NO. 45108-5

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Appellant/Cross-Respondent,

v.

AVNET, INC.,

Respondent/Cross-Appellant.

DEPARTMENT'S REPLY BRIEF AND RESPONSE TO CROSS-APPEAL

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I. INTRODUCTION

It is undisputed that Avnet has nexus with Washington and that all of the transactions it contests involve the sale of goods that it shipped into Washington by common carrier. These undisputed facts preclude Avnet from establishing its entitlement to a tax refund. Neither WAC 458-20-193 (Rule 193) nor the Commerce Clause permits Avnet to exclude from taxation any portion of its Washington destination sales.

Rule 193 is an interpretive rule intended to ensure the B&O tax is applied only to transactions with the requisite connection to Washington. The physical delivery of the goods in Washington satisfies the constitutionally required nexus with *the transaction*. If there is also nexus with *the taxpayer*, the transaction is taxable. Rule 193 can and should be read as providing that a sale takes place in Washington for B&O tax purposes when the goods are shipped by common carrier for delivery to the Washington destination designated by the purchaser. This Court should reject Avnet's attempt to parse the rule's provisions into a tax exemption that is neither authorized by statute nor required by the Constitution.

Avnet's attempt to carve out subcategories of its Washington sales based on the address of the customer or of the office that handled the sales transaction is contrary to decades of case law that rejects such

compartmentalization. Avnet's market-making activities in Washington create the requisite nexus with all of Avnet's Washington destination sales, not just those where there was a direct contact with its Washington office.

II. FACTS RELEVANT TO CROSS-APPEAL

The Department relies on the facts recited in its Opening Brief.

III. ARGUMENT IN RESPONSE TO CROSS-APPEAL

A. The B&O Tax Applies To All Of Avnet's Washington Sales Because Avnet Has Nexus With Washington And The Goods Were Physically Delivered Here.

Both Avnet's cross-appeal and the Department's appeal turn on the constitutional limitations on a state's ability to tax interstate sales. Under contemporary commerce clause and due process analysis, a state must have a connection - or nexus - with the taxpayer *and* with the transaction or activity it seeks to tax. Nexus with the taxpayer is established when the taxpayer's in-state business activities are "significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." *Tyler Pipe Indus., Inc. v. Dep't of Revenue*, 483 U.S. 232, 250, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987); *Lamtec Corp. v. Dep't of Revenue*, 151 Wn. App. 451, 215 P.3d 968 (2009), *aff'd*, 170 Wn.2d 838, 850-51, 246 P.3d 788 (2011).

Nexus with the transaction requires that there be some rational

relationship between the state and the taxable event or activity. "It has long been settled that a sale of taxable goods has a sufficient nexus to the State in which the sale is consummated to be treated as a local transaction taxable by that State." *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 184, 115 S. Ct. 1331, 131 L. Ed. 2d 261 (1995) (citing *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33, 60 S. Ct. 388, 84 L. Ed. 565 (1940)). Thus, "transactional nexus" always exists with the State in which goods are delivered upon sale because partial performance of the contract of sale, i.e. the transfer of physical possession in accordance with the buyer's direction, occurs in the State. *See Berwind-White*, 309 U.S. at 43-44 (affirming right of destination state to tax an interstate sale because "the tax is conditioned upon a local activity, delivery of goods within the state upon their purchase for consumption"). *International Harvester Co. v. Indiana Dep't of Treasury*, 322 U.S. 340, 64 S. Ct. 1019, 88 L. Ed. 1313 (1944) (same with respect to a gross receipts tax).[1]

[1] *See* Charles A. Trost, *Federal Limitations on State and Local Taxation* § 9.4 (2d ed.) ("[I]t seems settled that the state of destination has free reign in taxing the unapportioned gross receipts from interstate sales of goods that are delivered and consumed in the state"); Jerome R. Hellerstein & Walter Hellerstein, *State Taxation*, ¶ 18.02[1] (3d ed. 2014) ("[T]he legal standard governing the place of taxation of tangible personal property typically is stated in terms of the place of "delivery" or place of transfer of title or possession"). In contrast, the origin state has a more uncertain "nexus" with the transaction. *See, e.g., Evco v. Jones*, 409 U.S. 91, 93 S. Ct. 349, 34 L. Ed. 2d 325 (1972) (state where services were performed to produce the product sold lacked jurisdiction to tax the sale of goods delivered outside the state).

Here, Avnet concedes it has nexus with Washington. Resp. Br. at 29 n.9 ("Avnet does not dispute that it has a nexus with Washington by virtue of its instate business activities."). Nor does Avnet dispute that every contested transaction involved the sale of goods shipped into Washington by common carrier. CP 184-85. The physical delivery of the goods in Washington created the requisite "transactional nexus."

Nevertheless, Avnet contends it may "dissociate" its so-called "National" and "Third Party" sales because they lack an adequate connection with its instate business activities. The flaw in Avnet's legal theory is that Avnet posits a more onerous "transactional nexus" requirement than is supported by any statutory or constitutional law.

There is no requirement of a direct link between the instate activities that establish nexus with the taxpayer (sometimes referred to as "entity nexus") and the instate activities that establish nexus with the transaction (sometimes referred to as "transactional nexus").

Washington is permitted to use the gross proceeds of all Avnet's Washington destination sales as a measure of the value of its business activities in the state.

B. *Norton* Is Not Controlling Authority; Case Law On The Constitutional Nexus Requirement Has Evolved Since *Norton* To Limit "Dissociation" Claims By Out-Of-State Sellers.

Avnet's arguments are based on the incorrect premise that the controlling legal authority in this case is *Norton Co. v. Dep't of Revenue*, 340 U.S. 534, 537, 71 S. Ct. 377, 95 L. Ed. 517 (1951). Avnet correctly states *Norton* never has been expressly "overruled." Resp. Br. at 23. That begs the question, however, what rule of law it stands for. *Norton* has an important place in the development of the dormant commerce clause case law because it announced a market promotion rationale that looks to the advantages and benefits an out-of-state seller derives from its instate activities as justification for the state's taxing jurisdiction over interstate sales.[2] *Norton's* market promotion rationale became the predominant paradigm for determining whether a state has taxing jurisdiction over an interstate business.

That *Norton* has never been overruled does not mean it controls the outcome of other cases, even those presenting substantially similar facts. *See Department of Revenue v. Sears, Roebuck & Co.*, 660 P.2d 1188, 1190-91 n.4 (Alaska 1983) (rejecting taxpayer's argument that the facts were so similar the Court must either follow *Norton* or disregard it). This

[2] For a thorough analysis of the *Norton* decision, see Donald P. Simet, *The Concept of 'Nexus' and State Use and Unapportioned Gross Receipts Taxes*, 73 NW. U. L. Rev. 112, 122-23 (1978), and Paul J. Hartman, *Federal Limitations on State and Local Taxation* §9.4, at 226-231 (2003).

is because subsequent decisions have greatly expanded the scope of activities deemed relevant in determining whether an interstate sale is "dissociated" from a taxpayer's business activities in the taxing state.

As the West Virginia Supreme Court explained:

> It can be readily seen that *Norton's* test, whether there is some local service to support the state tax on a particular transaction, has been transformed by *General Motors* and *Standard Pressed Steel* into an inquiry as to the extent of the local business of the taxpayer ... In both *General Motors* and *Standard Pressed Steel*, the taxpayer's in-state activities were thought to be sufficient to uphold the tax even though these activities did not have a substantial direct relationship to the activity taxed.

J.C. Penney Co., Inc. v. Hardesty, 164 W. Va. 525, 547, 264 S.E.2d 604 (1979) (addressing a B&O tax very similar to Washington's).[3]

Norton established that an out-of-state seller that chooses to conduct business in the state has the burden to prove its instate activities "were not decisive factors in establishing and holding th[e] market" for its instate sales. *Norton*, 340 U.S. at 538. This is the enduring principle for which *Norton* continues to be cited.[4]

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[3] The Washington Supreme Court found the opinion of the West Virginia Court persuasive in addressing "substantially identical facts" in *Department of Revenue v. J.C. Penney Co., Inc.*, 96 Wn.2d 38, 45-46, 633 P.2d 870 (1981) (finding a sufficient connection between retailer's instate credit sales and its finance charge income to justify imposition of B&O tax).

[4] *Norton* has been cited in 15 published Washington appellate decisions. Only one of those decisions (issued a few months after *Norton* was decided) found the taxpayer met its burden of proving dissociation. In that decision, the Supreme Court followed *Norton* with obvious reluctance, stating, "[w]ere we free to decide this case differently,

Avnet argues *Norton* requires this Court to conclude its "National Sales" and drop shipment transactions are nontaxable. Resp. Br. at 28. It does not. As the Supreme Court subsequently explained:

> The disagreement in the [*Norton*] Court was not over the governing principle; it concerned the burden of showing a nexus between the local office and interstate sales-whether a nexus could be assumed and whether the taxpayer had carried the burden of establishing its immunity.

Standard Pressed Steel Co. v. Dep't of Revenue, 419 U.S. 560, 563, 95 S. Ct. 706, 42 L. Ed. 2d 719 (1975). Because the disagreement in *Norton* was a dispute over the facts (i.e., whether the taxpayer met its burden of proof) rather than a dispute over the law, it cannot be said that *Norton* "controls" any other taxpayer's dissociation claim.

The "governing principle" on which the justices agreed in *Norton* was that a corporation availing itself of the privilege of doing business in a state can avoid taxation on its sales activities "only by showing that particular transactions are dissociated from the local business and [are]

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we might well do so." *B.F. Goodrich Co. v. State*, 38 Wn.2d 663, 674-75, 231 P.2d 325 (1951).

The most recent decision addressing dissociation is *Lamtec Corp. v. Dep't of Revenue*, 151 Wn. App. 451, 215 P.3d 968 (2009). In that case, this Court stated the burden of proving dissociation requires a taxpayer to demonstrate "a complete absence of any connection" between instate business activities and interstate sales. *Id.* at 467-68 (finding that burden unmet where out-of-state seller's representatives made occasional visits to the state to help maintain relationships with select customers). In every other Washington case that cites *Norton*, the Washington court concluded the taxpayer failed to prove any of its sales transactions were nontaxable. *See, e.g., Chicago Bridge & Iron Co. v. Dep't of Revenue*, 98 Wn.2d 814, 659 P.2d 463 (1983); *Department of Revenue v. J.C. Penney Co., Inc.*, 96 Wn.2d 38, 47-48, 633 P.2d 870 (1981); *General Motors Corp. v. State*, 60 Wn.2d 862, 875-76, 376 P.2d 843 (1962).

interstate in nature." *Norton,* 340 U.S. at 541 (J. Clark, dissenting). The justices disagreed, however, as to whether Norton met that burden with respect to transactions in which customers ordered goods directly from the out-of-state office, with no direct involvement of the local office.

The difference of opinion on the *Norton* court turned on the justices' view of the "transaction." The majority viewed a transaction in terms of the activities directly related to a particular sale, such as "receiving the orders or distributing the goods." *Norton*, 340 U.S. at 538. Thus, the controlling facts in the majority's view were that these components of the sales transaction occurred outside the state. The *Norton* minority, in contrast, took a much broader view of the "transaction" in determining whether particular sales were associated with the seller's instate business activities. *Id.* at 539. Norton's local personnel stood ready to accept service of process in any court action, respond to customer complaints and requests for assistance, or provide engineering and technical advice. *Id.* at 538-39. In the *Norton* dissenters' view, "these multitudinous activities give to petitioner a local character which is most helpful in all its Illinois operations." *Id.* at 541. Thus, the dissenters would have held that the taxpayer could not prove its instate activities "were not decisive in establishing and holding this market" with respect to any of its instate sales, regardless of whether the local office

actually provided any service in connection with a particular transaction. *Id.*

Had the law stayed static since 1951, Avnet might be immune from Washington tax on its Washington sales. But subsequent cases, which Avnet ignores, have endorsed a broader view of the "transaction."

The first indication the tide had turned in favor of the *Norton* dissenters' view came in, *Field Enterprises v. State*, 47 Wn.2d 852, 289 P.2d 1010 (1955), *aff'd by*, 352 U.S. 806, 77 S. Ct. 55, 1 L. Ed. 2d 39 (1956). That case involved a B&O tax assessment on mail-order sales of encyclopedias shipped directly to Washington customers from outside the state. The sellers' instate representatives solicited orders and carried out promotional activities from its Seattle office, but the orders were accepted, fulfilled, paid for, and shipped from outside the state.[5] In affirming the assessment, the Washington Supreme Court stated: "[I]t cannot be denied that the services rendered by the taxpayer's Seattle office are decisive factors in establishing and holding the market in this state"). 47 Wn.2d at 856. In its per curiam opinion affirming the decision, the Supreme Court simply cited *Norton* without comment. *Field Enterprises,* 352 U.S. 806.

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[5] Today, there would be no serious dispute that Washington could tax the sales. But at the time *Field Enterprises* was decided, it was thought instate solicitation, alone, did not create taxing jurisdiction over an out-of-state seller. *See Norton*, 340 U.S. at 537 The Supreme Court abandoned that view in *Scripto, Inc. v. Carson*, 362 U.S. 207, 80 S. Ct. 619, 4 L. Ed. 2d 660 (1960).

In 1964, in a majority opinion written by Justice Clark (who wrote the dissenting opinion in *Norton*), the Supreme Court in *General Motors* held that "the test" for evaluating a taxpayer's claim of dissociation was whether "the bundle of corporate activity" it carried on within the state supported the taxpayer's ability to establish and hold a market for its instate sales. *General Motors Corp. v. Washington*, 377 U.S. 436, 447-48, 84 S. Ct. 1654, 12 L. Ed. 2d 430 (1964). In that case, an automobile manufacturer with twenty employees carrying out a variety of promotional and supervisory activities in Washington sought to dissociate a substantial portion of its gross receipts that it considered insufficiently related to any instate activity to justify taxation by Washington, including its wholesale sales of car parts ordered directly by customers from its Portland warehouse and shipped directly from the out-of-state warehouse to Washington destinations. *Id.* at 445-46. An independent operating division ran the warehouse with no involvement by the taxpayer's instate personnel, who were dedicated to promoting retail car sales. *Id.*

The Supreme Court concluded that General Motors failed to establish that its business activities within Washington were not "decisive factors in establishing and holding this market":

> General Motors voluntarily pays considerable taxes on its Washington operations but contests the validity of the tax levy on four of its Divisions, Chevrolet, Pontiac,

> Oldsmobile and General Motors Parts. Under these circumstances appellant has the burden of showing that *the operations* of these divisions in the State are "dissociated from the local business and interstate in nature."

General Motors, 377 U.S. at 441 (emphasis added).

The Court found that although none of General Motors' instate personnel were involved in handling the orders, the direct sales were attributable to the increased demand generated by the corporation's instate business activities. Accordingly, Washington could impose the wholesaling B&O tax on all of General Motors' Washington destination sales, including those ordered directly from out-of-state offices and independently operated warehouses. 377 U.S. at 447.

If there was any doubt that *General Motors* intended to significantly broaden the scope of instate activities deemed sufficient to support the state of destination's taxing jurisdiction over an interstate sale, the Court put such doubt to rest in 1975, with its unanimous decision in *Standard Pressed Steel*, 419 U.S. 560.[6]

In *Standard Pressed Steel*, the taxpayer's instate activities consisted of a single employee working from a home office whose main function was to gather information needed to qualify as a supplier for the taxpayer's principal (but not sole) instate customer, the Boeing Company.

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[6] *See* Paul J. Hartman, *Federal Limitations on State and Local Taxation*, § 8.4 at 440-41 (1981).

419 U.S. at 561. The decision whether to become a supplier for particular products was made out-of-state and the taxpayer's out-of-state engineers resolved any technical difficulties, with the in-state employee merely relaying information. *See Standard Pressed Steel Co. v. Dep't of Revenue*, 10 Wn. App. 45, 47-48, 516 P.2d 1043 (1973). The employee "had nothing to do with quoting prices, delivery dates, receiving, soliciting, accepting orders, handling shipments, or approving credit. No inventories were kept in this state, and all deliveries were made by plaintiff directly through a common carrier." *Id.* at 48.

Even though the instate employee had no role in any actual sales transactions, this Court found his activities were sufficient to support imposing the B&O tax on the privilege of engaging in local business activities. *Standard Pressed Steel*, 10 Wn. App. at 50. The United States Supreme Court affirmed this Court and rejected the taxpayer's reliance on *Norton*. *Standard Pressed Steel*, 419 U.S. at 562.

As in *General Motors*, the Supreme Court in *Standard Pressed Steel* refused to consider only the elements of particular transactions (e.g., solicitation, ordering, fulfillment, delivery, payment) in evaluating the taxpayer's dissociation argument. 419 U.S. at 563 (stating *General Motors* "is almost precisely in point"). Instead, the Court examined the role of the seller's sole in-state technical consultant in maintaining

relationships and contributing information in order to establish and maintain *the market* for its sales. *Id.* at 562. In the Court's view, the contention that those activities were too "thin and inconsequential" to support the state's taxing jurisdiction "verges on the frivolous." *Id.*

Following *General Motors* and *Standard Pressed Steel*, all of a seller's instate business activities that are related, directly or indirectly, to establishing and maintaining a market for its sales are relevant in evaluating whether a state has taxing jurisdiction over the seller's interstate sales transactions. The substance and practical effect of the seller's activities are the relevant focus, not the mechanics of particular sales transactions or the departmentalization of the business operation. Avnet's claim to the contrary is incorrect and should be rejected.[7]

C. Avnet's Income From Washington Destination Sales Is Taxable Because Avnet's Instate Activities Are Significantly Associated With Its Ability To Establish And Maintain A Market For Those Sales.

Avnet offers a number of arguments to support its *Norton*-based claims, but none of them withstand scrutiny under current nexus standards.

1. Avnet improperly limits its focus to the facts of the specific transactions at issue.

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[7] *See* Walter Hellerstein, *State Taxation of Interstate Business and the Supreme Court, 1974 Term: Standard Pressed Steel and Colonial Pipeline*, 62 Va. L. Rev. 149, 155 (1976) (commenting that, in *Standard Pressed Steel*, "the Court seems to have liberated the State completely from the restraints of *Norton*.").

Avnet's recitation of the acts it purportedly does not perform in Washington, *see* Resp. Br. at 7, ignores the broad range of market development and market maintenance functions it *does* perform. This is the same tactic the courts repeatedly have rejected. Under *General Motors*, *Standard Pressed Steel* and *Tyler Pipe*, the indirect activities a business undertakes within the state to generate demand for its products are as important as the activities directly associated with a particular sale.

Avnet tries to distinguish these authorities on the ground the instate representatives in those cases engaged in "either procuring or consummating the sales, or providing support after the sales." Resp. Br. at 27. In none of the cases, however, did the court analyze the nexus issue on a transaction by transaction basis. Rather, in each case the court looked to the activities undertaken by the local representatives to determine whether they were significantly associated with the taxpayer's ability to establish and maintain *a market* for its sales in the state. *General Motors*, 377 U.S. at 448; *Standard Pressed Steel*, 419 U.S. at 563; *Tyler Pipe*, 483 U.S. at 250. Having concluded that such a nexus existed, the court rejected the premise that the taxpayer could avoid state taxation based on the absence of any activities directly associated with specific transactions.

Avnet ignores the work of its instate personnel in gathering information necessary for the company to manage rapid technological

developments that affect the market demand for the electronic components and computer products it sells. Avnet is in the business of selling electronic components supplied by hundreds of manufacturers worldwide. Rapid technological change is the hallmark of the computer industry. To effectively compete, Avnet must anticipate advances in technology and must quickly and efficiently move the goods sold through the supply chain to the consumer. CP 504-05. Thus, Avnet deploys business development managers and teams of field engineers in Washington to work closely with customers, suppliers, manufacturers, and fellow engineers in the high-tech industry. CP 447. Their role is not merely to provide technical assistance to specific customers, but also to gather information needed to anticipate and promote the development of technological innovations for the next generation of electronic components. CP 433.

On these undisputed facts, Avnet cannot establish that the work of its managers and field engineers in Washington does not promote "the realization and continuance" of its sales. *See Space Age Fuels, Inc. v. State*, 178 Wn. App. 756, 761, 315 P.3d 604 (2013) (quoting *Standard Pressed Steel,* 419 U.S. at 562), *rev. denied.* These activities contribute to the continuing demand for the products Avnet sells worldwide, including in Washington. Just as in *Standard Pressed Steel*, the market intelligence

gathered by Avnet's instate personnel is instrumental in maintaining a market for its sales.

Avnet tries to distinguish *Standard Pressed Steel* on the basis that its Washington engineers do not work directly with the customers who purchased the products that Avnet claims are immune from taxation. But that makes no difference. Resp. Br. at 27. In *Standard Pressed Steel*, it was important to work directly with the customer because the taxpayer dealt in specialized products that were designed and manufactured in accordance with the unique needs of that customer. 419 U.S. at 561. That is not the case here, where the relevant market is much broader, with mass-produced items distributed worldwide. *See* CP 427-31 (lists of companies whose products Avnet distributes). There is no need to gather market intelligence from specific customers. Rather, as in *General Motors*, the relevant "market" consists of a broad range of consumers who use the products Avnet offers for sale worldwide. Information gathered from any customer (or non-customer) helps Avnet maintain the market for its sales to all customers who use the same product, regardless of their location.

In *General Motors*, the Court considered the broad range of promotional and marketing activities that the seller directed at the market as a whole to be decisive factors in allowing the company to establish and

maintain the market for its wholesale sales to local dealers. 377 U.S. at 443-44. It did not matter that those activities largely were directed at consumers who were not General Motors' actual customers. What mattered is that the activities generated increased demand for its wholesale sales. Avnet's activities associated with keeping abreast of the latest technological advances are as significant in the context of its business operations as were the activities of General Motors in promoting car sales to the customers of its customers in Washington.

2. Avnet has not cited any appellate decision that has followed *Norton* in finding some portion of a seller's transactions "dissociated" from its instate activities.

Although Avnet insists *Norton* is "controlling authority," it cites no case that has followed *Norton* in finding some portion of a seller's inbound sales "dissociated" from its instate business activities. Resp. Br. at 17. Avnet only cites a handful of decisions that distinguish *Norton*. Resp. Br. at 24-25.[8]

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[8] *See 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) (citing *Norton* in concluding the taxpayer failed "to sustain its burden of proving any unrelated business activity on the part of its subsidiaries and affiliates" that would prevent the state from taxing their income); *National Geographic Soc'y v. Cal. Bd. of Equalization*, 430 U.S. 551, 560-61, 97 S. Ct. 1386, 51 L. Ed. 2d 631 (1977) (refusing to apply a dissociation analysis in the context of the imposition of a use-tax collection duty); *Chicago Bridge & Iron Co. v. Dep't of Revenue*, 98 Wn.2d 814, 822, 659 P.2d 463 (1983) (concluding taxpayer could not prove the presence of local personnel were not "decisive factors" in obtaining contracts for the design and manufacture of a bridge in Washington), *appeal dismissed for want of substantial federal question*, 104 S. Ct. 542, 78 L. Ed. 718 (1983); *Dep't of Revenue v. J.C. Penney Co., Inc.*, 96 Wn.2d 38, 47-48, 633 P.2d 870 (1981) (finance charges on

Since deciding *Norton*, the Supreme Court never has held that a taxpayer with a physical presence in the state could "dissociate" some of its sales of goods into that state. The only instance where the Supreme Court cited *Norton* in finding that a state lacked taxing jurisdiction over an interstate sale is *American Oil Co. v. Neill*, 380 U.S. 451, 85 S. Ct. 1130, 14 L. Ed. 2d 1 (1965). That case is distinguishable, however, because it involved a taxpayer that carried out *no* business activities within the state. *Id.* at 458. The Court held that a foreign corporation whose *only* contact with the state was to procure a permit needed to ship fuel into the state could not, consistent with due process, be subject to tax on a sale of fuel delivered outside the state for eventual transport into the state. The taxpayer's lack of nexus with the taxing state was decisive. *See National Geographic Soc'y v. State Bd. of Equalization*, 16 Cal.3d 637, 648-49, 547 P.2d 458, 128 Cal. Rptr. 682 (1976), *aff'd*, 430 U.S. 551, 97 S. Ct. 1386, 51 L. Ed. 2d 631 (1977).

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credit sales could not be dissociated from activities of a national retail department store doing business in the state); *Lamtec Corp. v. Dep't of Revenue*, 151 Wn. App. 451, 467-68, 215 P.3d 968 (2009) (taxpayer could not dissociate sales of goods shipped into the state from periodic trips to the state to maintain "customer relationships"), *aff'd*, 170 Wn.2d 838, 246 P.3d 788 (2011); *Dep't of Revenue v. Sears, Roebuck & Co.*, 660 P.2d 1188, 1190-91, & n.4 (Alaska 1983) (taxpayer with multiple retail outlets in the state where customers could, if needed, receive assistance with repairs, returns, exchanges, or payments, could not dissociate sales transactions handled exclusively by its out-of-state mail order division).

Avnet does not dispute it has nexus with Washington. Thus, this is not a case in which the taxpayer lacks a sufficient connection to support the state's taxing jurisdiction. As the Supreme Court has noted, a taxpayer with a physical presence in the state bears "little similarity" with one whose sole contact is by mail or common carrier. *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 33, 108 S. Ct. 1619, 100 L. Ed. 2d 21 (1988). Thus, *American Oil* does not support Avnet's argument.

3. *Quill* does not hold that the shipment of goods into the state is not an "instate activity" for nexus purposes.

Avnet also contends the physical delivery of the goods in this state does not constitute an "instate activity" for purposes of nexus because *Quill* creates a "rule" that delivery by mail or common carrier does not create substantial nexus. Resp. Br. at 30, *citing Quill Corp. v. North Dakota*, 504 U.S. 298, 309, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992). Avnet misunderstands the Court's holding.

What *Quill* actually said is that a seller whose "*only* contacts with taxing State are by mail or common carrier" lacks nexus. 504 U.S. at 311 (emphasis added). *Quill* addressed whether there was a sufficient connection with *the taxpayer* to impose a use-tax collection obligation. It did not create a new or higher standard for nexus. Rather, *Quill* preserved a "safe harbor" for mail order vendors that lack any *physical presence* in

the state. *Space Age Fuel*, 178 Wn. App. at 760. Recognizing that *Quill* rests primarily on the doctrine of stare decisis, Washington courts have followed the lead of other state courts in strictly interpreting its "bright-line rule." *See Lamtec,* 170 Wn.2d at 847-49 (questioning whether *Quill's* physical presence requirement even applies outside the context of sales and use taxes); *Space Age Fuel*, 178 Wn. App. at 761 (rejecting taxpayer's argument that delivery alone cannot establish a substantial nexus and concluding that taxpayer's delivery of goods using its own trucks did so).

In *Quill*, there was no dispute an adequate *transactional* nexus existed by virtue of the physical delivery of merchandise purchased for use within the state. The sole issue was whether the taxpayer's physical presence in the state was required to establish "entity" nexus. Here, Avnet concedes entity nexus. Thus, *Quill* is of no help to Avnet.

4. *National Geographic* does not support Avnet's argument that the contested sales lack "transactional nexus" with Washington.

Avnet asserts the United States Supreme Court "expressly affirmed *Norton's* dissociation principle in the context of a direct tax" in *National Geographic*, 430 U.S. 551, 97 S. Ct. 1386, 51 L. Ed. 2d 631 (1977). Resp. Br. at 26, n.8. Avnet is incorrect.

In *National Geographic*, the Court held that a state could impose a use tax collection obligation on a mail order seller with a physical

presence in the state even if there was no direct connection between the sales transactions and the seller's instate activities. 430 U.S. at 560. In other words, the Court required no direct link between the activity creating nexus with the taxpayer and the activity creating nexus with the transaction.[9] *See Quill*, 504 U.S. at 325 ("By decoupling any notion of a *transactional* nexus from the inquiry, the *National Geographic* Court in fact repudiated the free trade rationale of the *Bellas Hess* majority."). Instead of requiring a direct link between the transactions and National Geographic's instate activities, the Court applied a minimum contacts analysis examining links between the seller and the state "wholly apart from the seller's in-state transaction that was being taxed." *Id.*

National Geographic operated two offices in California that sold advertising copy for the taxpayer's monthly magazine. *National Geographic*, 430 U.S. at 552-53. The local offices performed no activities related to the taxpayer's independently operated mail order division which sold maps, atlases, globes, and books to California residents from outside

[9] Avnet incorrectly asserts the *National Geographic* court held that "transactional nexus is not a requirement in the unique context of a use-tax collection duty." Resp. Br. at 28, n.8. The Court did not eliminate the requirement of nexus with the transaction. As in *Quill,* the existence of such a nexus was undisputed by virtue of the physical delivery of the goods into the state for use or consumption. What *National Geographic* held is that there is no requirement of a *direct* link between the seller's instate activities and the transactions to be taxed in the sales tax context. *See National Geographic*, 430 U.S. at 557-58. The Court relied on its nexus analysis in *Standard Pressed Steel* in affirming California's imposition of a use tax collection obligation on National Geographic.

the state. *Id.* Relying on *Norton*, the taxpayer claimed it could not be required to collect use tax on the mail order sales because those transactions were dissociated from its instate activities.

The Court rejected the taxpayer's argument, holding the question was "simply whether the facts demonstrate 'some definite link, some minimum connection between (the State and) *the person*...it seeks to tax." *National Geographic*, 430 U.S. at 561 (emphasis added).

As the Department noted in its opening brief, the *National Geographic* Court suggested, in dicta, the result of a nexus analysis might differ in the case of a "direct tax." Dep't Br. at 43, n.11. But Avnet's assertion that the Court thereby "expressly affirmed *Norton's* dissociation principle" is plainly inconsistent with the Court's discussion of *Standard Pressed Steel.*

Addressing National Geographic's claim that an insufficient nexus existed between its sales of advertising copy and the mail-order sales to justify California's imposition of an obligation to collect a use tax on the transactions, the Court pointed out that in *Standard Pressed Steel*, it had affirmed the imposition of a "direct tax," Washington's B&O tax, based on an even more attenuated connection between the taxpayer's instate activities and its sales transactions. 430 U.S. at 557. The Court observed that the case was "even stronger" for the imposition of a use tax collection

duty than it had been for the imposition of Washington's B&O tax. *Id.* at 558.[10] Thus, notwithstanding its suggestion the outcome might differ in the case of a "direct tax," the *National Geographic* Court's actual analysis demonstrates the practical impossibility of proving dissociation under the nexus analysis adopted in *General Motors* and *Standard Pressed Steel.* Moreover, in *Tyler Pipe*, the Court cited *National Geographic* in affirming that substantial nexus supported imposing the B&O tax on income from all the taxpayer's Washington destination sales. 483 U.S. at 250.

As the Supreme Court's cross-referencing of cases involving "direct" and "indirect" taxes suggests, the distinction between "direct" and "indirect" taxes no longer has any constitutional significance. That distinction is an artifact of the long-discarded direct/indirect burdens approach, which carved out an area of "tax immunity" for interstate commerce. *See Department of Revenue v. Ass'n of Washington Stevedoring Co.*, 435 U.S. 734, 98 S. Ct. 1388, 55 L. Ed. 2d 682 (1978) ("With the distinction between direct and indirect taxation of interstate

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[10] In affirming the state's right to tax National Geographic's mail order sales, the Court rejected the lower court's adoption of a "slightest presence" nexus standard. *National Geographic,* 430 U.S. at 556. However, the Court agreed with the California Supreme Court's determination that an adequate connection existed between the mail order sales and National Geographic's instate activities to satisfy the due process and commerce clauses. *Id.* The California Court reasoned that the taxpayer's instate sales of advertising copy were integrally related with its mail order sales to subscribers of its monthly magazine. 16 Cal.3d at 646-47. The California court's analysis is a straightforward application of the nexus analysis applied in the context of the B&O tax in *General Motors*, *Standard Pressed Steel.*

commerce thus discarded, the constitutionality under the Commerce Clause of the application of the Washington business and occupation tax to stevedoring depends upon the practical effect of the exaction.").

The *Complete Auto Transit* test supplanted the direct/indirect burdens approach with a four-pronged test that treats "direct" and "indirect" taxes equally. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977). Following *Complete Auto Transit*, a state tax does not rise or fall based on whether the formal legal incidence of the tax falls on the seller or the buyer, but rather depends on a practical assessment of its effect on interstate commerce. *See Quill*, 504 U.S. at 315 (explaining why *Complete Auto* rejected "formalistic" distinctions between direct and indirect taxes).

In sum, *National Geographic* does not support Avnet's dissociation claim. Under *Complete Auto Transit*, a state's power to tax the sale of goods that are physically delivered in the state turns on whether the tax is internally and externally consistent. *See Jefferson Lines*, 514 U.S. at 184-87. It is undisputed the B&O tax satisfied those tests. Under such circumstances, "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." *Ford Motor Co. v. City of Seattle*, 160 Wn.2d 32, 54, 156 P.3d 185 (2007).

5. Case law addressing income taxes does not support Avnet's claim that the contested sales are "unrelated" to its instate activities.

Avnet relies on *Allied-Signal, Inc. v. Div. of Taxation*, 504 U.S. 768, 778, 112 S. Ct. 2251, 119 L. Ed. 2d 533 (1992), for the principle that a state's taxing authority does not extend to transactions that are not significantly associated with a taxpayer's instate business activities. Resp. Br. at 26. Strictly speaking, *Allied Signal* is inapposite because it involves a net income tax, not a gross-receipts tax. *See Nordstrom Credit, Inc. v. Dep't of Revenue*, 120 Wn.2d 935, 942, 845 P.2d 1331 (1993) (rejecting taxpayer's reliance on case law analyzing the "minimum contacts" needed for a state to reach a portion of the net income of a multistate business enterprise).[11] In any event, the income tax cases Avnet cites support the conclusion that Washington may tax all of Avnet's Washington destination sales.

[11] In the context of a net income tax, a state taxes a portion of the taxpayer's total income using a formula to measure the relative amount attributable to its instate activities. In the context a gross receipts tax, a state taxes the entire gross proceeds of those interstate sales assignable to the state rather than a portion of the total income of a multistate business. Apportionment and allocation are two fundamentally different methods of measuring the tax base. *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 444-45, 100 S. Ct. 1223, 63 L. Ed. 2d 510 (1980).

To exclude certain income from the apportionment formula a state uses to measure the revenue generated by a multi-state business, a business must prove the income was earned from "a discrete business enterprise" unrelated to the activities carried out within the state. *Allied-Signal*, 504 U.S. at 772. A multistate business cannot satisfy that burden with respect to income generated by operating entities that are involved in essentially the same line of business. *See Container Corp. of Amer. v. Franchise Tax Bd.*, 463 U.S. 159, 166, 103 S. Ct. 2933, 77 L. Ed. 2d 545 (1983) (state may tax income of foreign operating subsidiaries that share common managerial or operational resources resulting in economies of scale and transfers of value across taxing jurisdictions).

The drop shipment and "National sales" that Avnet seeks to isolate from its concededly taxable ones are part of a functionally integrated worldwide distribution network, not the result of a "discrete business enterprise." Thus, if Avnet were subject to a Washington income tax, it could not carve out the proceeds of these sales from the tax base. Likewise, it cannot "dissociate" those sales for purposes of Washington's B&O tax. *Cf. Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 100 S. Ct. 2109, 65 L. Ed. 2d 66 (1980) (states are not bound by taxpayer's internal accounting or departmentalization of its business operations).

Avnet asserts the contested sales were "derived from completely separate markets, comprised of completely separate customers, served by completely different employees. There was no overlap." Resp. Br. at 29. But Avnet offers essentially the same line of products for sale worldwide through a centralized online ordering system, and it ships the goods to wherever the purchaser requests. *See* CP 447-50 (describing the virtual integration of Avnet's business operations, which enables "virtual alliances and virtual relationships" among manufacturers, suppliers, employees and customers in "the interconnected marketplace"). The relevant "market" for purposes of the state's taxing jurisdiction is defined by the geographical borders of the state, not by the geographical location of Avnet's suppliers, customers, or employees, or by the organization of its business operations by geography, product line, or customer base. Washington may impose the B&O tax on Avnet's gross receipts from all its sales of goods that were physically delivered in Washington.

D. Avnet Does Not Meet Rule 193's Requirements For Dissociating Its Drop Shipment Or National Sales.

Avnet asserts the "plain language" of the Department's interpretive rule on interstate sales, Rule 193, entitles it to "dissociate" its drop shipment transactions even if the dormant commerce clause does not. Resp. Br. at 17-20. Avnet claims Rule 193 "codifies" what it calls "the

dissociation doctrine"[12] of *Norton*, 340 U.S. 534, when, in fact, the rule reflects the nexus standard embraced by the United States Supreme Court in subsequent decisions that specifically addressed Washington's wholesaling B&O tax. *See General Motors v. Wash.*, 377 U.S. 436, 84 S. Ct. 1564, 12 L. Ed. 2d 430 (1964), *Standard Pressed Steel Co. v. Dep't of Revenue*, 419 U.S. 560, 95 S. Ct. 706, 42 L. Ed. 2d 719 (1975), *Tyler Pipe Indus., Inc. v. Dep't of Revenue*, 483 U.S. 232, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987). Avnet misreads and misapplies Rule 193.

1. Rule 193 is an interpretive rule that does not, and cannot, allow taxpayers to "dissociate" transactions the State constitutionally may tax.

At the outset, it is important to stress that interpretive rules do not have the force of law. In authorizing the Department to adopt interpretive rules, the Legislature did not authorize it to grant a tax exemption that is neither statutorily nor constitutionally required. *See Space Age Fuel*, 178 Wn. App. at 608 ("an interpretive rule such as WAC 458-20-193(11) is

[12] There is no mention of a "dissociation doctrine" in any case law, treatise, or law review article concerning the Commerce Clause. Even the authors of the two law review articles Avnet cites in support of its "dissociation doctrine" argument assert that "transactional nexus" would be satisfied by applying the *Tyler Pipe* nexus standard to determine whether an out-of-state seller has a duty to collect sales or use taxes. M. Bowen, *Sales and Use Taxes*, 20 J. Multistate Tax'n & Incentives 16 (July 2010) (asserting "the constitutional test" for transactional nexus is "likely found in *Tyler Pipe*"); *see also* J. Friedman, *Consumption Tax Nexus: The Connection with the Transaction to be Taxed*, 38 Ga. L. Rev. 119, 140 (2003) ("If the in-state activities create and enhance the in-state market for the activities the state seeks to tax, the transactional nexus requirement would be satisfied.").

'not binding on the courts at all'"), *citing Association of Wash. Bus. v. Dep't of Revenue*, 155 Wn.2d 430, 447, 120 P.3d 46 (2005). Thus, Avnet's reliance on the principle that "agencies are bound by their own rules" is misplaced. Resp. Br. at 19.

Rule 193 is an interpretive rule that "parallels the rule for determining nexus under federal commerce clause analysis." *Lamtec,* 151 Wn. App. at 460-61. The Department has revised the rule many times to conform to developments in the dormant commerce clause case law. Nevertheless, a taxpayer cannot avoid the B&O tax by relying on an interpretive rule that purportedly allows a greater deduction than authorized by statute or required by the constitution.[13] *Coast Pac. Trading, Inc. v. Dep't of Revenue*, 105 Wn.2d 912, 917, 719 P.2d 541 (1986) (rejecting taxpayer's reliance on provisions of Rule 193 that had not been updated to reflect case law narrowing the constitutional prohibition on state taxation of export sales); *Space Age Fuels*, 178 Wn. App. at 760 (taxpayer's assertion that Rule 193 purportedly creates a stricter nexus standard than required by the commerce clause "lacks

[13] However, a taxpayer has a statutory right to receive "upon request, clear and current tax instructions," upon which it may rely. RCW 82.32A.020(2). Taxpayers are entitled "to rely on specific, official written advice and written tax reporting instructions from the department of revenue to that taxpayer." RCW 82.32.A.020(5). WAC 458-20-100 describes the administrative process for receiving and contesting a letter ruling on the state tax consequences of a taxpayer's business transactions. There is no evidence Avnet ever requested such a letter ruling from the Department.

relevance"). Thus, the Department's rules must be interpreted and applied consistently with the legislative intent "to tax all business activities not expressly excluded." *Coast Pac.*, 105 Wn.2d at 917-18 (citations omitted).

2. Rule 193 interprets the constitutional constraints on the States's authority to tax interstate sales.

Under Rule 193, a taxpayer whose instate business activities are significantly associated with establishing or maintaining *a market* for its sales may "dissociate" particular transactions only by establishing the sales did not occur within Washington, i.e., physical delivery of the goods sold took place outside the state. Avnet cannot meet its burden of proving dissociation under Rule 193 because Avnet undisputedly has nexus with Washington, and every sale transaction at issue involved goods shipped into Washington by common carrier to the purchaser/consignee. CP 185.

Avnet relies on WAC 458-20-193(7)(c) in support of its dissociation argument, which provides:

> (7) **Inbound sales**. ... There must be both the receipt of goods in Washington by the purchaser and the seller must have nexus for B&O tax to apply to a particular sale. The B&O tax will not apply if one of these elements is missing. ...
>
> (c) If a seller carries on significant activity in this state and conducts no other business in the state except the business of making sales, this person has the distinct burden of establishing that the instate activities are not

> significantly associated in any way with the sales into this state. ...

WAC 458-20-193.

Avnet fails to recognize this language essentially equates "dissociation" with the absence of nexus: "'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." WAC 458-20-193(2)(f). Rule 193 provides specific examples of instate activities that create "sufficient nexus in Washington for the B&O tax to apply," including the following:

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

WAC 458-20-193(7)(c)(v). The Department first adopted this language in a 1974 revision of the rule, which incorporated post-*Norton* developments in the case law. *See* Dep't Br. at 46.

The 1974 rule revision superseded language that provided sales of goods shipped into Washington were immune from the B&O tax if "there has been no participation whatsoever in the transaction by the seller's branch office, local outlet, or other local place of business...." CP 641. The Department replaced "in the transaction" with the phrase, "in the

state." Former WAC 458-20-193B (1974). That change conformed Rule 193 with *General Motors*, 377 U.S. 436, in which the Supreme Court held that a business that comes into the state to conduct business "has the burden of showing that *the operations*" of the taxpayer's independently organized operating divisions were "dissociated from the local business and interstate in nature." 377 U.S. at 441 (emphasis added).

The Washington Supreme Court endorsed the 1974 rule changes in *Tyler Pipe*, where the Court rejected the taxpayer's claim that it could dissociate transactions where the customer ordered goods directly from the seller's out of state office with no involvement by any local representative. *Tyler Pipe v. Dep't of Revenue,* 105 Wn.2d 318, 323, 715 P.2d 123 (1986). In that case, the Court held the promotional activities of an independent contractor within the state created taxing jurisdiction over *all* of the taxpayer's Washington destination sales, not just those involving some participation by an instate representative. *Id.* at 321.

Following the *Tyler Pipe* decision, the Department *deleted* the following provision from Rule 193:

> Sales transactions in which the property is shipped directly from a point outside the state to the purchaser in this state are exempt *only if there is and there has been no participation whatsoever in this state* by the seller's branch office, local outlet, or other local place of business, or by an agent or other representative of the seller.

Former WAC 458-20-193B (1974) (emphasis added) (CP 637); *compare* former WAC 458-20-193 (1991) (CP 633).

The Department also adopted a "trailing nexus" rule, which presumes the seller's market-creating activities have a lingering influence on the demand for a seller's products. WAC 458-20-193(7)(c) ("Once nexus has been established, it will continue throughout the statutory period of RCW 82.32.050 (up to 5 years), notwithstanding that the instate activity which created the nexus ceased." Former WAC 458-20-193(7)(c) (1991). The "trailing nexus" marks the outer limits of the link required between a particular transaction and a seller's instate activities.

Avnet is asking the Court to interpret and apply Rule 193 as though the changes made in 1974 and 1991 never occurred. Resp. Br. at 20 ("Nothing has changed. So long as Rule 193(7)(c) remains on the books, and it does, DOR must apply dissociation [as] a matter of Washington law."). As revised in 1991, however, Rule 193 recognizes only two factual circumstances that will support a dissociation claim: (1) where the seller presents adequate documentary proof the goods sold were physically delivered to the purchaser at a point outside Washington, *see* WAC 458-20-193(10)(a), or (2) where more than five years have passed since the seller carried on nexus-creating activities within the state, *see* WAC 458-20-193(11)(g). Neither circumstance exists here.

3. Both the Department and the Board of Tax Appeals have applied Rule 193 in a manner consistent with current constitutional standards.

Avnet asserts the Department has "uniformly accepted the viability of *Norton* and *Goodrich*" in "decades of its own published decisions." Resp. Br. at 25. The Department's view of *Norton* and *Goodrich* is irrelevant to this Court's determination of whether any of Avnet's Washington destination sales are nontaxable. *See Space Age Fuel*, 178 Wn. App. at 760 (courts are not bound by the DOR's interpretation of nexus requirements because "the Department does not administer or enforce the commerce clause of the United States Constitution").

Moreover, Avnet does not fairly characterize the Department's position on dissociation. Most of the agency rulings cited by Avnet determined the taxpayer failed to prove dissociation, including *every* ruling that applied the post-1991 version of Rule 193.[14]

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[14] *See* Det. No. 93-283, 14 WTD 041 (1994) (taxpayer failed to meet its burden of establishing dissociation, citing *Tyler Pipe*); Det. No. 94-209, 15 WTD 96 (1996) (taxpayer failed to establish interstate sales ordered over the phone were not significantly associated with activities of local sales representatives who played no role in the transaction); Det. No. 96-144, 16 WTD 201 (1996) (taxpayer that periodically attended trade shows and provided dealer training in the state failed to meet its burden of establishing dissociation); Det. No. 97-235, 17 WTD 107 (1998) (taxpayer failed to establish the presence of a sales manager who was available to assist customers, resolve problems, or maintain goodwill was not significantly associated with its ability to maintain the market for its sales of electronic components shipped into the state); Det. No. 97-061, 18 WTD 211 (1999) (occasional visits by nonresident employees to monitor needs of instate customers established nexus; taxpayer failed to prove dissociation).

In addition, Avnet ignores a published determination that defines dissociation as the opposite of *Tyler Pipe* nexus. Det. No. 04-0208, 24 WTD 217 (2005) explains:

> [S]ignificant activities are ones that establish or maintain a market for the taxpayer's products. Therefore, to be eligible for dissociation, a sale must not be in any way associated with any of the taxpayer's in-state activities that establish or maintain a market for its products.

CP 386.

Avnet also fails to acknowledge that the Board of Tax Appeals (BTA) agrees with the Department's analysis of the dissociation issue. *See Maxwell Corp. v. Dep't of Revenue*, Bd. Tax Appeals No. 62814 (2006). While noting it is "always hard to prove a negative," the BTA found the taxpayer failed to prove the increased brand recognition arising from its instate business activities was not significantly associated with sales into the state handled exclusively by an independent, out-of-state division that purportedly served a separate set of customers, sold a separate set of products, and competed in a separate market.[15] *Id.* at 2, 5.

Even less persuasive than Avnet's arguments about the Department's published decisions is its argument that the Department's failure to amend Rule 193 to eliminate the word "dissociation" should affect this Court's interpretation of the rule. Avnet cites no authority for

[15] While not binding on the court, BTA decisions can be persuasive. *Lamtec*, 170 Wn.2d at 846.

the proposition that an agency's internal deliberations on whether to amend a rule should have any relevancy in defining legal standards, particularly those of constitutional significance. The Department doubts any such authority exists. In the context of failed amendments to statutes, the Washington Supreme Court has declined to speculate on the reasons for the Legislature's failure to adopt an amendment, stating that "nothing can be inferred from the legislature's inaction" on a proposed bill. *City of Medina v. Primm*, 160 Wn.2d 268, 280, 157 P.3d 379 (2007). This Court should likewise refrain from drawing inferences from agency inaction.

For all these reasons, Avnet's arguments that the Department continues to adhere to a long-discarded view of *Norton* is without merit. The Department's rule revisions and published determinations mirror developments in the dormant commerce clause case law that have eased restrictions on the state's ability to tax interstate commerce. Those developments have effectively eliminated the opportunities of an out-of-state seller that has nexus with a state to avoid state taxation of its sales of goods shipped into the state. The Commerce Clause does not prohibit the state from taxing any of Avnet's Washington destination sales.

The trial court correctly concluded that Avnet failed to meet its burden of dissociating any of its "National Sales" and should have held the same with respect to Avnet's drop shipment sales.

IV. REPLY ARGUMENT

Avnet's sales occurred in Washington for B&O tax purposes when the goods were physically delivered by common carrier to the Washington address provided by the buyer. This Court should reject Avnet's arguments in response to the Department's appeal, because neither statutory nor constitutional law entitles Avnet to avoid B&O tax on its drop shipment sales.

It is undisputed that Avnet has nexus with Washington and that its drop shipment transactions are wholesale "sales" as defined by RCW 82.04.040. *See* Resp. Br. at 13, n.3 ("[D]rop Ship Sales are "sales."). Accordingly, the B&O tax applies to Avnet's drop shipment sales absent an applicable statutory or constitutional provision to the contrary. *See Coast Pac.,* 105 Wn.2d at 917-18 (Legislature intended to tax all business activities "not expressly excluded"). As previously discussed, the Constitution does not prohibit Washington from taxing all of Avnet's Washington sales. Thus, Rule 193 can and should be read consistently with the legislative intent to impose the B&O tax on Avnet's drop shipment transactions to the fullest extent constitutionally permissible.

Under the Department's regulations, the locations of the seller and of the purchaser are irrelevant in determining whether the sale occurred in the state. The physical delivery of tangible personal property within or

into the state determines the place of sale. If the goods are physically delivered to the buyer at a point within Washington, the sale is deemed to have occurred in this state, giving rise to wholesaling B&O tax liability for sellers that have nexus with Washington.

A. Under Rule 193, Avnet's Drop Shipments Are Taxable Because The Goods Were Physically Delivered In Washington To The Place Designated By The Buyer.

1. Avnet's interpretation of Rule 193's place of sale provisions rests on its false distinction between "receipt" and "delivery."

The linchpin of Avnet's proposed interpretation of Rule 193 is the false assumption that the rule adopts a "receipt" standard that is materially different from a "delivery" standard for determining the place of sale. Resp. Br. at 11. When those terms are properly understood as referring to the same event--the transfer of physical possession from the seller to the buyer--and when the words concerning "receipt" and "delivery" are read together and in the context of the rule as a whole, it is plain that the transfer of possession from a for-hire carrier to the purchaser's customer (the consignee) constitutes "receipt" by the purchaser.

The notion that there is a material difference between "delivery" and "receipt" is incorrect. Both terms refer to the same event, i.e., the transfer of physical possession from the seller to the buyer. They differ only in which party to the transaction – the purchaser or the seller – is

identified as the subject and which the object of the transaction. "Receipt by the purchaser" means physical delivery of the goods sold. Goods are "received by the purchaser" when they are "delivered to the purchaser."

The fact that "receipt" and "delivery" are separately defined in Rule 193 does not, as Avnet contends, mean the rule adopts a "receipt" standard as opposed to a "delivery" standard in determining the place of sale. WAC 458-20-103 states the place of sale is determined by the transfer of physical possession from the seller to the buyer: ("A sale takes place in this state when the goods sold are delivered to the buyer in this state, irrespective of whether title to the goods passes to the buyer at a point within or without the state.").

The provisions pertaining to "receipt" and "delivery" must be read together and in the context of the rule as a whole. "Delivery" is defined as "the act of transferring possession of tangible personal property." WAC 458-20-193(2)(c). "Receipt" or "received" is defined as the purchaser or its agent "first taking physical possession of the goods or having dominion and control over them." WAC 458-20-193(2)(d). "Agent" means "a person authorized to receive goods with the power to inspect and accept or reject them." WAC 458-20-193(2)(e). Rule 193 uses these terms in the context of explaining when the "transfer of...possession" of the goods from the seller to the buyer (which is the event that determines the place of

sale, *see* WAC 458-20-103) will be deemed to have occurred for B&O tax purposes under various factual circumstances. Some provisions refer to "receipt" when addressing certain factual circumstances while others refer to "delivery" when addressing different circumstances.[16] But "receipt by the purchaser" is conceptually equivalent to "delivery to the purchaser."

Notably, Rule 193 defines "state of destination" as "the state or place where the *purchaser/consignee* or its agent receives a shipment of goods." WAC 458-20-193(2)(b) (emphasis added). Many of the rule's provisions specifically address how the rule applies in the context of interstate sales of goods delivered by common carrier.

When a seller's shipping documents indicate the "ship to" address is in Washington, a seller who claims the sale did *not* occur in Washington has the burden to prove the purchaser received the goods at a point *outside* the state before the goods reached their destination. *See* WAC 458-20-193(7); WAC 458-20-193(4)(a)(ii) ("Proof of exempt outbound sales").

Rule 193 recognizes that a transfer of physical possession occurs when a seller delivers goods to a common carrier. "'Delivery'... 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

[16] *See, e.g.,* WAC 458-20-193(6)(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...."); WAC 458-20-193(5)(a) (manufacturers who "transfer or make delivery of [products] for receipt at points outside the state are subject to tax[.]).

carrier to another, or *for-hire carrier to consignee*. WAC 458-20-193(2)(c) (emphasis added). Specific provisions of the rule explain that delivery to a common carrier does not constitute receipt by the purchaser for purposes of determining the place of sale. WAC 458-20-193(7)(a) ("Delivery of the goods to a . . . 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."); *see also* WAC 458-20-193(4)(b) (outbound sales).

As discussed in the Department's opening brief, the common carrier provisions clarify that the delivery of goods to a common carrier does not constitute "receipt" by the buyer. Dep't Br. at 23-34. Washington disregards the intermediate transfers of possession that occur during the course of transit when goods are shipped by common carrier. This is consistent with the purpose to locate the sale in the "market" state, i.e., the place where the goods are likely to be used or consumed.[17]

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[17] Rule 193 reflects the "destination principle," which assigns an interstate sale to the "destination state" rather than to the "origin state." *See* Hellerstein, *State Taxation*, ¶ 18.02[1] ("The Destination Principle"), ¶ 19A.06[1] ("Sourcing Rules"). The place to which a product is shipped or delivered "is used as a proxy for the market." *Id.* The assumption is that the state of delivery will also be the state in which consumption occurs. *Id.* The Department's interpretative rule on the allocation of an interstate sale is consistent with the sourcing rules of other taxing jurisdictions. For example, under the

In support of its purported distinction between "receipt" and "delivery," Avnet relies on informal internal communications among agency staff that it claims show a "delivery" standard that is materially different from a "receipt" standard. Avnet presents snippets of dialogue relating to a different tax, takes them out-of-context, distorts their meaning, and draws false inferences from them. The internal discussions pertained to a potential conflict between an example in Rule 193 and a model law provision relating to the retail sales tax that has no relevance to any material issue in this case.[18] *See* CP 548 (discussing whether WAC 458-20-193(11)(k) conflicts with a newly adopted sourcing rule adopted pursuant to the Streamlined Sales and Use Tax Agreement (SSUTA), which is a multi-state compact to bring about greater uniformity in the administration of sales and use tax nationwide).

Uniform Division of Income for Tax Purposes Act (UDIPTA), which has been adopted by 46 states, sales are within a state if "the property is delivered or shipped to a purchaser...within [the] state regardless of the f.o.b. point or other conditions of sale." The comments to the uniform law explain that "shipped to or delivered" in the state includes shipments made directly to a person in the state at the direction of the purchaser (i.e. drop shipments). Uniform Division of Income for Tax Purposes Act § 16 ("Situs of Sales of Tangible Personal Property").

[18] Contrary to Avnet's assumption, substituting "delivery" for "receipt" would not necessarily have changed Rule 193 in any material way. *See* CP 573 (""The draft rule defines where a sale occurs in terms of where the goods are delivered. For the most part, this concept is consistent with the destination concept of SSTP, but the Department has not adopted the streamlining terminology since it is not in place yet."). Describing the place of sale in terms of "delivery to" rather than "receipt by" the purchaser would not have changed the triggering event for the sale, i.e., the transfer of physical possession of the goods from the seller to the buyer. *See* Jerome R. Hellerstein & Walter Hellerstein, *State Taxation*, ¶ 19A.0606 (3d ed. 2014) (SSUTA's sourcing rules "embrace the destination principle).

2. WAC 458-20-193(11)(h) is not relevant to this controversy.

Rule 193 provides a number of examples to show how the rule provisions apply in different factual circumstances. *See* WAC 458-20-193(10) (outbound sales); WAC 458-20-193(11) (inbound sales). Avnet claims one of those examples demonstrates that its drop shipment sales were not "received by the purchaser" under the "plain language" of the rule. The example is inapposite because it applies only to drop shipment sales by an out-of-state retailer and it only addresses the retail sales tax.[19]

Rule 193(11)(h) does not apply to Avnet's sales. Avnet claims the example "specifically addresses" its drop shipment transactions and "expressly" provides the goods were not received in Washington. Resp. Br. at 9. Avnet is incorrect. As *Space Age Fuel* makes clear, the examples in Rule 193 should not be applied outside the specific legal and factual context they address. 178 Wn. App. at 608 (firmly rejecting a

[19] The example clarifies that a retailer that lacks nexus with Washington will not be subject to Washington's B&O or retail sales tax merely because it has arranged for the shipment of goods to Washington by a third-party supplier that has nexus with Washington. WAC 458-20-193(11)(h). The example confirms Washington's administration of the retail sales tax to a model rule adopted by the SSUTA providing that a state may not require a third-party supplier, like Avnet, to collect retail sales tax when it delivers goods on behalf of an out-of-state retailer. Moreover, the state may not impose retail sales tax liability on the out-of-state retailer unless it has nexus with the state. But the rule only applies to the retail sales and only to the seller's obligation to collect it. The SSUTA's rule on drop shipments, Rule 317.2, is available online at http://www.streamlinedsalestax.org/uploads/downloads/Rules/Governing%20Board%20Rules%20%20as%20amended%2010_6_11.pdf (last viewed April 29, 2014). *See also* http://www.streamlinedsalestax.org/uploads/downloads/IP%20Issue%20Papers/IP02006_sourcing01_02_clean2_ip_01_02.pdf (sourcing issue paper).

taxpayer's similar attempt to rely on an inapposite example in Rule 193).

If this were a dispute over Avnet's obligation to collect sales tax on the retail sales to the Washington consumers that received the goods, WAC 458-20-193(11)(h) would be on point. But the example does not address the question here, which is whether the third-party supplier is liable for *wholesaling* B&O tax on the wholesale sale it made when it delivered goods in Washington. Clearly, the wholesaling B&O tax would apply to these circumstances, as the Department previously has ruled.[20]

In support of its erroneous interpretation of Rule 193(11)(h), Avnet seizes on internal Department debates about the advisability of clarifying that the wholesaling B&O tax would apply to a third-party supplier like Avnet. Resp. Br. at 9-10. Avnet presents snippets from emails and drafts of internal documents which do not represent the Department's official agency position, while ignoring others that present an opposing point of view.[21] Read in context, it is clear the contemplated revisions were

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[20] The Department has issued an administrative determination on drop-shipment transactions to explain that a third-party supplier that delivers goods to a Washington consumer on behalf of an out-of-state retailer is liable for wholesaling B&O tax on the transaction. *See* Det. No. 08-0111, 27 WTD 221 (2008).

[21] For example, a Department employee who apparently participated in drafting the example Avnet relies on strongly disputed the suggestion that a seller in Avnet's position would not be subject to wholesaling B&O tax under Rule 193(11)(h), stating: "[T]his scenario is only meant to deal with a supplier that is located in Washington...It wasn't meant to cover suppliers located outside of Washington having nexus with Washington. I think it was an oversight that I didn't deal with the out-of-state supplier with nexus, Washington seller, and Washington customer scenario. It seems odd to me that we'd say that the sale from the out-of-state supplier to the Washington seller would

intended to clarify, not change, the Department's position on drop shipment transactions.

B. The Common Law Principle That Receipt By A Purchaser's Designee Is Receipt By The Purchaser Prevails Over Avnet's Overly Restrictive Reading Of The Rule's Receipt Provisions.

Avnet cursorily dismisses the common law authorities the Department relies on to support the proposition that receipt by the purchaser's designee is receipt by the purchaser for B&O tax purposes. Resp. Br. at 15-16. However, it is especially appropriate to apply common law principles to defeat a taxpayer's attempt to avoid the B&O tax by relying on a hyper-technical interpretation that defies common sense. *See Time Oil Co. v. State*, 79 Wn.2d 143, 147, 483 P.2d 628 (1971) (rejecting taxpayer's form over substance argument).

There is no reason common law or commercial law principles do not apply to the extent they are consistent with the state's tax laws. Dept's Br. at 20-21. In *Lamtec*, for example, this Court held that Rule 193's provisions control over inconsistent common law principles regarding the passage of title, ownership or possession in determining the place of sale. 151 Wn. App. at 460. Those provisions disregard the intermediate transfers of possession to and from a common carrier during the course of transit, and locate the sale in the "state of destination." WAC 458-20-

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not be subject to wholesaling B&O tax. It seem[s] that you have the two requirements for a sale: nexus and deliver[y] of the goods in Washington." CP 578.

193(2)(b). Under *Lamtec* and similar authorities, a taxpayer cannot defeat Rule 193's provisions by relying on a shipping contract that provides for the passage of title at the shipping point.

The common law authorities are fully consistent with the Department's rules applicable to the issue in this case, i.e., whether receipt by the purchaser's designee at the shipping destination is receipt by the purchaser. Dep't Br. at 21-22. The common carrier provisions disregard the intermediate transfers of possession *to* a common carrier and *between* common carriers during the course of transit. As *Lamtec* shows, the result is that it is only the *final* delivery – from the "for-hire carrier to consignee" – that constitutes "receipt by the purchaser." *Lamtec*, 151 Wn. App. at 460. *See* WAC 458-20-193(2)(c) (defining "delivery" in terms of transfer of possession from seller to common carriers to consignee) and WAC 458-20-193(7)(a) (transfers of possession to and between common carriers do not constitute "receipt" by the purchaser). The purpose and effect of these provisions is to ensure the sale is located in the "state of destination," i.e., "the place where the purchaser/consignee or its agent receives a shipment of goods." WAC 458-20-193(2)(b).

Read together and in the context of the rule as a whole, these provisions are consistent with the common law principle that receipt by the purchaser's designee is receipt by the purchaser. Dep't Br. at 19-21.

C. Rule 193's "Agency" Provisions Are Inapposite Because The Goods Were Received By The Purchaser/Consignee.

Avnet contends the Department "completely ignores Rule 193's very strict limitations on a purchaser's ability to designate an agent to receive goods on the purchaser's behalf." Resp. Br. at 13. But it is undisputed that the drop shipment sales involve goods that were shipped into the state by common carrier and delivered to the consignee in Washington. *See* CP 199. In order to "dissociate" those sales from its Washington business activities, Avnet has the burden to prove the goods were physically delivered to the purchaser at a point outside the state before arriving at the shipping destination.

Avnet claims the consignee could not have been the purchaser's "agent" because Rule 193 requires "express written authority to inspect and accept or reject goods" to establish agency status. Resp. Br. at 13-14. But that requirement only applies when a seller claims the sale occurred outside Washington even though the goods were shipped into Washington. *See* WAC 458-20-193(4)(b), WAC 458-20-193(7)(b). It does not follow that a seller may rely on the *absence* of such "express written authority" to *disprove* the existence of a Washington sale when the goods were shipped into Washington.

When goods are shipped in interstate commerce by common carrier, the consignee is by operation of law authorized to receive the goods at the shipping destination. *CSX Transp. Co. v. Novolog Bucks Cnty.*, 502 F.3d 247, 257-58 (3rd Cir. 2007). Avnet's customer is the person who ordered the goods, provided the name and address of the person who was to receive the goods, and undertook the contractual obligation to pay for the goods. Where goods are shipped into Washington by common carrier, nothing more is required to prove that the goods were received in Washington by the purchaser or its agent. *Cf. D.H. Holmes*, 486 U.S. at 32 (for a taxpayer to claim it lacked sufficient control or dominion over the products to be considered the buyer "verges on the nonsensical" under such circumstances).

For all these reasons, this Court should reject Avnet's argument that receipt by the consignee did not constitute receipt by the purchaser for purposes of Rule 193.

D. Avnet Cannot Avoid The B&O Tax By Relying On "The Technicalities Of The Transfer Of Title And Possession."

Finally, this Court should reject Avnet's attempt to avoid the B&O tax on its drop shipment sales by parsing snippets of Rule 193's "receipt" provisions. The rule can and should be read as providing that goods are "delivered to" or "received by" the buyer in this state within the meaning

of Rules 103 and 193, respectively, when the goods are shipped into Washington by common carrier and delivered to the buyer's "consignee." This interpretation of the rule's provisions is reasonable and should prevail over Avnet's proposed interpretation.

Accordingly, this Court should reject Avnet's reliance on the "technicalities of the transference of title and possession" and hold that Washington's wholesaling B&O tax applies to Avnet's drop shipments transactions. *Cf. Time Oil*, 79 Wn.2d at 147.[22] As in *Time Oil*, "[t]o hold otherwise would be to exalt form over substance, and would import an exemption into the tax statutes where none now exists." *Id.*

It is particularly appropriate to reject Avnet's "form over substance" arguments in this case because, as the United States Supreme Court said in a similar dispute, when addressing commerce clause issues, the courts "are dealing ... with matters of substance, not with dialectics." *International Harvester*, 322 U.S. at 347.

It does not matter that Avnet's customer did not, itself, take physical possession of the goods. In substance, Avnet's wholesale sales

[22] Avnet tries to dismiss *Time Oil*, asserting it "did not consider or discuss where receipt by the purchaser occurs." Resp. Br. at 13, n.2. Avnet misses the point of *Time Oil*. The issue was whether Time Oil could avoid the B&O tax on those barter transactions where it did not, itself, transfer "title, ownership or possession" of property to the buyer. 79 Wn.2d at 145-46. Just as Time Oil tried to parse the statutory definition of a "sale," Avnet tries to parse the "receipt" provisions of Rule 193. The principle that a court should reject such "technicalities" in favor of a practical application of the B&O tax has even more force in the context of a taxpayer's parsing of an interpretive rule, which does not have the force of law. *See Space Age Fuel*, 178 Wn. App. at 608.

are properly assignable to Washington because the goods were shipped into this state for use or consumption.

V. CONCLUSION

The Court should hold that neither Rule 193 nor the Commerce Clause allows Avnet to avoid the wholesaling B&O tax on any of its Washington destination sales. Avnet's Washington destination sales occurred in Washington for B&O tax purposes because the goods were physically delivered in Washington to the person designated by the buyer. Moreover, Avnet has nexus with Washington by virtue of its instate business activities. Thus, Avnet cannot meet its burden of proving the "dissociation" of any of its drop shipment sales, much less its "National" sales of goods delivered to the Washington office of an out-of-state buyer.

RESPECTFULLY SUBMITTED this 21st day of May, 2014.

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

DATED this 1st day of May, 2014, at Tumwater, WA.

Julie Johnson, Legal Assistant

WASHINGTON STATE ATTORNEY GENERAL

May 01, 2014 - 4:26 PM

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