) A certification of the purchaser that the goods will not be used in the state of Washington and are intended for use in the specified noncontiguous state, territory or possession.

(ii) Written instructions signed by the purchaser directing delivery of the goods to a dock, depot, warehouse, airport or other receiving terminal for transportation of the goods to their place of ultimate use. Where the purchaser is also the carrier, delivery may be to a warehouse receiving terminal or other facility maintained by the purchaser when the circumstances are such that it is reasonably certain that the goods will be transported directly to their place of ultimate use.

(iii) A dock receipt, memorandum bill of lading, trip sheet, cargo manifest or other document evidencing actual delivery to such dock, depot, warehouse, freight consolidator or forwarder, or receiving terminal.

(iv) The requirements of (i) and (ii) above may be complied with through the use of a blanket exemption certificate as follows:

Exemption Certificate

We hereby certify that all of the goods which we have purchased and which we will purchase from you will not be used in the State of Washington but are for use in the state, territory or possession of

You are hereby directed to deliver all such goods to the following dock, depot, warehouse, freight consolidator, freight forwarder, transportation agency or other receiving terminal:

.....
.....

for the transportation of those goods to their place of ultimate use.

This certificate shall be considered a part of each order that we have given you and which we may hereafter give to you, unless otherwise specified, and shall be valid until revoked by us in writing.

DATED

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

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

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

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

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

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

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

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

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

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

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

(v) The out-of-state seller, either directly or by an agent or other representative, performs significant services in rela-

tion to establishment or maintenance of sales into the state, even though the seller may not have formal sales offices in Washington or the agent or representative may not be formally characterized as a "salesperson."

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

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

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

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

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

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

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

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

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

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

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

(a) Company A is located in Washington. It sells machine parts at retail and wholesale. Company B is located in California and it purchases machine parts from Company A. Company A carries the parts to California in its own vehicle to make delivery. It is immaterial whether the goods are received at either the purchaser's out-of-state location or at

any other place outside Washington state. The sale is not subject to Washington's B&O tax or its retail sales tax because the buyer did not receive the goods in Washington. Washington treats the transaction as a tax exempt interstate sale. California may impose its taxing jurisdiction on this sale.

(b) Company A, above, ships the parts by a for-hire carrier to Company B in California. Company B has not previously received the parts in Washington directly or through a receiving agent. It is immaterial whether the goods are received at either Company B's out-of-state location or any other place outside Washington state. It is immaterial whether the shipment is freight prepaid or freight collect. Again, Washington treats the transaction as an exempt interstate sale.

(c) Company B, above, has its employees or agents pick up the parts at Company A's Washington plant and transports them out of Washington. The sale is fully taxable under Washington's B&O tax and, if the parts are not purchased for resale by Company B, Washington's retail sales tax also applies.

(d) Company B, above, hires a carrier to transport the parts from Washington. Company B authorizes the carrier, or another agent, to inspect and accept the parts and, if necessary, to hold them temporarily for consolidation with other goods being shipped out of Washington. This sale is taxable under Washington's B&O tax and, if the parts are not purchased for resale by Company B, Washington's retail sales tax also applies.

(e) Washington will not tax the transactions in the above examples (a) and (b) if Company A mails the parts to Company B rather than using its own vehicles or a for-hire carrier for out-of-state receipt. By contrast, Washington will tax the transactions in the above examples (c) and (d) if for some reason Company B or its agent mails the parts to an out-of-state location after receiving them in Washington. The B&O tax applies to the latter two examples and if the parts are not purchased for resale by Company B then retail sales tax will also apply.

(f) Buyer C who is located in Alaska purchases parts for its own use in Alaska from Seller D who is located in Washington. Buyer C specifies to the seller that the parts are to be delivered to the water carrier at a dock in Seattle. The buyer has entered into a written contract for the carrier to inspect the parts at the Seattle dock. The sale is subject to the B&O tax because receipt took place in Washington. The retail sales tax does not apply because of the specific exemption at RCW 82.08.0269. This transaction would have been exempt of the B&O tax if the buyer had taken no action to receive the goods in Washington.

(11) Examples - Inbound sales. The following examples show how the provisions of this section relating to interstate sales of tangible personal property will apply when the goods originate outside Washington (inbound sales). The examples presume the seller has retained the proper proof documents.

(a) Company A is located in California. It sells machine parts at retail and wholesale. Company B is located in Washington and it purchases machine parts for its own use from Company A. Company A uses its own vehicles to deliver the machine parts to its customers in Washington for receipt in

this state. The sale is subject to the retail sales and B&O tax if the seller has nexus, or use tax if nexus is not present.

(b) Company A, above, ships the parts by a for-hire carrier to Company B in Washington. The goods are not accepted by Company B until the goods arrive in Washington. The sale is subject to the retail sales or use tax and is also subject to the B&O tax if the seller has nexus in Washington. It is immaterial whether the shipment is freight prepaid or freight collect.

(c) Company B, above, has its employees or agents pick up the parts at Company A's California plant and transports them into Washington. Company A is not required to collect sales or use tax and is not liable for B&O tax on the sale of these parts. Company B is liable for payment of use tax at the time of first use of the parts in Washington.

(d) Company B, above, hires a carrier to transport the parts from California. Company B authorizes the carrier, or an agent, to inspect and accept the parts and, if necessary, to hold them temporarily for consolidation with other goods being shipped to Washington. The seller is not required to collect retail sales or use tax and is not liable for the B&O tax on these sales. Company B is subject to use tax on the first use of the parts in Washington.

(e) Company B, above, instructs Company A to deliver the machine parts to a freight consolidator selected by Company B. The freight consolidator does not have authority to receive the goods as agent for Company B. Receipt will not occur until the parts are received by Company B in Washington. Company A is required to collect retail sales or use tax and is liable for B&O tax if Company A has nexus for this sale. The mere delivery to a consolidator or for-hire carrier who is not acting as the buyer's receiving agent is not receipt by the buyer.

(f) Transactions in examples (11)(a) and (11)(b) will also be taxable if Company A mails the parts to Company B for receipt in Washington, rather than using its own vehicles or a for-hire carrier. The tax will continue to apply even if Company B for some reason sends the parts to a location outside Washington after the parts were accepted in Washington.

(g) Company W with its main office in Ohio has one employee working from the employee's home located in Washington. The taxpayer has no offices, inventory, or other employees in Washington. The employee calls on potential customers to promote the company's products and to solicit sales. On June 30, 1990 the employee is terminated. After this date the company no longer has an employee or agent calling on customers in Washington or carries on any activities in Washington which is significantly associated with the seller's ability to establish or maintain a market for its products in Washington. Washington customers who had previously been contacted by the former employee continue to purchase the products by placing orders by mail or telephone directly with the out-of-state seller. The nexus which was established by the employee's presence in Washington will be presumed to continue through December 31, 1994 and subject to B&O tax. Nexus will cease on December 31, 1994 if the seller has not established any new nexus during this period. Company W may disassociate and exclude from B&O tax sales to new customers who had no contact with the former employee. The burden of proof to disassociate is on the seller.

(h) Company X is located in Ohio and has no office, employees, or other agents located in Washington or any other contact which would create nexus. Company X receives by mail an order from Company Y for parts which are to be shipped to a Washington location. Company X purchases the parts from Company Z who is located in Washington and requests that the parts be drop shipped to Company Y. Since Company X has no nexus in Washington, Company X is not subject to B&O tax or required to collect retail sales tax. Company X has not taken possession or dominion or control over the parts in Washington. Company Z may accept a resale certificate (WAC 458-20-102A) for sales made before January 1, 2010, or a Streamlined Sales and Use Tax Agreement Certificate of Exemption or a Multistate Tax Commission Exemption Certificate (WAC 458-20-102) for sales made on or after January 1, 2010, from Company X which will bear the registration number issued by the state of Ohio. Company Y is required to pay use tax on the value of the parts. Even though resale certificates are no longer used after December 31, 2009, they must be kept on file by Company Z for five years from the date of last use or December 31, 2014.

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

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

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

[Statutory Authority: RCW 82.32.300, 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.]

WAC 458-20-19301 Multiple activities tax credits.

(1) Introduction. Under the provisions of RCW 82.04.440 as amended effective August 12, 1987, Washington state's business and occupation taxes imposed under chapter 82.04 RCW

were adjusted to achieve constitutional equality in the tax treatment of persons engaged in intrastate commerce (within this state only) and interstate commerce (between Washington and other states). The business and occupation tax system taxes the privilege of engaging in specified business activities based upon "gross proceeds of sales" (RCW 82.04.070) and the "value of products" (RCW 82.04.450) produced in this state. In order to maintain the integrity of this taxing system, to eliminate the possibility of discrimination between taxpayers, and to provide equal and uniform treatment of persons engaged in extracting, manufacturing, and/or selling activities regardless of where performed, a statutory system of internal and external tax credits was adopted, effective August 12, 1987. This tax credits system replaces the multiple activities exemption which, formerly, assured that the gross receipts tax would be paid only once by persons engaged in more than one taxable activity in this state in connection with the same end products. Unlike the multiple activities exemption which only prevented multiple taxation from within this state, the credits of the new system apply for gross receipts taxes paid to other taxing jurisdictions outside this state as well.

(2) Definitions. For purposes of this section the following terms will apply.

(a) "Credits" means the multiple activities tax credit(s) authorized under this statutory system also referred to as MATC.

(b) "Gross receipts tax" means a tax:

(i) Which is imposed on or measured by the gross volume of business, in terms of gross receipts or in other terms, and in the determination of which the deductions allowed would not constitute the tax an income tax or value added tax; and

(ii) Which is not, pursuant to law or custom, separately stated from the selling price.

(c) "Extracting tax" means a gross receipts tax imposed on the act or privilege of engaging in business as an extractor, and includes the tax imposed by RCW 82.04.230 (tax on extractors) and similar gross receipts taxes paid to other states.

(d) "Manufacturing tax" means a gross receipts tax imposed on the act or privilege of engaging in business as a manufacturer, and includes:

(i) The taxes imposed in RCW 82.04.240 (tax on manufacturers) and subsections (2) through (5) and (7) of RCW 82.04.260 (tax on special manufacturing activities) and

(ii) Similar gross receipts taxes paid to other states.

The term "manufacturing tax," by nature, includes a gross receipts tax upon the combination of printing and publishing activities when performed by the same person.

(e) "Selling tax" means a gross receipts tax imposed on the act or privilege of engaging in business as a wholesaler or retailer of tangible personal property in this state or any other state. The term "selling" has its common and ordinary meaning and includes the acts of making either wholesale sales or retail sales or both.

(f) "State" means:

(i) The state of Washington,

(ii) A state of the United States other than Washington or any political subdivision of such other state,

(iii) The District of Columbia,

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Subject: State of Washington, Department of Revenue v. AVNET, Inc., No. 92080-0

Please file the attached Respondent Department of Revenue's Supplemental Brief. Thank you.