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No. 92080-0

IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent

v.

AVNET, INC.,

Petitioner

ON PETITION FOR REVIEW FROM
COURT OF APPEALS, DIVISION II
(Court of Appeals Case No. 45108-5-II)

AVNET, INC.'S SUPPLEMENTAL BRIEF

Scott M. Edwards
WSBA No. 26455
Ryan P. McBride
WSBA No. 33280
Attorneys for Petitioner Avnet, Inc.

LANE POWELL PC
1420 Fifth Avenue, Suite 4200
P.O. Box 91302
Seattle, WA 98111-9402
Telephone: 206.223.7000
Facsimile: 206.223.7107

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I. INTRODUCTION

This case arises from DOR's assessment of B&O tax on two kinds of interstate sales made by Avnet, Inc. Under the United States Supreme Court's controlling decision in *Norton Co. v. Dep't of Revenue of Ill.*, 340 U.S. 534 (1951)—which has not been overruled, but rather steadfastly followed—the Commerce Clause forbids state taxation on both sets of sales because they are “dissociated” from Avnet's instate activities. Indeed, for decades and throughout the relevant period, DOR's rule regarding inbound sales (former Rule 193) and its own administrative decisions recognized the continued authority of *Norton* and permitted taxpayers to prove dissociation—which Avnet indisputably did here.

The Court of Appeals failed to recognize the authority of *Norton*, and then refused to hold DOR to its own rule. Both holdings were error, and each provides grounds for reversal. Only the United States Supreme Court can overrule its own cases on issues of federal constitutional law; Washington courts have no authority to predict *Norton's* demise. Further, and in any event, former Rule 193 was a reasonable interpretation of the B&O tax statute upon which taxpayers have long relied. DOR cannot ignore the plain meaning of its own rule, nor can it adopt a new interpretation of the B&O statute without prospectively amending the rule—which it did not do here until after the audit period at issue.

II. ISSUES FOR REVIEW

1. Did the Court of Appeals err when it refused to apply controlling United States Supreme Court precedent on an issue of federal

constitutional law based on its speculation that *Norton's* dissociation doctrine had been "overruled by implication" in subsequent cases?

2. Did the Court of Appeals err when it permitted DOR to abandon its long-standing interpretation of the former Rule 193, and to retroactively apply a new interpretation of the rule without amendment, on the grounds that it was merely "interpretive" and, therefore, not binding?

3. Did the Court of Appeals err when it ignored the plain meaning of former Rule 193, which permitted dissociation and required the goods to be "received by the purchaser in this state," so as to uphold wholesale B&O tax on Avnet's National Sales and Drop-Shipped Sales?

III. STATEMENT 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 headquarters and principal place of business in Arizona. *Id.* Avnet ships products to customers in all 50 states 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.

The Redmond office performs a variety of functions for Avnet's Washington customers, including soliciting orders, responding to requests for quotes, receiving orders, responding to questions and otherwise meeting the needs of Avnet's Washington customers. CP 9. Avnet does not dispute that it owes wholesaling B&O tax on sales to its Washington

customers and sales in which Avnet's Redmond office was associated. CP 195. During the period January 2003 to December 2005, Avnet paid \$565,295 in B&O tax with its Washington tax returns on sales involving the Redmond office. *Id.* These sales are not at issue.

B. National Sales and Drop-Shipped Sales.

The sales at issue fall into two categories, referred to as "National Sales" and "Drop-Shipped Sales." Both National Sales and Drop-Shipped 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) Avnet's Washington office was not associated in any way with the sale. The distinguishing characteristic between the two kinds of sales is the party to whom Avnet's buyer asked Avnet to ship the goods. For National Sales, Avnet's customer instructs Avnet to ship the order to one of the customer's facilities in Washington. For Drop-Shipped Sales Avnet's customer instructs Avnet to ship the order to a third party (usually, the purchaser's customer) in Washington. CP 196-99.

It is undisputed that Avnet engaged in no activity in Washington associated with the National Sales or Drop-Shipped Sales—no soliciting, no taking or receiving orders, no warehousing, no shipping, no billing, no customer service, no technical calls. Nothing. *Avnet, Inc. v. Dep't of Revenue*, 187 Wn. App. 427, 432, 348 P.3d 1273 (2015). As DOR conceded and the Court of Appeals recognized, there is no factual difference between this case and *Norton* or *B.F. Goodrich Co. v. State*, 38

Wn.2d 663, 231 P.2d 325 (1951)—in which the United States Supreme Court and this Court invoked the dissociation doctrine to invalidate the state tax on Commerce Clause grounds. *Avnet*, 187 Wn. App. at 445.

C. Trial Court and Court of Appeals Decisions.

Following an audit, DOR assessed Avnet wholesaling B&O tax on its National Sales and Drop-Shipped Sales. CP 205. As required by RCW 82.04.180, Avnet paid the assessment and filed this refund suit in superior court. CP 4. On cross-motions for summary judgment, the trial court upheld the tax on the National Sales, but ordered a tax refund on the Drop-Shipped Sales. CP 700; 6/7/13 Tr. at 30-31. DOR appealed the trial court’s judgment on the Dropped-Ship Sales, CP 694, and Avnet cross-appealed the judgment on the National Sales. CP 705.

The Court of Appeals ruled in favor of DOR on both issues, upholding DOR’s assessment of B&O tax on the National Sales and Drop-Shipped Sales. It conceded that this case is indistinguishable from *Norton* and *Goodrich*, and that “those cases have not been expressly overruled,” but held that they had been “eroded by subsequent precedent.” *Avnet*, 187 Wn. App. at 445-47. The Court further rejected Avnet’s argument that the plain meaning of former Rule 193’s dissociation and place-of-receipt provisions forbid B&O tax on both kinds of sales—holding that this “interpretive” rule was not binding on the courts, and could “provide Avnet with no more haven than the B&O statute does.” *Id.* at 439-442.

IV. ARGUMENT

A. Washington Courts Must Recognize Dissociation As A Federal Constitutional Requirement Until And Unless The United States Supreme Court Expressly Overrules *Norton*.

Basic principles of federalism and the Supremacy Clause compel reversal of the Court of Appeals as to both the National and Drop-Shipped Sales. For a state to constitutionally tax an interstate sale, the Commerce Clause requires two kinds of nexus: (1) nexus between the state and the taxpayer, and (2) nexus between the state and the activity being taxed. *Avnet*, 187 Wn. App. at 442; *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). “[T]here must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax.” *Allied-Signal, Inc. v. Director, Div. of Tax’n*, 504 U.S. 768, 778 (1992); see also Friedman & Houghton, *The Other Nexus: Transactional Nexus and the Commerce Clause*, 4 St. & Loc. Tax Lawyer 19, 20 (1999).

“Dissociation” prohibits a state from taxing sales when the seller proves that its instate activities are not associated with the transactions the state seeks to tax. Bowen, *Transactional Nexus and the Continued Relevance of National Geographic*, 20 J. Multistate Tax’n & Incentives 16 (July 2010). In *Norton*, the seller had an office in Illinois, but also accepted mail orders at its Massachusetts headquarters. Illinois sought to tax sales on orders placed by Illinois buyers directly with the seller’s Massachusetts office. 340 U.S. at 536. The seller’s Illinois office was not involved in the sales. *Id.* The United States Supreme Court held that the Commerce Clause forbid Illinois from taxing the sales because they were

“dissociated” from the seller’s Illinois activities. *Id.* at 539.

1. Norton Is Controlling And Has Never Been Overruled.

Norton is factually indistinguishable from this case and therefore controlling. DOR argues that it is a “settled issue of constitutional law” (*Answer to Pet.* at 1) that *Norton* was implicitly overruled in a series of subsequent cases—specifically, *Tyler Pipe Indus., Inc. v. Wash. Dep’t of Revenue*, 483 U.S. 232 (1987), *Standard Pressed Steel Co. v. Wash. Dep’t of Revenue*, 419 U.S. 560 (1975), and *General Motors Corp. v. Washington*, 377 U.S. 436 (1964). The Court of Appeals agreed, and held that the “state need not demonstrate a direct connection between a taxpayer’s nexus-creating activities and the particular sales into the state in order to tax those sales.” *Aynet*, 187 Wn. App. at 447.

The Supreme Court has never overruled *Norton*, nor has any court criticized its holding. Certainly, the cases upon which DOR relies did not reject *Norton*—nor did they find transactional nexus based solely on activities “establishing and maintaining a market” in the state.¹ *General Motors* and *Standard Steel Press* expressly followed *Norton*, but rejected dissociation on the merits because, unlike *Norton* and here, the taxpayers’

¹ DOR argues that *Standard Pressed Steel* “summarily dismissed the taxpayer’s reliance on *Norton*, stating it ‘verges on the frivolous’ in view of the Court’s subsequent decision in *General Motors*.” *Answer to Pet.* at 8-9. This is flat wrong. The Court rejected the taxpayer’s Due Process argument as frivolous based on its holding in *Wisconsin v. J.C. Penney*, 311 U.S. 435 (1940). *Standard Pressed Steel*, 419 U.S. at 562. That holding has nothing to do with *Norton* or dissociation. Rather, the Court addresses the Commerce Clause argument in the next paragraph, and holds that *Norton* states the “governing principle.” *Id.* Like *General Motors*, the taxpayer simply could not show dissociation on the facts.

instate activities were directly connected to the sales at issue. *General Motors*, 377 U.S. at 447 (instate employees “performed substantial services ... particularly with relation to the establishment and maintenance of sales, upon which the tax was measured”); *Standard Pressed Steel*, 419 U.S. at 562-63 (following *General Motors*). *Tyler Pipe* did not mention *Norton* or dissociation at all—presumably because the taxpayer’s instate agent solicited and facilitated the sales at issue. 483 U.S. at 249-51.²

It is not surprising, then, that Washington authorities have been steadfast in their recognition of *Norton*’s precedence—long after *General Motors*, *Standard Steel Press* and *Tyler Pipe* were decided. This Court continued to apply *Norton*’s dissociation rule. *Chicago Bridge & Iron Co. v. Dep’t of Revenue*, 98 Wn.2d 814, 659 P.2d 463 (1983); *Dep’t of Revenue v. J. C. Penney Co., Inc.*, 96 Wn.2d 38, 633 P.2d 870 (1981). As has the Court of Appeals. *Lamtec Corp. v. Dep’t of Revenue*, 151 Wn. App. 451, 467-68, 215 P.3d 968 (2009).³ These cases did not reject the taxpayer’s dissociation claim because post-*Norton* cases had “broadened

² Notably, in *Tyler Pipe*, the State did not argue that *Norton* had been overruled or the test for dissociation modified. Rather, it argued that the taxpayer was not entitled to *Norton* immunity because the taxpayer’s instate activities were directly connected to the sales at issue. *Tyler Pipe*, Appellee’s Br., 1986 WL 728567, *41 (“The *Norton* majority’s observation that ‘no solicitors work the territory,’ 340 U.S. at 537, also distinguishes the present case, where active solicitors represent the Utility department, make secondary calls and solicit orders for that department, and receive commissions on Utility sales.”).

³ *Lamtec* was affirmed on other grounds. 170 Wn.2d 838, 246 P.3d 788 (2011). Because the appellant in *Lamtec* did not challenge the Court of Appeals’ ruling on dissociation, this Court did not consider the issue. See www.courts.wa.gov/content/Briefs/A08/835799%20prv.pdf.

the activities deemed relevant” to nexus. *Answer to Pet.* at 11-12. They rejected the claim because, unlike *Norton* and the undisputed facts in this case, the taxpayer’s activities were connected to the taxed transactions.⁴

DOR itself has long recognized *Norton*’s continued supremacy on transactional nexus—in both codifying former Rule 193 and applying dissociation as a constitutional requirement. The rule was promulgated in 1991—many years after *General Motors*, *Standard Steel Press* and *Tyler Pipe* supposedly overruled *Norton*. Yet, like the 1974 version that preceded it, former Rule 193 expressly codified dissociation doctrine, and reflected DOR’s contemporaneous (now abandoned) acknowledgement that *Norton*’s dissociation limitation is constitutionally required.⁵ The rule was revised in 2015 to eliminate reference to dissociation. See WSR 15-15-025 (Aug. 7, 2015). As noted, no case or other authority—and certainly, no United States Supreme Court decision—overruled or even

⁴ See *Chicago Bridge*, 98 Wn.2d at 822 (“it defies common sense to say the presence of a local office, full-time supervisors, and a warehouse containing installation and maintenance equipment did not play a role in CBI’s successful attainment of these contracts”); *J.C. Penney*, 96 Wn.2d at 47-48 (“the imposition of the finance charge involves a great deal of Washington activity relating to establishing credit accounts and handling local problems relating to that credit account”); *Lamtec*, 151 Wn. App. at 468 (“Lamtec’s activities in Washington are not separate and independent from its sales to its Washington customers”).

⁵ DOR disingenuously suggests that the 1991 version of Rule 193 deleted language from the 1974 version of the rule to reflect an abandonment of *Norton*’s dissociation test. *Answer to Pet.* at 14 & n. 7. In fact, both versions contained the exact same language codifying *Norton*, which is the language that controls here: “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.” WAC 458-20-193(B) (1974); WAC 458-20-193(7)(c) (1991). See CP 632-38.

questioned *Norton* in the intervening 25 years.

DOR's own published tax decisions—all post-dating *Tyler Pipe*—likewise applied *Norton*'s dissociation decades after it was supposedly overruled. Det. No. 94-209R, 15 WTD 100 (1996) (“Even though Taxpayer has established nexus with the state of Washington, it still may be exempt from B&O taxes if it can dissociate some portion of its sales from the significant in-state activity that created the nexus.”).⁶ DOR notes that more than “twenty years” have passed since it last issued a published decision finding dissociation. *Answer to Pet.* at 13-14. But all the cases rejecting dissociation did so on the facts, not because *Norton* was overruled. And, in none of those cases did the taxpayer present facts, like here, identical to those at issue in *Norton* and indisputably demonstrating dissociation between its instate activities and the sales at issue.

Indeed, it wasn't until 2003 that DOR first “discovered” that “*Norton* ... was overruled in *Complete Auto*,” Det. No. 00-098, 22 WTD 151 (2003)—even though *Complete Auto* was decided more than 25 years earlier. Now, DOR doesn't even cite *Complete Auto* to support its theory.

⁶ See 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. 96-144, 16 WTD 201 (1996); Det. No. 97-235, 17 WTD 107 (1998); Det. No. 97-061, 18 WTD 211 (1999); Det. No. 98-134, 18 WTD 85 (1999). In publishing these determinations, DOR deemed them “precedential,” RCW 82.32.410(1), and they are entitled to deference by the Washington courts. See *Cashmere Valley Bank v. Dep't of Revenue*, 181 Wn.2d 622, 334 P.3d 1100 (2014). These tax decisions are available at <http://taxpedia.dor.wa.gov/>.

Nor did anything change in the intervening 15 years since *Tyler Pipe* was decided in 1987 to spark DOR's sudden revelation (other than, perhaps, a greater need for revenue). Not surprisingly, not all Washington taxing authorities have shared DOR's revelation. The last time it considered the issue in 2010, the Board of Tax Appeals held, "even if the Department disagrees with *Norton* and expects it to be overruled some day, both the Department and this Board's only concern is to observe *Norton*." *Guy Brown Mgmt. LLC/Guy Brown Office Products v. Dep't of Revenue*, 2010 WL 11187542 (Wash. Bd. Tax. App. 2010). The Board got it right.

2. This Court Must Follow *Norton* Until It Is Expressly Overruled By The United States Supreme Court.

The Court of Appeals is the first and only court to hold that *Norton* has been overruled by implication. Indeed, beyond DOR's own recent tax decisions, no court or taxing authority has ever suggested such a thing. *See 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"). Simply put, Washington courts have no authority to presume *Norton*'s demise. Only the United States Supreme Court can do that—and, despite the opportunity, it never has. "If a precedent of [the Supreme Court] has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, the [lower courts] should follow the case which directly controls, leaving to [the Supreme Court] the prerogative of overruling its own decisions." *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989).

This Court has adhered to this tenet of our federal system—and it has done so in tax cases like this one: “[W]e must hold the tax invalid; we do so in recognition of our duty to abide by controlling United States Supreme Court decisions construing the federal constitution. Hence, we find it unnecessary to discuss the aforementioned cases beyond the fact that nowhere in them do we find language criticizing, expressly contradicting, or overruling (even impliedly)” the decisions. *Ass’n of Wash. Stevedoring Co. v. Dep’t of Revenue*, 88 Wn.2d 315, 559 P.2d 997 (1977); *Goodrich*, 38 Wn.2d at 676 (“with respect to matters involving the Federal constitution, we, as an inferior tribunal, must follow the pronouncements of that court no matter what our private views may be.”). The same is true here. Washington courts must follow *Norton* unless the Supreme Court says otherwise—which, so far, it has refused to do. The Court of Appeals’ decision must be reversed for this reason alone.

B. Former Rule 193 Does Not Permit DOR To Assess B&O Tax On Avnet’s National Or Drop-Shipped Sales.

Former Rule 193 provides an independent basis upon which to reverse the Court of Appeals, as to both the National Sales and Drop-Shipped Sales. As explained below, in upholding the assessment, the Court of Appeals refused to apply the rule’s unambiguous dissociation and place-of-receipt provisions, and ignored DOR’s long-standing and settled application of those provisions—holding that the rule was not binding and, in any event, could not be construed to confer a greater tax exemption than the B&O tax statute itself. *Avnet*, 187 Wn. App. at 440-42. That holding

was wrong. DOR is bound by, and taxpayers may rely upon, DOR's reasonable interpretive rules until and unless they are amended—which did not occur here until well *after* the audit period at issue.

1. DOR Is Not Entitled To Disavow Or Apply A Different Meaning To Its Own Interpretive Rules.

The legislature painted the B&O tax in broad strokes. It applies to the “act or privilege of engaging in business activities” in the state. RCW 82.04.220. As it relates to Avnet, the B&O tax applies to “the business of making sales at wholesale” but only for sales “within this state.” RCW 82.04.270. The statute defines “sale” as “any transfer of the ownership of, title to, or possession of property for a valuable consideration,” *see* RCW 82.04.040(1), but does not define where an inbound sale (*i.e.*, a sale of goods originating out-of-state) occurs for purposes of determining if the B&O tax applies. In short, were it not for DOR's implied authority to adopt an “interpretive rule” on the subject of inbound sales, *see Ass'n of Wash. Bus. v. Dep't of Revenue*, 155 Wn.2d 430, 440, 120 P.3d 46 (2005) (“*AWB*”), the statute would provide no standard whatsoever.

Former Rule 193 provided that standard, and Avnet was entitled to rely on it. Although courts retain “the ultimate authority to determine the purpose and effect of a statute,” they still must afford “[c]onsiderable judicial deference to the interpretation of the provision by those charged with its enforcement.” *Impecoven v. Dep't of Revenue*, 120 Wn.2d 357, 363, 841 P.2d 752 (1992). When DOR promulgated former Rule 193 in 1991, it reflected DOR's interpretation of the B&O tax statute—both as to

dissociation and place-of-receipt. DOR revised the rule to eliminate both provisions in 2015. See WSR 15-15-025 (Aug. 7, 2015). Nothing changed in the intervening 24 years to render DOR's original interpretation unsound: no changes to the B&O tax statute; no rule amendments; no contrary judicial authority. DOR simply chose to interpret the B&O tax statute differently, ignore its own rule, assess tax on previously un-taxed activities, and defend its new interpretation in court.

DOR cannot repudiate its reasonable, long-standing and codified interpretation of the B&O tax statute—nor can a court accept DOR's invitation to do so. Absent a statutory change or clear judicial abrogation, neither of which occurred here, courts must defer to DOR's original interpretation. *Dot Foods, Inc. v. Dep't of Revenue*, 166 Wn.2d 912, 921, 215 P.3d 185 (2009); *Tesoro Ref. & Mktg. Co. v. Dep't of Revenue*, 164 Wn.2d 310, 323-24, 190 P.3d 28 (2008); *Group Health Coop. of Puget Sound, Inc. v. Wash. State Tax Comm'n*, 72 Wn.2d 422, 428, 433 P.2d 201 (1967); *Hansen Baking Co. v. City of Seattle*, 48 Wn.2d 737, 743-44, 296 P.2d 670 (1956). Of course, if it acts within the scope of its authority, DOR can change its interpretation of the B&O tax statute, but it cannot do so retroactively—which is why DOR amended (indeed, eliminated) Rule 193's dissociation and place-of receipt provisions in 2015.⁷

⁷ DOR's internal communications reflect the same understanding. CP 561 ("Rule 193, not *Norton*, permits taxpayers to dissociate."). Contrary to its current position, DOR correctly understood that—even if it believed *Norton* was overruled—it was compelled to allow dissociation unless former Rule 193 was amended. CP 574 ("as long as dissociation remains in the rule, the Department (continued)

The Court of Appeals therefore erred in holding that former Rule 193 was not binding on DOR (and, by extension, the courts) because it was merely “interpretive.” *Avnet*, 187 Wn. App. at 439-42. Certainly, *AWB* stands for no such principle. In *AWB*, this Court held that *taxpayers* may challenge DOR’s interpretive rules and, if a rule goes too far, courts may agree with the taxpayer and strike it down. *Id.* at 446-47. But nothing in *AWB* stands for the proposition that DOR can ask the courts to ignore its own rules or give them new meaning—at least without some change in the law. On the contrary, *AWB* recognized that DOR’s rules are “de facto authoritative for the public until the public challenges them in court and the court agrees.” *Id.* at 448. At bottom, this Court assumed DOR would defend, not disavow, its own rules. *Id.* at 447 (“DOR will stick by its rules ... unless and until they are stricken by a court”).

DOR’s interpretive rules serve as “advance notice of the agency’s position,” *AWB*, 155 Wn.2d at 447, and taxpayers rely on them when structuring their transactions and paying their taxes. *Group Health*, 72 Wn.2d at 428 (“If it were permissible for a taxing agency to challenge, years later, [its own] rules ..., taxpayers would never be able to close their books with assurance”); *Silverstreak, Inc. v. Dep’t of Labor & Indus.*, 159 Wn.2d 868, 889-90, 154 P.3d 891 (2007) (“[b]idders must be able to rely on the plain meaning of regulations and Department interpretations,

cannot test the continued validity of *Norton*.”). It had the same understanding with respect to the former rule’s place-of-receipt provision. CP 562-63 (recommending amendment to former Rule 193 regarding drop-shipments).

without fear that a state agency will later penalize them by adopting a different interpretation”). If DOR can walk away from its own rules, or interpret them differently without a corresponding rule change, the rules will be meaningless to the very individuals for whom they are intended. Settled taxpayer expectations will be traded for unpredictable, arbitrary and unfair results.⁸ As explained below, that is what happened here.

To be sure, *Coast Pacific Trading, Inc. v. Dep't of Revenue*, 105 Wn.2d 912, 719 P.2d 541 (1986), does not allow DOR to disavow the plain language of its own rules simply because it later decides to give the B&O tax statute a broader interpretation. Rather, *Coast Pacific* permits DOR to ignore its rules only where a subsequent change in the law renders the rule contrary to the statute. In *Coast Pacific*, DOR promulgated a rule that codified federal Import-Export Clause cases conferring tax immunity on exports based on the statutory exemption for amounts the state is constitutionally prohibited from taxing. RCW 82.04.4286. Years later, the United States Supreme Court overruled those cases, but the old immunity rule remained on the books. *Id.* at 916-17. This Court held that DOR could abandon the rule (and the taxpayer could not rely on it), because the rule—if applied—would confer an exemption RCW 82.04.4286 no longer required or permitted. *Id.* at 918.

⁸ For example, while it dismissed former Rule 193(7) as interpretive, without noting the irony, the Court of Appeals deferred to DOR’s interpretation of Rule 103 in upholding DOR’s assessment on the Drop-Shipped Sales. *Avnet*, 187 Wn. App. at 440 (“Under our case law, WAC Rule 193 is an interpretive rule that cannot subtract from the force of the statute or WAC Rule 103”).

This exception does not apply here. In *Coast Pacific*, it was clear the cases underlying the rule were overruled; even the taxpayer agreed. *Id.* at 916-17. At that point, the rule was not a reasonable interpretation of the exemption statute; taxpayers would know it was *ultra vires*. In contrast, *Norton* has not been overruled. And, even if DOR is right about *Norton*, former Rule 193's dissociation test was a reasonable interpretation of the B&O tax imposition statute itself—not an exemption required by RCW 82.04.4286. That interpretation was reasonable when the rule was promulgated in 1991, and nothing has changed over the next 24 years to make it any less reasonable; taxpayers would not know it was *ultra vires*. Application of *Coast Pacific* to the Rule's place-of-receipt provision is even more inapt. That provision did not codify a case or constitutional limitation; it interpreted the B&O tax statute's threshold condition: that the sale occur "within this state." RCW 82.04.270. Of course, the B&O tax statute did not change over those 24 years either.

2. Avnet Carried Its Burden Of Establishing That Its National And Drop-Shipped Sales Are Not Significantly Associated In Any Way With Its Instate Activities.

The Court of Appeals' mistaken refusal to apply former Rule 193's dissociation test was outcome determinative. Although the court did not reach the issue, it presumed as much. *Avnet*, 187 Wn. App. at 442. This Court can easily dismiss DOR's suggestion that the rule did not actually codify *Norton*, but rather "defines 'nexus' in terms of the *Tyler Pipe* standard." *Answer to Pet.* at 14-15. Nonsense. The former rule provides:

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

Former WAC 458-20-193(7)(c); *see also* former WAC 458-20-101(5)(a) (“Persons with out-of-state business locations should not include income that is disassociated from their instate activities”).⁹ DOR’s published tax determinations recognized no distinction between former Rule 193 and *Norton*—because there is none. Det. No. 96-144, 16 WTD 201 (1996). Indeed, even after DOR questioned *Norton* in 2003, it recognized the rule “continues to allow dissociation.” Det. No. 00-098, 22 WTD 151 (2003); *also Maxwell Corp. v. Dep’t of Revenue*, 2006 WL 4059847, *4 (Wash. Bd. Tax. App. 2006) (DOR “admits its regulation allows dissociation.”).

Regardless, Avnet satisfied former Rule 193(7)(c)’s unambiguous terms because it was undisputed that its Washington activities were not significantly associated in any way with the sales. *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.”). Avnet’s customers are located outside

⁹ DOR cites former Rule 193(2)(f), which defines “nexus” as “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.” This refers to taxpayer nexus, not transactional nexus. *Id.*, (c)(7) (“Washington does not assert B&O tax on sales of goods which originate outside this state unless ... the seller has nexus.”). Dissociation doctrine presumes taxpayer nexus, but not transactional nexus. DOR’s arguments, and the Court of Appeals’ decision, reflect an erroneous effort to conflate the former with the latter.

Washington; they deal and place orders with Avnet offices located outside Washington; and the products are shipped from facilities located outside Washington. Avnet's Washington office plays no role in soliciting or facilitating the sales, nor does it provide any customer support, service or technical advice after the fact. CP 194-201; CP 9-12. In short, regardless of *Norton's* status, DOR was not permitted to assess B&O tax on Avnet's National or Drop-Shipped Sales under the plain meaning of its rule.

3. Avnet's Drop-Shipped Sales Were Not Subject To B&O Tax Because Avnet's Purchasers Did Not Receive The Goods In Washington.

The plain meaning of former Rule 193's place-of-receipt provision likewise precludes the assessment of B&O tax on Avnet's Drop-Shipped Sales. Former Rule 193 determines whether a sale is deemed to occur "in this state," for purposes of imposition of the wholesale B&O tax. The Court of Appeals quoted the rule, but then simply ignored it—citing its "interpretive" nature and *Coast Pacific*. As discussed above, neither thing permits DOR or the courts to abandon the plain meaning of an otherwise valid interpretive rule. The rule provides in relevant part:

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. ... The B&O tax will not apply if one of these elements is missing.

Former WAC 458-20-193(7) (emphasis added). Former Rule 193(2)(d), in turn, defines receipt as "the purchaser or its agent first either taking physical possession of the goods or having dominion and control over them." Former WAC 458-20-193(2)(d). As DOR has explained, "the

Rule covers both actual possession and constructive possession. ‘Actual possession means that the goods are in the personal custody of the person ...; whereas, constructive possession means that the goods are not in actual, physical possession, but that the person ... has dominion and control over the goods.’” Det. No. 14-0157, 33 WTD 539 (2014).

In a Drop-Shipped Sale, Avnet’s purchaser does not take actual possession of the goods, but does take constructive possession of them, *i.e.*, it exercises dominion and control, when it instructs Avnet where and to whom to ship the goods. Thus, just like the former Rule’s example, when an out-of-state wholesale purchaser gives Avnet instructions from its out-of-state office to ship the goods to a third party in Washington, the wholesale purchaser “has not taken possession or exercised dominion and control over the goods in Washington.” Former WAC 458-20-193(11)(h). This is so because Avnet’s purchaser constructively received the goods at the out-of-state location where it gave the shipping instruction.

“For years,” consistent with the former Rule 193’s express terms, DOR advised taxpayers that drop-shipped sales to out-of-state purchasers were not taxable. CP 578.¹⁰ Yet, just as it did with the rule’s dissociation

¹⁰ The Court of Appeals dismissed DOR’s internal emails as irrelevant because, “[a]t most,” they merely suggest that agency staff wished to clarify Rule 193 to prevent parties from wrongly interpreting it. *Avnet*, 187 Wn. App. at 437 n. 6. That is not what the documents say. They show that it was DOR’s own policy to interpret former Rule 193’s place-of-receipt provision to preclude B&O tax on drop-shipped sales and that it advised taxpayers of that policy. CP 562 (“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 579 (“I think that for years, [DOR staff] (continued)

provision, the Court of Appeals permitted DOR to abandon that decades-long interpretation of the B&O tax statute, and espouse an entirely new interpretation based on a separate “interpretive” rule, WAC 458-20-103, that addresses an entirely different issue—*i.e.*, *when* an in-state sale is deemed to occur. For the reasons explained above, neither DOR nor the courts can simply repudiate former Rule 193’s place-of-receipt provision without amendment.¹¹ At the very minimum, DOR’s new-found reliance on Rule 103 in lieu of former Rule 193 creates an ambiguity regarding the scope of the B&O tax for the Drop-Shipped Sales that “must be resolved against the taxing power and in favor of the taxpayer.” *Agrilink Foods, Inc. v Dep’t of Revenue*, 153 Wn.2d 392, 396-97, 103 P.2d 1226 (2005).

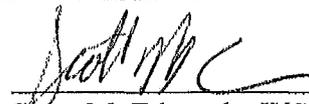
VI. CONCLUSION

The Court of Appeals must be reversed, and the trial court ordered to grant Avnet’s petition for review and enter judgment for Avnet.

RESPECTFULLY SUBMITTED this 19th day of February, 2016.

LANE POWELL PC

By



Scott M. Edwards, WSBA No. 26455

Ryan P. McBride, WSBA No. 33280

Attorneys for Petitioner Avnet, Inc.

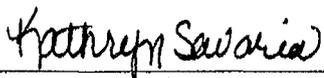
were advised that tax would not apply in that situation.”); CP 578 (“that’s what we were advised to say years ago and have consistently done so when asked.”).

¹¹ As noted above, DOR prospectively amended Rule 193 to remove the place-of-receipt provision, WSR 15-15-025 (Aug. 7, 2015)—a move that further confirms the plain meaning of the former version of the rule. Notably, the new version of Rule 193 does not incorporate any aspect of Rule 103.

CERTIFICATE OF SERVICE

I hereby certify under penalty of perjury of the laws of the State of Washington, that on February 19, 2016, I caused to be served a copy of the foregoing on the following persons in the manner indicated below at the following addresses:

Mr. Charles Zalesky Ms. Rosann Fitzpatrick Mr. Joshua Weissman Office of the Attorney General of Washington Revenue Division 7141 Cleanwater Drive SW PO Box 40123 Olympia, WA 98504-0123 chuckz@atg.wa.gov JulieJ@atg.wa.gov RosannF@atg.wa.gov JoshuaW@atg.wa.gov	<input checked="" type="checkbox"/> by Electronic Mail <input type="checkbox"/> by Facsimile <input checked="" type="checkbox"/> by First Class Mail <input type="checkbox"/> by Hand Delivery <input type="checkbox"/> by Overnight Delivery
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Kathryn Savaria

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Case Number: 92080-0
Case Name: State of Wash. Dept. of Revenue v. Avnet, Inc.
Pleading Name: Avnet, Inc.'s Supplemental Brief
Filing Attorneys: Scott M. Edwards and Ryan P. McBride

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