96137-9

No. 50057-4-II

SUPREME COURT OF THE STATE OF WASHINGTON

Warehouse Demo Services, Inc.,

Appellant,

v.

State of Washington, Department of Revenue,

Respondent.

PETITION FOR REVIEW

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I. IDENTITY OF PETITIONER AND INTRODUCTION

Warehouse Demo Services, Inc. ("WDS", or "Taxpayer") requests this Court to review the Court of Appeals Div. II unpublished opinion.

The first question is whether the Court erred when it found that the Board of Tax Appeals (BTA) did not have sufficient evidence to find facts to conclude the presence of an agency. The second and perhaps more pressing question is whether the Court has created a conflict in the law with its holding that the BTA did not have sufficient evidence to find facts sufficient to conclude the presence of an agency. In other words, it has effectively held that WDS can be an agent for one B&O tax purpose (establishing nexus for an out-of-state principal) but not be an agent for another B&O tax purpose (reducing the agent's tax measure) even though WDS was doing the same activity in both situations: demonstrating products with the hope of generating sales for the vendors' products. In neither case is "agent" defined by statute or rule for purposes of this question.

Both the BTA and the superior court found that WDS was an agent for B&O tax purposes. The court found there was insubstantial evidence to support the BTA's conclusion that WDS acted as the agent of product vendors.

Although WDS contends that there WAS substantial evidence to

support the BTA's conclusion, WDS also argued that it performed activities that helped the product vendors establish or maintain a market for its products. Under WAC 458-20-193 ("Rule 193"), a product vendor ("Vendor") has an agent in the state if that agent establishes or maintains a market for the Vendor's product.

WDS demonstrates Vendor's product samples at Costco stores in Washington. The demonstrations' purpose is to establish or maintain a market for the Vendors. Under Rule 193, WDS is the Vendors' agent that makes the Vendors taxable in Washington.

WDS claimed a refund of taxes overpaid, because RCW 82.04.290(2)(b) allows agents to exclude from the tax measure the value of samples furnished by principal or supplier to be used for promotional purposes. The Court of Appeals held that there was insubstantial evidence to support a conclusion that WDS was an agent for purposes of RCW 82.04.290(2)(b).

As a result of the Court opinion, there is an irregularity in that WDS is not an agent for purposes of RCW 82.04.290(2)(b), but it would be an agent for purposes of Rule 193. Neither the statute nor the rule defines "agent." There is no logical reason for WDS to be an agent for one B&O tax purpose but not an agent for a different B&O tax purpose. Either WDS is an agent and is entitled to the refund or it is not an agent

and out-of-state sellers are entitled to seek refunds if they have been assessed B&O tax because of the Rule 193 nexus rules.

This matter warrants review by this Court, because this is an issue of substantial public interest and forms a basis for review as provided in RAP 13.4(b)(4).

II. COURT OF APPEALS DECISION

WDS asks this Court to accept review of the unpublished opinion dated March 20, 2018 (the "Opinion"). WDS moved to publish and for reconsideration. The Court denied both motions on June 27, 2018. Copies of the Opinion and order on both motions are attached as Appendices A & B, respectively.

III. ISSUES PRESENTED FOR REVIEW

1. Did the Court of Appeals err when it overturned the BTA's conclusion of law that WDS acted as agent of principals under RCW 82.04.290(2)(b) because there was not substantial evidence that WDS was an agent of the sellers ("Vendors")?
2. Did the Court of Appeals err when it failed to apply the Department of Revenue's Rule 193 that concludes that if a person helps or maintain a market for a Vendor then that person is an agent of that Vendor?

IV. STATEMENT OF THE CASE

1. WDS Engages in Product Demonstration.

WDS demonstrates products at Costco stores in various regions, including Washington State. CP 14 (FOF 2). The BTA specifically found: "Such companies as General Mills, Heinz, Foster Farms, Nestlé, and many others hired the Taxpayer to demonstrate and promote their food products to Costco shoppers." *Id.*

WDS was required to "coordinate all product demonstrations of food and non-food products in Costco warehouses ... in particular ... [a]ct as liaison among Costco buyers and warehouse managers, and Vendors." CP 15 (FOF 3.1). Further, "[a]ll merchandise and supplies for use in [the Taxpayer's] Demos ... be supplied by Vendors or [the Taxpayer]" under the agreement that WDS had with Costco. CP 15 (FOF 3.3). Although WDS and the Vendors did not have a written agreement, the "Vendors contacted the Taxpayer directly to schedule the Taxpayer's services." CP 15 (FOF 4).

The services included "setting up and using product displays in Costco shopping aisles, distributing free product samples and written materials to Costco shoppers, and answering the shoppers' questions about the products." CP 15 (FOF 6). WDS's interaction with Costco shoppers

"typically included signs, pictures, nutritional information, and other product information." CP 15-16 (FOF 6.1).

The services also included "heating food, if necessary, and dividing food products into sample-sized portions. The purpose of the Taxpayer's demonstration services was to entice Costco's shoppers to purchase the vendors' products" CP 16 (FOF 6.2).

The Vendors did not directly sample products to WDS. Instead, for logistic purposes, Costco, the Vendors and WDS entered into a "purchase-and-repayment" arrangement "to facilitate the most efficient transfer of the vendors' demonstration products to the Taxpayer." CP 17 (FOF 11). The BTA found that "[t]he Taxpayer purchased the product to be demonstrated from the Costco store where the demonstration was scheduled to take place. The Taxpayer's purchase of the food product from the Costco store where the demonstration was to occur was logistically more reasonable than having the vendor deliver the product...." CP 16 (FOF 7). The parties benefitted from this arrangement because "the amount of the product used was variable; the typical product was perishable and required refrigeration and/or freezing; and the Taxpayer's on-site purchase ensured that the Costco shopper would be sampling a product that was for sale in that Costco store." *Id.* After the demonstrations, WDS billed the Vendors to be repaid for the amounts that

it paid to Costco for the products. CP 16 (FOF 9). WDS made no profit on the amounts it billed and received from the Vendors. CP 17 (FOF 11). The WDS invoices itemized the charges for the Costco location where the demonstration occurred. CP 16 (FOF 9.1). The invoice identified the product demonstrated. CP 16 (FOF 9.2). It also itemized what product was purchased for demonstration. CP 16 (FOF 9.4). The Vendors paid their invoices and WDS recorded the payments in its books and records. CP 17 (FOF 10, 10.1 and 10.2).

2. The BTA and Trial Court found that WDS was an Agent.

The BTA made fifteen findings of fact and nineteen conclusions of law. The BTA concluded "that the phrase 'demonstration ... materials ... furnished to an agent by his or her principal' means the necessary materials that were in some way supplied or provided to the agent by the principal." CP 20-21 (COL 13.3). The BTA concluded that "the facts, either expressly or by inference, establish that one person is acting at the instance of and in some material degree under the direction and control of the other." CP 21(COL 14.2). It also found that agency "may be proved by facts and circumstances, or in other words, by circumstantial evidence." *Id.* The BTA concluded that "[t]he vendor engaging the Taxpayer exercised control over the Taxpayer's purchase of the product to be demonstrated: the vendor, not the Taxpayer, selected the product to be

demonstrated, and the vendor authorized the Taxpayer to purchase the product at Costco in amounts meeting the Costco shoppers' demands." CP 21 (COL 14.3). It also concluded that WDS "acted as the vendor's substitute, purchasing the product on site." *Id.* The trial court upheld the BTA's findings and conclusions.

3. The Court of Appeals Holding in this matter.

The Court found that "[c]onsidering all of the Board's factual findings, its findings do not establish that Warehouse Demo was under the direction and control of each of its vendors to any material degree. As a result, Warehouse Demo fails to show that it performed its product demonstrations subject to its vendors' control." Opinion at 8.

The Court found that the law requires "that a principal have control over the agent means that there must be facts and circumstances that establish 'one person is acting at the instance of and in some material degree under the direction and control of the other.'"[1] Opinion at 6-7. Although the BTA found the facts described above, the Court rejected those facts as supported for the BTA's conclusion of law that the Vendors' direct contact with WDS to perform demonstration services, the Vendors' selection of the product to be demonstrated and the authorization to

[1] Citing to *Wash. Imaging Servs., LLC v. Dep't of Revenue*, 171 Wn.2d 548, 562, 252 P.3d 885 (2011)

purchase the sample products inferred agency. Opinion at 7-8. It did so because "[a]lthough Warehouse Demo's vendors generally provided promotional and marketing materials for its product demonstrations, there is no finding that any of the vendors controlled the manner in which Warehouse Demo conducted its demonstrations, or managed and supervised the product information shared by Warehouse Demo or otherwise exhibited control over the demonstrations." Opinion at 8. It also concluded that the "findings do not establish that the vendors selected the product Warehouse Demo would demonstrate or that the vendors authorized Warehouse Demo's purchase of the demonstration product. Moreover, the findings of fact do not contain any facts specific to any of Warehouse Demo's vendors." *Id.*

V. ARGUMENT IN FAVOR OF REVIEW

1. The Court of Appeals erred when it found that there was no evidence to support the conclusion that the Vendors controlled WDS.

First, the Court erred when it found that there were no findings that the Vendors selected the products that would be demonstrated. A reasonable inference of the facts does not support that conclusion. A reasonable inference from the BTA record is that the Vendor picks WDS should demonstrate. After all, the Vendors contacted WDS regarding when to demonstrate products. CP 15 (FOF 4). It is not a reasonable

inference that the Vendors left to WDS discretion which products to demonstrate. The BTA found that under the Costco agreement, WDS would demonstrate all merchandise and supplies used by WDS to be supplied by Vendors or WDS. CP 15 (FOF 3.3). It found that the Vendors provided promotional materials for WDS. CP 15-16 (FOF 6.1). If the Vendors supplied the merchandise, supplies *and the promotional, materials*, then a reasonable inference is that the Vendors selected the products for demonstration. It would defy logic for a Vendor to have supplied chicken nuggets and related promotional material and then be willing to repay WDS for demonstrating beef stir-fry kits. Why would the Vendor supply promotional material for nuggets but pay for beef stir-fry kits?

The Court found that there was no evidence that the vendors authorized WDS to purchase the sample products. A reasonable inference from the facts support that the Vendors did authorize the purchase. First, there was an agreement that the Vendors would reimburse WDS for the demonstration products purchased. CP 14 (FOF 7) and CP 17 (FOF 11). Second, the Vendors paid the invoice. CP 17 (FOF 10.1 and 10.2).

Whether there was an expressed agreement for the repayment, the Vendors did repay WDS (this is what forms the refund amount). The BTA saw invoices with itemized billing. Why would the Vendors pay

invoices if they did not previously agree with the service? The Vendors' conduct is consistent with an agreement, not the absence of an agreement.

Finally, the Court also found that there were no findings providing specifics of any Vendor. That is inaccurate. The BTA did make a finding about various Vendors that WDS serviced. CP 14 (FOF 2). The BTA reviewed sample invoices with vendor-specific detail that supported its findings regarding the Vendors.[2] CP 16-17 (FOF 9, 9.1, 9.2, 9.3, 9.4, 9.5 and 9.6). These invoices identified the Vendors by the customer number, Vendor's contact person, a fax number, invoice number and invoice date. That should be sufficient detail to identify the Vendors.[3]

None of the factual points that the Court found to be deficient is a reasonable interpretation of the BTA's factual record. The Court was obligated to review the facts and circumstances and then conclude whether such evidence would persuade a fair-minded person that the findings of facts are true:

> We review the findings of fact in Skagit Valley's case under the substantial evidence standard of RCW 34.05.570(3)(e). We uphold findings supported by *evidence sufficient to persuade a fair-minded person* of the declared premise's truth. Heinmiller v. Dep't of Health, 127 Wash.2d 595, 607, 903 P.2d 433, 909 P.2d 1294 (1995), cert. denied,518 U.S. 1006, 116 S.Ct. 2526, 135 L.Ed.2d 1051 (1996). *We view the evidence in the light most favorable to the party who prevailed in the administrative forum.* City of Univ.

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[2] *See* BTA Clerks Papers to Thurston County, BTA CP 278-288.
[3] *Id.*

> Place v. McGuire, 144 Wash.2d 640, 652, 30 P.3d 453 (2001). Accordingly, we accept the fact finder's determinations of the weight given to reasonable but competing inferences. McGuire, 144 Wash.2d at 652, 30 P.3d 453; Sec. Pac. Bank, 109 Wash. App. at 803, 38 P.3d 354.

Skagit County Pub. Hosp. Dist. No. 1 v. Dept. of Revenue, 158 Wn. App. 426, 242 P.3d 909 (2010). The court failed to do that.

Viewing the facts in the light most favorable to WDS, there is *no* evidence that WDS independently decided when and what to demonstrate and how much to charge. There *is* evidence that Vendors contacted WDS to identify when, where, and what to demonstrate; they provided promotional material for the product samples; and they paid the invoices with the details of the quantities of what WDS demonstrated on the Vendors' behalf. The product repayment was at cost and with no mark-up for profit. Viewing the evidence in a light most favorable to WDS leads one to conclude that there are sufficient facts to supports the BTA's findings of fact and conclusions of law. The Court erred when it failed to find that the BTA properly found sufficient facts that WDS acted as the Vendors agent.

Furthermore, the law doesn't the Court's conclusions. The agency analysis involves more than factors that the court claimed to be absent. Rather, the law requires that *all* the facts and circumstances be considered;

the parties' actions and conduct can create an implied agency. An implied agency is given the same status as an explicit agency:

> Through their actions, conduct and words, the parties may bring into existence an implied agency, despite their intention that this not come to pass. But, being implied in either law or fact, it is no less a true agency and carries with it all of the legal responsibilities arising from an agency created by explicit agreement. *Turnbull v. Shelton,* 47 Wash.2d 70, 286 P.2d 676; *Freeman v. Navarre,* 47 Wash.2d 760, 289 P.2d 1015.

Busk v. Hoard, 65 Wn.2d 126, 134, 396 P.2d 171, 175 (1964). In *Busk*, the relevant agreement "categorically denied the existence of any agency relationship between them." *Id.* at 128. Yet, the Court reviewed the totality of the facts and circumstances, applied the test quoted above, and found an agency to exist. Viewing the totality of the facts, the Vendors contacted WDS to demonstrate their products and provided the promotional material for WDS to give to Costco's customers. The relationship required WDS to coordinate the demonstrations and to act as the liaison among Costco buyers, warehouse manager, and *Vendors*. The Vendors expected WDS to *setup and use the product displays*, provided by the Vendors, at the Costco locations. The Vendors expected WDS to heat food and divide it into sample-sized portions. The Vendors' intent was for WDS to increase sales of the Vendors' products. The Vendors and WDS entered into the repayment arrangement as a matter of logistics, because the sample amounts would vary on a given day, the products were

typically perishable, and the Costco customers would know that the sample is exactly the same product that is in the Costco coolers. WDS billed the Vendors and the Vendors then repaid WDS for the samples. This is more than sufficient evidence, in a light most favorable to WDS, that facts exist to support the BTA's legal conclusion of agency. The totality of the evidence supports the presence of an agency, not the absence of an agency. The Court of Appeals erred and its decision should be reversed.

2. The Court of Appeals erred when it failed to follow the Department's Rule 193 to determinate agency.

The Court creates a serious conflict. Under RCW 82.04.290(2)(b), the Opinion concludes that WDS is *not an agent* when WDS is demonstrating the Vendors' products in Washington while establishing or maintaining a market for the Vendors. The BTA found that was the precise purpose for the demonstrations, to "promote their [Vendors'] food products." CP 14 (FOF 2). However, under Rule 193, if an agent helps the out-of-state vendor establish or maintain a Washington market for vendors, then WDS *would be an agent*. Consequently, applying these principles in this case, WDS is not an agent for RCW 82.04.290(2)(b) but is an agent for Rule 193 even though it is same activity for both purposes.

Either WDS is an agent in both cases, or not an agent in both cases. The inconsistency cannot be explained away.

The Court did not address Rule 193. WDS moved to publish its Opinion, arguing that the Court should publish it because out-of-state vendors should be aware that the court disagrees with the Rule 193 standard for agency. The motion was denied. WDS also moved for reconsideration to explain the reason why this unequal treatment is proper, but that motion was denied as well.

Rule 193(102)(a)(iii) explains that if an agent helps a seller establish or maintain a Washington market, then that agent has created nexus for that seller. The Department has found that such activity *alone* is sufficient to establish an agency. In Det. No. 86-303, 2 WTD 43 (1986)[4] (Appendix C),[5] the taxpayer made wholesale sales of food to related entities: "... Tax was assessed based on the activities of the parent's and affiliated companies' activities when setting up the franchises and the ongoing consulting activities of the affiliated company." 2 WTD at 45. The Department held that the parent's and the franchisees' instate activities helped the taxpayer establish or maintain a market, specifically noting that "Certainly the evidence supports finding that [the franchisor

[4] Online at http://taxpedia.dor.wa.gov/documents/current%20wtds/2wtd43.pdf
[5] WTDs are written determinations designated by the Director to be precedent. RCW 82.32.330(3)(j)

company or parent] served as the taxpayer's *agent* in processing the [product] orders at issue." *Id.* at 49 (italics supplied). Aside from the parent's and the franchisees' activities, there was no agency agreement or other evidence of the taxpayer controlling the parent or the franchisees. Yet, the Department found an agency to exist.

In Det. No. 94-074E, 14 WTD 085 (1994) (Appendix D)[6], a taxpayer hired an independent, third-party inspector to "certify the quantity and quality of the product purchased and sold in Washington." *Id.* at 86 and 89. The taxpayer purchased, sold, and exchanged petroleum products. Washington assessed the taxpayer on the transactions in Washington even though the taxpayer had no physical presence in Washington. The Department observed that "[t]he role played by the inspectors was significant to the taxpayer's sales in the state. The taxpayer must know the quantity and quality of what it acquires as well as what it sells. This assurance is essential to maintain its sales in the state." *Id.* at 90. The Department then concluded:

> The taxpayer paid for the inspectors' services. *They were the taxpayer's agents.* They performed a significant service necessary to maintain the taxpayer's sales in the state. Under Rule 193(7)(c)(v) such activity is sufficient nexus for the B&O tax to apply. Taken together, the taxpayer's possession of the product and inspection *by its agents* clearly establish contacts sufficient to subject its Washington sales to B&O tax. The activities

[6] Online at http://taxpedia.dor.wa.gov/documents/current%20wtds/14wtd85.pdf

> correspond to examples (i), (iv), and (v) in subsection (7)(c) of Rule 193. (Italics supplied.)

Ibid. Again, there was no evidence that the taxpayer controlled, supervised, or inspected the inspector's activities in Washington.

In Det. No. 96-147, 16 WTD 117 (1996) (Appendix E)[7], the taxpayer had no physical presence in Washington; its business was home sales. It hired Regional and District Managers who in turn contracted with Supervisors. The Supervisors engaged Hostesses who held home parties. The Hostesses received "free gifts" for displaying the taxpayer's products in their homes. The taxpayer argued that it lacked taxable nexus, because it had no physical presence in Washington. The Department explained that if a seller has activity in the state that helps it establish or maintain a market in the state, then nexus exists. The taxpayer argued that the downstream sellers were not agents; instead, they were retailers selling product that they purchased from the taxpayer. The Department rejected that argument: "[t]he Hostesses are the taxpayer's *agents*." *Id.* at 123. (Italics supplied.)

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[7] Online at http://taxpedia.dor.wa.gov/documents/current%20wtds/16wtd117.pdf (formatting as appears on as the Department's website)

In Det. No. 08-0158ER, 29 WTD 10 (2010) (Appendix F)[8], two subsidiaries were registered insurance companies. The taxpayer provided pharmacy services for them. The Department described Subsidiary A:

> The facts clearly establish that representatives of [Subsidiary A] perform activities significantly associated with [the taxpayer's] ability to maintain a market in Washington for its sales. [Subsidiary A] has employees and representatives soliciting sales of insurance in this state. *These agents and representatives distribute brochures to customers containing information about the benefits of ordering from [the taxpayer]. The brochures also direct subscribers to [Corporation's website], which contains additional descriptive information about [the taxpayer] and a link to [the taxpayer's] website*... Currently ... subscribers can order drugs from within [Corporation's] secure site. The distribution of this information and making representations about its quality is a significant service in relation to the establishment and maintenance of sales into this state.

Id. at 16 (italics supplied). Their agreement rejected that the subsidiaries acted as an agent or representative; the Department cited to no evidence that the taxpayer controlled Subsidiary A. Nevertheless, the Department concluded:

> We conclude that [Subsidiary A's] marketing of the taxpayer to subscribers in this state is significantly associated with the taxpayer's ability to establish and maintain a market in this state and therefore confers nexus. We are not convinced by the taxpayer's argument that [Subsidiary A] markets the taxpayer in this state solely on its own behalf, and not pursuant to some agency or representative relationship or agreement with the taxpayer. Accordingly, we sustain the assessment and deny the petition for reconsideration.

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[8] Online at http://taxpedia.dor.wa.gov/documents/current%20wtds/29wtd10.pdf

Id. at 18. Here, the Department concluded that Subsidiary A distributed brochures and marketed the taxpayer, which was enough to establish that the marketer was an agent or representative of the taxpayer.

The Department has not followed the Court's strict control analysis of what constitutes an agent under Rule 193(102)(a)(iii). It has done just the opposite, looking *only* at whether the marketer in the state is helping establish or maintain a market for the vendor. Similarly, Det. No. 10-0057, 30 WTD 82 (2011) (Appendix G) follows the *Borders Online, LLC v. State Bd. Of Equalization*, 129 Cal. App. 4th 1179, 29 Cal. Rptr.3d 176 (Cal. App. 2005). In 30 WTD 82, an out-of-state mail order retailer argued that its related corporation that operated retail stores in Washington was not an agent representing the taxpayer in the state. The instate corporation (1) bought the taxpayer's catalogs and distributed them in Washington; (2) sold gift cards that can be used to pay for goods sold by the taxpayer; and (3) would accept returns on items sold by the taxpayer, even though the instate retailer had a company policy that the instate retailer would not accept returns of goods sold by the online store. No evidence supported that the taxpayer controlled any part of what the instate retail store did, but the Department found that an agency existed. It did so because "[t]he creation of an agency or representative relationship can be implied based on conduct, circumstances, or ratification," citing to

Borders. *Id.* at 87-88. The "cross-selling synergy" established sufficient facts to authorized representative significantly help the seller establish or maintain a market for its goods. *Id.* at 88.

In each of these cases, the Department found an agent or representative if that person helped the taxpayer establish or maintain a market as explained in Rule 193(102)(a)(iii). As the Court observed (Opinion at 3), the BTA found that WDS demonstrated the vendors' products. CP 16. The vendors provided promotional and marketing materials to WDS to be displayed during demonstrations. *Id.* The BTA also made found that "...General Mills, Heinz, Foster Farms, Nestle, and many others *hired* the Taxpayer to demonstrate and promote their food products to Costco shoppers." CP 14 (italics supplied). The BTA also made Finding of Fact 6 that WDS set up displays in the Costco aisles, distributed free product samples and written materials to Costco shoppers. CP 15. The BTA also made Finding of Fact 6.1 that WDS "distributed signs, pictures, nutritional information and other product information" to Costco Shoppers. CP 13-14. Finally, the BTA also made Finding of Fact 6.2 that WDS prepared food samples and that the purpose of the demonstration "was to entice Costco shoppers to purchase the vendors' products." CP 16. These findings of facts have been routinely sufficient

for the Department to find the existence of an agent. They are sufficient in this case as well.

The Court's unpublished Opinion requires evidence that "the product vendors controlled the manner in which WDS conducted the demonstrations, or managed and supervised the product information shared by WDS, or otherwise exhibited control over the demonstrations." Opinion at 8. This holding conflicts with the Department's administration of Rule 193(102)(a)(iii) that looks at whether the activity helps make a market.

The Court of Appeals failed to explain this disconnection of RCW 82.04.290(2)(b) and 193(102)(a)(iii), and it should have done so.

VI. CONCLUSION

This Court should accept review to clarify the conflict the Opinion presented by the Court.

RESPECTFULLY SUBMITTED this 26th day of July, 2018.

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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 at Tacoma, Washington this 26th day of July, 2018.

Cindy C. Rochelle, Legal Assistant

APPENDIX A

Filed
Washington State
Court of Appeals
Division Two

March 20, 2018

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

WASHINGTON STATE DEPARTMENT OF REVENUE, Appellant, v. WAREHOUSE DEMO SERVICES, INC., Respondent.	No. 50057-4-II UNPUBLISHED OPINION

WORSWICK, J. — The Department of Revenue (Department) appeals an order granting Warehouse Demo Services Inc.'s (Warehouse Demo) tax refund claim. Warehouse Demo corresponded with various food vendors to provide demonstrations and free samples of the vendors' products to Costco patrons. As part of this arrangement, Warehouse Demo purchased the products necessary for the demonstrations of the vendors' products from Costco and was later reimbursed by the vendors for the total cost of the product purchased.

Warehouse Demo filed a tax refund claim with the Department, arguing that the amount it received from its vendors for demonstration products was exempt from Washington's business and occupation (B&O) tax, chapter 82.04 RCW, under RCW 82.04.290(2)(b). The Board of Tax Appeals (Board) issued a final decision granting Warehouse Demo's claim.

The Department appeals, arguing that the Board erred in granting Warehouse Demo's tax refund claim because the Board misapplied the law in concluding that Warehouse Demo was an agent of its vendors. We determine that the Board's findings of fact do not support its

conclusion that Warehouse Demo had an agency relationship with its vendors. Accordingly, we reverse the Board's final decision granting Warehouse Demo's tax refund claim.

FACTS

Warehouse Demo performed demonstrations and provided samples of products from various food vendors in Costco locations throughout the Pacific Northwest and California. A written agreement between Warehouse Demo and Costco stated that Warehouse Demo performed the demonstrations at Costco locations on behalf of Warehouse Demo's vendors.

Before performing a product demonstration on behalf of a vendor, Warehouse Demo would purchase the vendor's product from the Costco where the demonstration was to be performed. After the demonstration, Warehouse Demo would send the vendor an invoice for the exact amount Warehouse Demo paid for the vendor's product, and the vendor would submit repayment. From 2006 until 2011, Warehouse Demo recorded the repayment from its vendors as gross revenue and paid B&O tax on the repayment amount.

In 2011, Warehouse Demo submitted a tax refund claim to the Department, arguing that its vendors' repayments for the demonstration products were not subject to the B&O tax. Under the B&O tax scheme, B&O tax is imposed on "all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class." Clerk's Papers (CP) at 18. RCW 82.04.290(2)(b) provides certain exemptions from the B&O tax:

> This subsection (2) includes, among others, and without limiting the scope hereof (whether or not title to materials used in the performance of such business passes to another by accession, confusion or other than by outright sale), persons engaged in the business of rendering any type of service which does not constitute a "sale at retail" or a "sale at wholesale." The value of advertising, demonstration, and promotional supplies and materials *furnished to an agent by his or her principal* or supplier to be used for informational, educational, and promotional purposes is not

> considered a part of the agent's remuneration or commission and is not subject to taxation under this section.

(Emphasis added.)

The Department and its appeals division denied Warehouse Demo's claim. Warehouse Demo then appealed the Department's denial to the Board. Following an evidentiary hearing, the Board entered its final decision, which included findings of fact and conclusions of law. The Board found that vendors directly contacted Warehouse Demo to perform demonstrations of the vendors' products. Warehouse Demo's vendors provided promotional and marketing materials to be displayed during the demonstrations, and Warehouse Demo purchased the products to be used in its demonstrations from Costco. The Board found that Warehouse Demo "billed the vendors for the vendor's own products, charging the vendors the exact amount [Warehouse Demo] had paid for the products" and that Warehouse Demo did not make a profit from the vendors' repayments. CP at 16.

The Board concluded that Warehouse Demo and its vendors had an agency relationship. The Board reasoned that the vendors exercised control over Warehouse Demo's actions because the vendors directly contacted Warehouse Demo to perform the demonstrations, selected the product that Warehouse Demo demonstrated, and authorized Warehouse Demo's purchase of the demonstration product. As a result, the Board concluded that the facts and circumstances showed that there was an inferred agency relationship between the principal, the vendors, and their agent, Warehouse Demo.

The Board granted Warehouse Demo's tax refund claim, ultimately concluding that the amount Warehouse Demo's vendors repaid it for the demonstration supplies was exempt from B&O taxes under RCW 82.04.290(2)(b). The Department filed a petition in superior court

seeking judicial review of the Board's final decision. The superior court entered an order affirming the Board's grant of Warehouse Demo's tax refund claim. The Department appeals.

ANALYSIS

The Department argues that the Board erred in granting Warehouse Demo's tax refund claim because the Board misapplied the law in concluding that Warehouse Demo was an agent of its vendors. We determine that the Board's findings of fact do not support its conclusion that Warehouse Demo had an agency relationship with its vendors and reverse the Board's final decision.[1]

I. STANDARD OF REVIEW

Appeals from the Board are governed by the Administrative Procedure Act (APA), chapter 34.05 RCW. *Steven Klein, Inc. v. Dep't of Revenue*, 183 Wn.2d 889, 895, 357 P.3d 59 (2015). Under the APA, we review the Board's findings of fact for substantial evidence. *Steven Klein, Inc.*, 183 Wn.2d at 895. Evidence is substantial where it is sufficient to persuade a fair-minded, rational person of the finding's truth. *Raven v. Dep't of Soc. & Health Servs.*, 177 Wn.2d 804, 817, 306 P.3d 920 (2013). Unchallenged findings of fact are verities on appeal. *City of Spokane v. Dep't of Revenue*, 145 Wn.2d 445, 451, 38 P.3d 1010 (2002). We review the Board's conclusions of law de novo to determine whether the Board correctly applied the law

[1] Because we hold that the Board erred in granting Warehouse Demo's tax refund claim because the Board's findings of fact do not support its conclusion that Warehouse Demo was an agent of its vendors, we do not address the Department's arguments that the Board erroneously interpreted RCW 82.04.290(2)(b) in concluding that B&O tax exemption for the "value" of demonstration products includes repayment for the products and that the demonstration products were "furnished" to Warehouse Demo by its vendors.

and whether the Board's findings of fact support its conclusions of law. RCW 34.05.570(3)(d); *Hardee v. Dep't of Health & Soc. Servs.*, 152 Wn. App. 48, 55, 215 P.3d 214 (2009).

II. AGENCY RELATIONSHIP CONCLUSION OF LAW

As an initial matter, the Department asserts that the Board's conclusion of law that an agency relationship existed between Warehouse Demo and its vendors was a mislabeled finding of fact. Although not explicitly stated, Warehouse Demo appears to concede that the Board's conclusion was a mislabeled finding. We reject the Department's argument.

A finding of fact mislabeled as a conclusion of law will be treated as a finding of fact. *Ives v. Ramsden*, 142 Wn. App. 369, 395 n.11, 174 P.3d 1231 (2008). A finding of fact is a determination that concerns whether the evidence shows that something occurred or existed. *Inland Foundry Co., Inc. v. Dep't of Labor & Indus.*, 106 Wn. App. 333, 340, 24 P.3d 424 (2001). A conclusion of law is a determination made by a process of legal reasoning from facts in evidence. 106 Wn. App. at 340.

In its final decision, the Board concluded that Warehouse Demo and its vendors had an agency relationship. The Board reasoned that the vendors exercised control over Warehouse Demo's actions because the vendors directly contacted Warehouse Demo to perform the demonstrations, selected the product that Warehouse Demo demonstrated, and authorized Warehouse Demo's purchase of the demonstration product. As a result, the Board concluded that the facts and circumstances showed that there was an inferred agency relationship between the vendors and Warehouse Demo.

Here, the Board considered the facts and circumstances in evidence—vendors directly contacted Warehouse Demo to perform the demonstrations and remitted payment to Warehouse Demo for the demonstration product—and applied legal reasoning to determine that those facts and circumstances demonstrated that an agency relationship existed. As a result, the Board's determination that an agency relationship existed was a conclusion of law. *See O'Brien v. Hafer*, 122 Wn. App. 279, 284, 93 P.3d 930 (2004). We therefore reject the Department's argument.

III. AGENCY RELATIONSHIP

Because we conclude that the Board did not mislabel its conclusion of law that an agency relationship existed between Warehouse Demo and its vendors, we review whether the Board's findings of fact support its conclusion. We determine that the Board's findings do not support its conclusion that Warehouse Demo had an agency relationship with its vendors.

RCW 82.04.290(2)(b) provides exemptions from the B&O tax for "[t]he value of advertising, demonstration, and promotional supplies and materials furnished to an agent by his or her principal." Chapter 82.04 RCW does not define the term "agent." Because there is no legislative statement to the contrary, we use the common law definition of agency in determining whether Warehouse Demo was an agent of its vendors for purposes of RCW 82.04.290(2)(b). *See, e.g., Rho Co. v. Dep't of Revenue*, 113 Wn.2d 561, 573, 782 P.2d 986 (1989).

The burden of establishing an agency relationship rests upon the party asserting its existence. *O'Brien*, 122 Wn. App. at 284. An agency relationship generally arises when two parties consent that one party, an agent, shall act on the other party's, the principal's, behalf and subject to their control. *Wash. Imaging Servs., LLC v. Dep't of Revenue*, 171 Wn.2d 548, 562, 252 P.3d 885 (2011). The requirement that a principal have control over the agent means that

there must be facts and circumstances that establish "'one person is acting at the instance of and in some material degree under the direction and control of the other.'" 171 Wn.2d at 562 (quoting *Matsumura v. Eilert*, 74 Wn.2d 362, 368-69, 444 P.2d 806 (1968)). Control establishes agency only if the principal controls the manner of performance. *Stansfield v. Douglas County*, 107 Wn. App. 1, 18, 27 P.3d 205 (2001). In addition, the existence of an agency relationship is not controlled by how the parties describe themselves and can be implied by the parties' actions. *Wash. Imaging Servs.*, 171 Wn.2d at 562.

Warehouse Demo performed demonstrations of products from various food vendors in Costco locations throughout Washington and the West Coast. The Board found that Warehouse Demo entered into a written agreement with Costco, which provided that Warehouse Demo would perform demonstrations at Costco locations on behalf of its vendors. The Board also found that vendors directly contacted Warehouse Demo to perform demonstrations of the vendors' products. The Board further found that Warehouse Demo was responsible for collecting from its vendors the cost of rental space at Costco for the product demonstration and remitting the rental costs to Costco. Warehouse Demo's vendors provided promotional and marketing materials to be displayed during the demonstrations. Warehouse Demo purchased the products to be used in its demonstrations from Costco and was later repaid by the vendor for the amount of the vendor's product purchased for the demonstration.

The Board concluded that the vendors exercised control over Warehouse Demo's actions because the vendors directly contacted Warehouse Demo to perform the demonstrations, selected the product that Warehouse Demo demonstrated, and authorized Warehouse Demo's purchase of

the demonstration product. Thus, the Board concluded that there was an inferred agency relationship between the principal, the vendors, and their agent, Warehouse Demo.

For Warehouse Demo to prevail on its tax refund claim, it was required to prove that it was an agent of the vendors. *See* RCW 82.04.290(2)(b). For it to receive all of its claimed refund, Warehouse Demo was required to prove that it was an agent of each of its vendors. *See generally* RCW 82.04.290(2)(b). The Board's findings of fact show that Warehouse Demo failed to meet its burden in proving that it acted as the agent of any vendor, let alone each of its vendors. Although Warehouse Demo's vendors generally provided promotional and marketing materials for its product demonstrations, there is no finding that any of the vendors controlled the manner in which Warehouse Demo conducted its demonstrations, or managed and supervised the product information shared by Warehouse Demo, or otherwise exhibited control over the demonstrations. The findings do not establish that the vendors selected the product Warehouse Demo would demonstrate or that the vendors authorized Warehouse Demo's purchase of the demonstration product. Moreover, the findings of fact do not contain any facts specific to any of Warehouse Demo's vendors.

Considering all of the Board's factual findings, its findings do not establish that Warehouse Demo was under the direction and control of each of its vendors to any material degree. As a result, Warehouse Demo fails to show that it performed its product demonstrations subject to its vendors' control. Accordingly, the Board's findings of fact do not support its conclusion that an agency relationship existed.

We reverse the Board's final decision granting Warehouse Demo's tax refund claim.

No. 50057-4-II

A majority of the panel having determined that this opinion will not be printed in the Washington Appellate Reports, but will be filed for public record in accordance with RCW 2.06.040, it is so ordered.

Worswick, P.J.

We concur:

Lee, J.

Melnick, J.

APPENDIX B

Filed
Washington State
Court of Appeals
Division Two

June 27, 2018

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

STATE OF WASHINGTON, DEPARTMENT OF REVENUE, Appellant, v. WAREHOUSE DEMO SERVICES, INC., Respondent.	No. 50057-4-II ORDER DENYING MOTION FOR PUBLICATION AND MOTION FOR RECONSIDERATION

Respondent filed a motion to publish and a motion for reconsideration of the Court's March 20, 2018 opinion. After consideration, the Court denies the respondent's motions. Accordingly, it is

SO ORDERED.

PANEL: Jj. Lee, Worswick, Melnick

FOR THE COURT:

Worswick J
JUDGE

APPENDIX C

BEFORE THE INTERPRETATION AND APPEALS SECTION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment	)	D E T E R M I N A T I O N
	)	No. 86-303
. . .	)	Registration No. . . .
	)	Tax Assessment No. . . .

[1] RULE 193B AND RCW 82.04.4286: B & O AND RETAIL SALES TAX -- INTERSTATE COMMERCE -- VALIDITY OF TAX. A state tax on interstate commerce is valid if it meets the four requirements set forth in Complete Auto Transit, Inc. v. Brady.

[2] RULE 193B: B & O AND RETAIL SALES TAX -- INTERSTATE COMMERCE -- DUE PROCESS -- NEXUS -- FACTORS DETERMINING. The crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales.

[3] RULE 193B: B & O AND RETAIL SALES TAX -- INTERSTATE COMMERCE -- DUE PROCESS -- DIVISIONAL NEXUS -- AFFILIATED CORPORATION AS TAXPAYER'S REPRESENTATIVE -- DISSOCIATION. There is a sufficient nexus between a state and the interstate commercial activity it taxes, for purposes of the commerce and due process clauses, if the in-state activities performed on the business' behalf are significantly related to the business' ability to establish and maintain an in-state market for its sales. The in-state activities do not have to be performed by the business' own employees, but can be performed by employees of an affiliated corporation. To avoid taxation, the foreign corporation must sustain the burden of showing the sales at issue are disassociated from the in-state activities.

[4] RULE 193B: B & O AND RETAIL SALES TAX -- INTERSTATE COMMERCE -- DUE PROCESS -- NEXUS -- WASHINGTON FRANCHISEE AS LOCAL OUTLET. A corporation that approaches a market through local outlets is distinguishable from a corporation approaching a market through solicitors only or one whose only connection with the customers

in the state is by common carrier or mail. Services provided by a local franchisee can be decisive in establishing and holding a market for the franchise products.

[5] RULE 193B: B & O AND RETAIL SALES TAX -- INTERSTATE COMMERCE -- NEXUS -- FRANCHISE PRODUCT -- FRANCHISOR'S ACTIVITIES CREATING MARKET. A franchisor corporation creates a market for franchise products by establishing franchises, providing training programs, management advice, marketing surveys, newspaper and network advertising. A franchisee and franchisor have a community interest in selling trademarked goods and services.

[6] RCW 82.32.100: PENALTIES -- UNREGISTERED TAXPAYER. RCW 82.32.100 provides that the Department shall add late payment penalties if a person fails to make any return required by the Revenue Act.

[7] RULE 228 AND RCW 82.32.105: PENALTIES OR INTEREST -- WAIVER -- CIRCUMSTANCES BEYOND CONTROL OF TAXPAYER -- WHAT CONSTITUTES. Lack of knowledge of a tax obligation does not render failure to pay taxes "beyond the control" of the taxpayer within the meaning of RCW 82.32.105 and WAC 458-20-228 which allow the Department of Revenue to waive or cancel interest and penalties under limited situations.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting a Determination.

TAXPAYER REPRESENTED BY: . . .

DATE OF HEARING: July 2, 1986

NATURE OF ACTION:

The taxpayer protests the assessment of Retailing business tax and retail sales tax on sales to Washington franchisees of an affiliate company. The taxpayer contests the assessment on grounds the state of Washington has no jurisdiction to tax those revenues.

FACTS AND ISSUES:

Frankel, A. L. J. -- The taxpayer is a [out-of-state] corporation engaged in the business of selling health food products at wholesale. It is a subsidiary of . . . . The taxpayer's records were audited for the period January 1, 1981 through June 30, 1984. The examination disclosed taxes,

interest, and penalties due . . . As the taxpayer was unregistered in Washington, the Department registered the company and issued Tax Assessment No. . . . on December 10, 1985, for the total amount found due.

. . . the parent corporation, (hereinafter the parent) underwent a corporate reorganization in January of 1983. Prior to the reorganization, [the parent] developed franchises in various states, including Washington. Subsidiary corporations, . . . various states, including Washington, operated the company-owned . . . [businesses].

In 1983, [the parent] merged all of the state companies except the taxpayer into [franchisor company]. [The parent] became a holding company and [franchisor company] the franchise operator. The taxpayer's activities have been the same before and after the reorganization. The taxpayer was formed to sell [product] to the . . . [company businesses] on the West Coast. During the audit period, the [taxpayer] consisted of a [an out-of-state] warehouse and office. . . with four employees. Billings were made by the home office of the parent in . . . .

At issue in this appeal is the assessment of retail sales tax and retailing and wholesaling business and occupation tax on the proceeds from the taxpayer's sales to Washington franchise operators. The auditor determined the sale of [product] was subject to the Wholesaling-Other tax (Schedule II) and the sale of supplies and promotional items subject to Retailing B & O and Retail Sales Tax. The auditor relied on WAC 458-20-193B, a copy of which was provided to the taxpayer.

The taxpayer protests the assessment, contending no nexus with this state exists because it has no business facilities or employees in Washington. Orders are submitted by mail from the franchisees in Washington to [franchisor company] in [its home state] and then telexed to the taxpayer in [its home state]. The orders are filled by the taxpayer's employees from the stock in its . . . warehouse and shipped by common carrier to the purchasers in Washington.

The taxpayer argues that neither its parent or affiliate undertakes any activities in Washington in connection with the sales. It stated that the only local activity engaged in by the affiliated operating company in relation to the franchisees was a less-than-annual visit to ensure that the franchisees were operating properly. The taxpayer contends that no part of the visits concerned marketing of its products and that any marketing assistance was provided from [out-of-state] by phone or mail.

The auditor recognized that the taxpayer itself had no employees or activity in Washington. Tax was assessed based on the activities of the

parent and affiliated companies when setting up the franchises and the ongoing consulting activities of the affiliated company.

If the Department finds nexus exists, the taxpayer requests a waiver of the penalty because of its good faith understanding that its revenues were not taxable in Washington.

ISSUES:

1) Whether the imposition of the B&O tax, measured by the gross receipts of all retail and wholesale sales to Washington franchisees, violates the due process clauses of the federal and state constitutions or the commerce clause of the federal constitution.

2) If the tax is upheld, whether the penalties should be waived because of the taxpayer's good faith belief that it was not required to be registered and pay B&O tax in Washington.

DISCUSSION:

[1] Washington's B&O tax is levied on every person for the act or privilege of engaging in business activities. RCW 82.04.220. A deduction is permitted for amounts derived from business which the Constitution or laws of the United States prohibit a state from taxing. RCW 82.04.4286.

In Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), the Court overruled prior decisions which held that a tax on the privilege of engaging in an activity in the state may not be applied to an activity that is part of interstate commerce. The court noted that such a rule has no relationship to economic realities. 430 U.W. at 279. "It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business." Id. quoting Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938).

To be valid, the state tax on interstate commerce must meet four requirements: (1) there must be a sufficient nexus between the interstate activities and the taxing state; (2) the tax must be fairly apportioned; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to the services provided by the state. Complete Auto Transit at 279. Accordingly, if the tax at issue meets those requirements, it is not invalid even if the shipments are considered a part of interstate commerce.

[2] The taxpayer does not contend that the tax at issue is not fairly apportioned, that it discriminates against interstate commerce, or that it

is not fairly related to the services provided by the state. The taxpayer contends the tax is invalid because Washington does not have adequate jurisdictional "nexus" with the sales at issue to impose a tax on the interstate activities. Accordingly, the taxpayer contends the tax violates both the Commerce Clause and the Due Process Clause of the Fourteenth Amendment. The Due Process Clause requires a "'minimal connection' between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise." Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 436-37 (1980).

WAC 458-20-193B (Rule 193B) is the administrative rule which defines the Constitutional limits upon this state's ability to impose its excise tax upon sales of goods originating in other states to persons in Washington. The crucial factor in establishing the requisite minimal connection or "nexus" is whether the taxpayer's instate services enable it to make the sales:

> Sales to persons in this state are taxable when the property is shipped from points outside this state to the buyer in this state and the seller carries on or has carried on in this state any local activity which is significantly associated with the seller's ability to establish or maintain a market in this state for the sales. . . . The characterization or nature of the activity performed in this state is immaterial so long as it is significantly associated in any way with the seller's ability to establish or maintain a market for its products in this state.

The fact that a tax is contingent upon events that take place outside a state does not destroy the nexus between the tax and the transactions within the state being taxed. Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444-45 (1940). Nor does nexus require that a majority of a taxpayer's business activity lie in the taxing state. Standard Pressed Steel co. v. Dep't of Revenue, 419 U.S. 560 (1975) (one lone employee who engaged in no direct sales activity created the necessary relationship).

[3] Although the taxpayer itself may not be engaged in any local activity which enables it to make the sales at issue, we do not agree that the taxpayer's parent or affiliate has not done so on its behalf. Washington courts have upheld this state's B&O tax against claims of divisional nexus. See, e.g. General Motors Corp. v. State, 60 Wn.2d 862 (1962), affirmed 377 U.S. 436 (1963).

General Motors argued that the sales by its parts division which were filled from a warehouse in Oregon should not be subject to Washington's B&O tax. The Supreme Court disagreed, however, finding the corporation's

activity "was so enmeshed in local connections" as to subject all of its sales within the state to the B&O tax. 377 U.S. at 447. As in the present case, the orders were sent to an out-of-state office by mail or telephone. The orders were shipped from the factory by common carrier and payment received outside the state.

The absence of a local office was not the controlling factor. The essential inquiry was directed to the "amount and effect of the activities involved and not the form of the operations. 60 Wn.2d at 874. The Washington Court noted General Motors' extensive promotional and service efforts Id. at 875. These activities included advertising on television, billboards, newspapers and magazines, as well as the activities by the field organization representatives who advised the independent dealers on almost every aspect of their operations. The Court noted that where extensive business activity occurs within a state, taxation can only be avoided upon a showing that the activities are dissociated from the sales in question. The Court found General Motors failed to meet that burden, even though, as here, the mechanical aspects of the sales occurred outside the state. The Court noted that "the substance of each transaction occurs in Washington where the customer is located and where the demand for the manufactured product exists, in very large degree, as a result of General Motors promotional activities." Id. at 875-76.

Following General Motors, the Washington Supreme Court has taken a hard line on the divisional nexus issue, also upholding the tax in the presence of substantial activity on the part of a sister corporation acknowledged to be taxable in the state. Chicago Bridge & Iron Co. v. Department of Revenue, 98 Wn.2d 814 (1983). The United States Supreme Court has also noted that the form of business organization may have nothing to do with the underlying unity or diversity of he business enterprise. Mobil Oil Corp. v. Commissioner of Taxes, supra. For Due Process purposes, the Court in Mobil Oil found no difference in the underlying economic realities of a unitary business operated as legally separate entities from those operated as separate divisions of legally as well as functionally integrated enterprises. 445 U.S. at 440-41.[1]

[1]Mobil Oil addressed the imposition of Vermont's corporate income tax based on an apportionment formula, upon "foreign source" dividend income received by the corporation from its subsidiaries and affiliates doing business abroad. The Court found the tax did not violate the Due Process Clause. Mobil failed to establish that its subsidiaries and affiliates engaged in business activities unrelated to its sales of petroleum products in Vermont. The Court rejected the argument that a division between a parent and subsidiary should be treated as a break in the scope of a unitary business, noting that the form of business

In Clairol, Inc. v. Kingsley, 109 N.J. Super. 22, 262 A.2d 213 (1970), the Court appeared to attribute the activities of a subsidiary corporation to the parent. One author noted the rationale might be justified on the theory that the services were rendered by the subsidiary to Clairol's customers as agent for Clairol. J. HELLERSTEIN, STATE TAXATION 246 n. 126 (1983).

Certainly the evidence supports finding that [the franchisor company or parent] served as the taxpayer's agent in processing the [product] orders at issue. The purchase invoices and order forms are printed with [the franchise's] name and logo and the order forms state they are to be sent to the [parent company], Although these activities took place out of state, we believe the evidence supports our finding the parent's or affiliate's instate activities established the market for the Washington sales.

This is not a case where the taxpayer's only contact with this state is via the United States mail or common carrier, as was the situation in National Bellas Hess v. Department of Revenue, 386 U.S. 753 (1967). In that case, the Illinois Court had found National was required to collect Illinois' use tax upon sales to Illinois consumers. The Supreme Court reversed. National's relationship with Illinois, however, is distinguishable from the taxpayer's relationship with this state:

> "[National] does not maintain in Illinois any office, distribution house, sales house, warehouse or any other place of business; it does not have in Illinois any agent, salesman, canvasser, solicitor or other type of representative to sell or take orders, to deliver merchandise, to accept payments, or to service merchandise it sells; it does not own any tangible property, real or personal, in Illinois; it has no telephone listing in Illinois and it has not advertised its merchandise for sale in newspapers, on billboards, or by radio or television in Illinois."

386 U.S. at 754, quoting the State Supreme Court. 34 Ill. 2d at 166-167.[2]

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organization may have nothing to do with the underlying unity or diversity of a business enterprise. Although the present case involves Washington's B&O tax rather than an income tax, we believe the Court's "unitary business" analysis also supports our decision that activity by an affiliate, as well as a division of a corporation, can establish the requisite nexus.

[2]National acknowledged its obligation to collect a use tax on sales to customers in states in which it had retail outlets. 386 U.S. at 757, n. 10.

As in National Bellas Hess, the Court in Norton Co. v. Department of Revenue, 340 U.S. 534 (1951) also distinguished the situation where a company had only minimal contact with the taxing state "[w]here a corporation chooses to stay at home in all respects except to send abroad advertising or drummers to solicit orders which are sent directly to the home office for acceptance, filing, and delivery back to the buyer, it is obvious that the state of the buyer has no local grip on the seller." 340 U.S. at 537.

In this case, however, the taxpayer's affiliate has entered into franchise agreements with Washington franchisees and has company-owned weight loss centers in Washington. As the affiliated company has entered this state to do local business by state permission and has submitted itself to the taxing power of the State, it can avoid taxation on the sales at issue only by showing they are disassociated from the local business and interstate in nature. Id.

We would agree that if sales were made by the taxpayer to Washington customers who were not part of the franchise system, such sales would not be taxable if no instate activity by the taxpayer or its affiliates promoted them. See, e.g., B.F. Goodrich Co. v. State, 38 Wn.2d 663 (1951) (the Court applied the principles laid down in Norton and did not uphold the tax on sales made by a division of B. F. Goodrich to Washington outlets of J.C. Penney Company).

[4] Norton Company could not establish that the services rendered by its Illinois office were not decisive in establishing and holding a market for the goods sold to Illinois customers. The Court discussed the advantages of approaching a market through a local outlet to process orders, noting that without a local outlet, customers may view the seller as "remote and inaccessible." In such a case, customers cannot reach the seller with process of local courts for breach of contract, or for service if the goods are defective or in need of replacement. Id. at 539. The court upheld the Illinois Retailers' Occupation tax on the sales to the Illinois customers except on orders sent directly by the customer to Norton Company's head office and shipped directly to the customer.

In this case, the "local outlets" are the Washington franchisees. The fact that they are operated independently is not controlling. The sales at issue in General Motors Corp.v. State, supra, were made to dealers which had individual proprietorships, partnerships, or corporations having no corporate relationship to General Motors. The Court found that General Motors was engaged in business in Washington and that its promotional and service activities had a direct effect upon the sales and operations of the independent retail dealers. 60 Wn.2d at 868.

[5] The affiliated corporation, [franchisor], registered with the Department in 1983 and has been paying B&O tax on its franchise fees and retail sales to Washington [company businesses] since that time. On its Certificate of Registration, it listed eight branch locations in Washington and stated sales are solicited in Washington in its name by resident employees. It also stated it maintained inventories at all eight branches located in Washington and that it is a franchisor, with franchisee locations with the State. Question 5 asked, "Do you render service within the state of Washington to customers, clients or franchisees?" The answer was yes-- "Sale of . . . to be sold by franchise centers."

The additional evidence relied on by the auditor also supports a finding that the affiliated company's instate services were significantly associated with the taxpayer's ability to establish or maintain a market in this state for the sales. The franchise agreement provided the franchisor company would provide, inter alia, assistance in obtaining a suitable location for operating the franchise centers, training programs, operational manuals and diet charts, consultation and advice by a company's representative as to the operation and management of the Centers, marketing surveys, etc. (. . . .) As with many franchise agreements, the franchisee was required to purchase . . . products from an approved supplier. Of course, the taxpayer is an approved supplier. The taxpayer has submitted no evidence of any activity on its part to create the market for its sales to the Washington franchisees. The evidence indicates that newspaper advertising and network television are important parts of the [franchise] advertising program. (. . .)

Washington's Franchise Investment Protection Act recognizes that a franchisee and franchisor have a community interest in selling the trademarked goods and services. See RCW 19.100.010(4). The extensive advertising of the [franchise] program promotes the interests of the entire franchise system, including the taxpayer. See, e.g., Ungar v. Dunkin' Donuts of America, Inc., 68 F.R.D. 65 (D.C.Pa 1975) (relevant advertising is inextricable from the trademark, franchise system and logo as it is the major vehicle for promoting them). The requirement of uniformity of product and control "causes the public to turn to the franchise stores for the product." Susser v. Carvel Corp., 206 F. Supp. 636, 640 (1962). See also Perma Life Mufflers, Inc. v. International Parts Corp., 376 F.2d 692, 694 (1967).[3]

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[3] At least one jurisdiction has held that an out-of-state corporation was "engaging in business" in the state simply because its franchisees were located in the state. Baskin-Robbins Ice Cream Co. v. Revenue Div., 93 N.M. 301, 599 P.2d 1098 (1979); American Dairy Queen Corp. v. Revenue Div., 93 N.M. 743, 605 P.2d 251 (1979) (a franchisor which enters into agreements

As with any exemption, the taxpayer bears the burden of establishing that the sales at issue are dissociated under Norton. The taxpayer has failed to meet this burden. It has shown no independent source for promoting the sales or established that its affiliate's and/or parent's instate activities did not help establish and maintain its market for the sales to the Washington franchisees.

In conclusion, we find that adequate jurisdictional nexus exists to uphold the tax on the wholesale and retail sales to the Washington franchisees. Case law supports our decision that the parent or affiliate can be considered the taxpayer's agent or other representative for due process purposes. The evidence supports a conclusion that the instate activities by the parent and/or affiliate company are significantly associated with the taxpayer's ability to establish or maintain a market for its products sold to and through the Washington franchisees. Accordingly, we find the sales at issue similar to those on which the tax was upheld in General Motors v. State and Norton Company v. Department of Revenue, supra. The tax is not invalid because the taxpayer itself has no formal sales office or no agent or representative formally characterized as a "salesman" in Washington. Rule 193B(5).

[6] As an adminstrative agency, the Department has limited authority to waive penalties and interest. RCW 82.32.100 provides that when a taxpayer fails to make any return as required, the Department shall proceed to obtain facts and information on which to base its estimate of the tax. As soon as the Department procures the facts and information upon which to base the assessment, "it shall proceed to determine and assess against such person the tax and penalties due, . . . To the assessment the department shall add, the penalties provided in RCW 82.32.090." (Emphasis added.)

RCW 82.32.090 provides that if any tax due is not received by the Department of Revenue by the due date, there shall be assessed a penalty. The penalty for returns which are not received within 60 days after the due date is 20 percent of the amount of the tax. RCW 82.32.050 provides that if a tax or penalty has been paid less than properly due, the Department shall assess the additional amount due and shall add interest at the rate

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for use of its trade name and trademark is engaged in business in New Mexico even though franchisor had no employees or offices in New Mexico). In those cases, the New Mexico court upheld the state's B & O tax on the royalty payments or franchise fees. The taxpayer has been paying B & O tax on the income from franchise fees and has not contended it is not "doing business" in Washington to make such income subject to Washington's tax.

of nine percent per annum from the last day of the year in which the deficiency is incurred until the date of payment.

[7] The only authority to cancel penalties or interest is found in RCW 82.32.105. That statute allows the Department to waive or cancel interest or penalties if the failure of a taxpayer to pay any tax on the due date was the result of circumstances beyond the control of the taxpayer. That statute also requires the Department to prescribe rules for the waiver or cancellation of interest and penalties.

The administrative rule which implements the above law is found in the Washington Administrative Code 458-20-228 (Rule 228). Rule 228 lists the situations which are clearly stated as the only circumstances under which a cancellation of penalties and/or interest will be considered by the Department. None of the situations described in Rule 228 apply in the present case. Lack of knowledge or a good faith belief that one is not subject to Washington's B & O tax is not identified by statute or rule as a basis for abating interest or penalties.

DECISION AND DISPOSITION

The taxpayer's petition for correction of Tax Assessment No. . . . is denied.

DATED this 21st day of November 1986.

APPENDIX D

Cite as Det. No. 94-074E, 14 WTD 085 (1994).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	D E T E R M I N A T I O N
	)	No. 94-074E
. . .	)	Registration No. . . .
	)	Petition for Refund

[1] RULE 193: NEXUS - OIL EXCHANGES - INSPECTORS. Nexus found for a petroleum trader engaged in all of the following activities:

. .1. Delivery of products into Washington to customers;

. .2. Instantaneous possession of products purchased in Washington prior to their sale; and

. .3. Independent inspectors hired to confirm quantity and quality of products purchased and sold in Washington.

[2] RULE 252: INTERSTATE TRANSPORTATION FINALLY ENDED. Out- of-state sellers or producers need not pay hazardous substance or petroleum products taxes on substances shipped directly to customers in this state provided they did not certify to their customers that these taxes were paid.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

. . .

NATURE OF ACTION:

A trader of petroleum products petitions for refund contending that it had no nexus in Washington.

FACTS:

Pree, A.L.J.-- The taxpayer is engaged in the business of trading petroleum which it buys, sells, and exchanges inside and outside of Washington. The taxpayer is headquartered outside Washington and has no office or employees here. It owns no petroleum handling facilities such as barges, tanks, refineries, or retail outlets. It limits its dealings to paper transactions. It purchases the products and sells them as well as arranging shipping. Other entities physically handle the petroleum products. Its employees do not travel to Washington to solicit sales or purchase products. It pays inspectors who certify the quantity and quality of the products purchased and sold in Washington.

Through trading, the taxpayer states that it attempted to profit by buying a product from one oil company and arranging a simultaneous sale to another oil company for a higher price. If a simultaneous sale could not be arranged, it would have had to pay storage or transportation fees to third parties after a purchase. Those expenses would have reduced its profit in a subsequent sale. The taxpayer states that this never occurred in the case of property purchased in Washington. In other words, all its purchases in Washington were matched with simultaneous sales. This fact has not been verified by the Audit Division.

Some of these transactions were accomplished through exchanges. The taxpayer received consideration in the form of oil products in a location outside of Washington at a later date in exchange for the taxpayer's petroleum products in Washington at the time of the exchange. The taxpayer also received payments or other credits for sales.

Often the taxpayer purchased products outside Washington with a subsequent sale agreed to within Washington. The taxpayer arranged to have an independent carrier or oil company ship the product into Washington. When the product was unloaded at the flange of the ship, title transferred to the buyer.

The taxpayer paid wholesaling B&O tax on petroleum products sold in Washington. The Audit Division also assessed wholesaling B&O tax on unreported exchanges of these products for the period January 1, 1987 through June 30, 1991, which the taxpayer paid. The taxpayer now requests a refund for all B&O taxes paid with interest for the period January 1, 1989 through January 31, 1993, claiming it lacked sufficient contacts or nexus with the state of Washington. It does not dispute that the exchanges constituted sales in Washington.

The taxpayer also paid hazardous substance tax and petroleum products tax on these products during the period January 1, 1989 through January 31, 1993. The taxpayer is not aware that it ever

certified to its customers that it paid hazardous substance or petroleum products taxes. It requests that these taxes be refunded based on the same lack of nexus. It also contends that these taxes are not applicable to its products because interstate transportation had not finally ended under WAC 458-10-252 (Rule 252), subsection (4)(e)(ii).

The Audit Division denied the taxpayer's refund claim. It found that the taxpayer acquired products through its exchanges in Washington. As such, the taxpayer held inventory in this state, sufficient for nexus. In addition, the Audit Division found that the taxpayer hired independent contractors to inspect and verify the product sold. According to the Audit Division, the taxpayer's relationship with these inspectors and their activities regarding the sales in question constituted sufficient nexus.[1]

The taxpayer states that it never held title to products purchased in Washington. According to the taxpayer, any purchases in Washington were simultaneously sold. Only in cases where a product was purchased outside of Washington then shipped to Washington, did the taxpayer hold title to it. Rarely did this occur. If the taxpayer did hold such title at month's end, it would be shown on the books as an asset "in transit."

ISSUES:

1. Were the taxpayer's contacts with Washington sufficient to create nexus?

2. Had interstate transportation ended on its products?

In the case of an adverse determination, the taxpayer would like to provide documentation to the Audit Division to verify the exempt nature (i.e., export) of selected transactions.

DISCUSSION:

[1] Nexus. States may tax interstate business if there is nexus between the business being taxed and the state and if the income to which the tax is applied is rationally related to values connected with the state. Chicago Bridge & Iron Co. v. Department of Rev., 98 Wn.2d 814, 659 P.2d 463 (1983). The business and occupation tax collected on the gross proceeds of sales within the state does not violate the due process rights of a company involved in interstate business. Chicago Bridge at 820.

WAC 458-20-193 (Rule 193), subsection (2)(f), defines nexus as:

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[1]Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

. . . 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.

Subsection (7) provides:

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

The following activities are examples of sufficient nexus in Washington for the B&O tax to apply:

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

. . .

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

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

. . .

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

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

. . .

(h) Company X is located in Ohio and has no office, employees, or other agents located in Washington or any other contact which would create nexus. Company X receives by mail an order from Company Y for parts which are to be shipped to a Washington location. Company X purchases the parts from Company Z who is located in Washington and requests that the parts be drop shipped to Company Y. Since Company X has no nexus in Washington, Company X is not subject to B&O tax or required to collect retail sales tax. Company X has not taken possession or dominion or control over the parts in Washington. Company Z may accept a resale certificate from Company X which will bear the registration number issued by the state of Ohio. Company Y is required to pay use tax on the value of the parts.

The taxpayer's admitted contacts with Washington were:

.A. Delivery of products into Washington to customers;

.B. Instantaneous possession of products purchased in Washington prior to their sale; and

.C. Independent inspectors hired to confirm quantity and quality of products purchased and sold in Washington.

We must determine whether these contacts are sufficient under Rule 193 to tax the taxpayer's sales in Washington. Under subsection (7), delivery alone of the product into Washington to customers is insufficient activity to create nexus.

The taxpayer likens instantaneous possession of products purchased in Washington prior to their sale to the drop shipment example in subsection (11)(h) of Rule 193. That example is distinguishable because the seller received the order to sell the product prior to arranging to have a third party provide its product to the buyer. In the taxpayer's situation, the opportunity to purchase the products may precede finding a buyer or arranging their sale. Arguably, the taxpayer has a stock of goods in Washington.

While it was the taxpayer's goal to instantaneously resell the products acquired in Washington, it was never assured that this would be the case. In such circumstances, the taxpayer would be obligated to arrange for storage or transportation of the products.

The taxpayer states that it never held title to the products in Washington. It only had these "paper rights" to the property. Yet these rights did constitute an asset "in transit". No one

else held title to the taxpayer's products during the time the taxpayer had these rights. The products to which the taxpayer held title were not intangible.

We have held that a taxpayer' ownership of commodities provides nexus where the taxpayer is out-of-state but the commodities underlying the warrants are warehoused in Washington. Det. No. 90-215A, 12 WTD 297 (1993). Likewise, title held by the taxpayer, even for an instant, gives the taxpayer property purchased in Washington at the time of sale. Under example (7)(c)(i), when goods are located in Washington at the time of sale, this creates nexus unlike the drop shipment example where the goods were sold prior to the taxpayer arranging to have them drop shipped.

The role played by the inspectors was significant to the taxpayer's sales in the state. The taxpayer must know the quantity and quality of what it acquires as well as what it sells. This assurance is essential to maintain its sales in the state.

The fact that it hires the inspectors also casts doubt on the taxpayer's claim that its possession is instantaneous and that it never really held title to the products in Washington. The taxpayer pays the inspectors to act on its behalf. Inspectors acting on the taxpayer's behalf would not be necessary if it were merely dealing in paper transactions. The seller would be obligated to deliver to the buyer the taxpayer's contracted amounts. If the buyer found the quality or quantity to be less than what it bargained to pay, the taxpayer should be indemnified by the seller who agreed to deliver the bargained quantity. None of these transactions involved companies whose ability to pay such claims is questioned. Through its inspector agents, the taxpayer actively participated in the physical possession and purchase of the products in Washington.

The taxpayer paid for the inspectors' services. They were the taxpayer's agents. They performed a significant service necessary to maintain the taxpayer's sales in the state. Under Rule 193(7)(c)(v) such activity is sufficient nexus for the B&O tax to apply. Taken together, the taxpayer's possession of the product and inspection by its agents clearly establish contacts sufficient to subject its Washington sales to B&O tax. The activities correspond to examples (i), (iv), and (v) in subsection (7)(c) of Rule 193.

[2] Hazardous substance and petroleum products taxes. The hazardous substance tax and petroleum products taxes are imposed on the privilege of possessing these products in Washington. RCW 82.21.030 and 82.23A.020. The fact that the taxpayer possessed these products in Washington is sufficient to impose the tax.

Rule 252 provides in Part I, subsection (4)(e)(ii):

> (ii) The tax will not apply with respect to any possession of any hazardous substance purchased, extracted, produced or manufactured outside this state which is shipped or delivered into this state until the interstate transportation of such substance has finally ended in this state. Thus, out of state sellers or producers need not pay the tax on substances shipped directly to customers in this state. The customers must pay the tax upon their first possession unless otherwise expressly exempt. (Emphasis supplied.)

Under Part II, subsection (1)(a), the application of the petroleum products tax with the exceptions noted therein is the same as the hazardous substance tax. To the extent that the taxpayer verifies that it paid these taxes on products shipped directly to customers
in Washington the taxes will be refunded, provided that the taxpayer did not bill or certify to subsequent possessors that it paid the tax relieving them of their obligation to pay the tax.

DECISION AND DISPOSITION:

Regarding the nexus issue, the taxpayer's petition for refund is denied. The taxpayer may provide verification to the Audit Division of hazardous substance and petroleum products taxes it paid on products shipped directly to this state for which no previously paid certificates were provided to the customers.

DATED this 18th day of April, 1994.

APPENDIX E

Cite as Det. No. 96-147, 16 WTD 117 (1996)

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 96-147
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

RULE 195; RCW 82.04.070: B&O TAX -- MEASURE OF TAX. A taxpayer may not treat collected retail sales tax as a reduction of the selling price for the purpose of the measure of the tax. The B&O tax is imposed on the business and cannot be charged to the buyer.

1 RULE 193: SUBSTANTIAL NEXUS. Substantial nexus, for commerce clause purposes, includes three factors: (1) An activity within the state attempting to impose taxes; (2) A physical presence related to the activity; and (3) The activity must be for the purpose of either entering or maintaining a position in the marketplace of the taxing state.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

The taxpayer requests a refund of retail sales and retailing business and occupation (B&O) taxes paid as the result of a tax assessment issued by the Department of Revenue (Department).[1]

FACTS:

Coffman, A.L.J. -- The taxpayer is a corporation whose only office is in another state (State A). All of the taxpayer's employees are located in State A. The taxpayer sells its products through in-home parties. The taxpayer's method of operation consists of contracting with individuals to be Regional and District Managers. The District Managers contract with individuals to act as Supervisors. The

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

Supervisors contract with individuals who act as Demonstrators. The Demonstrators engage Hostesses who hold parties in their homes for the purpose of selling the taxpayer's products.

The taxpayer developed the form contracts used throughout its sales organization. The contracts identify the Regional Manager, District Manager, Supervisor, and Demonstrator as independent contractors. The taxpayer was requested by the Department to provide the name, address, and physical location of its agents in this state. The taxpayer replied: "WE WILL NOT SUPPLY THIS INFORMATION."

The Regional Manager is responsible for training the District Managers who report to him or her. Further, the Regional Manager will act as a District Manager. District Managers are required to "recruit and encourage Supervisors."

The Supervisor Agreement is signed by the District Manager. The Supervisor Agreement states that the taxpayer will pay the Supervisor's commissions. Further, it requires the Supervisor to hire Demonstrators. The Supervisor can sell the taxpayer's products only through the "party plan." Under the "party plan" only the Hostess handles the money.

The Demonstrator agreement is entered into between the Supervisor and the Demonstrator and binds the taxpayer to pay the Demonstrator a commission.

The taxpayer provides each person within its sales organization a sample kit valued at $300. If certain sales levels are achieved, the kit becomes the property of the independent contractor. If those sales levels are not achieved, the independent contractor may purchase the kit for $150.

The Regional Manager is paid a commission based on the productivity of the District Managers under him or her. The District Managers are paid a commission based on the productivity of the Supervisors reporting to him or her. Likewise, the Supervisors are paid a commission based on the productivity of the Demonstrators. The Demonstrators receive a commission based on the sales at parties they arrange and Hostesses receive free merchandise based on the sales at their parties.

The taxpayer registered with the Department and collected retail sales tax on all orders taken in Washington. The Department audited the taxpayer's books and records for the period January 1, 1989 through March 31, 1993. The Department's Audit Division determined that the taxpayer had underreported its gross sales from its retail activity. The "Auditor's Detail of Differences and Instructions to Taxpayer" states:

In the past, you calculated gross sales by dividing the sales tax collected for each location by the sum of the sales tax rate and the retailing business and occupation tax rate (.00471 during the audit period). This resulted in sales being underreported. Sales tax collected by you must be remitted to the state as sales tax and cannot be used to pay the business and occupation tax, an expense of your firm.

Thus, if the taxpayer made a $100 sale and retail sales tax rate was 8%, then the taxpayer collected $108. When it reported its gross sales, the taxpayer divided $8 by .08471 and reported the quotient ($94.44) as its gross sales. In so doing, the taxpayer paid $7.56 in retail sales tax and $.44 in B&O tax. The Audit Division believes that the gross sale was for $100.

The Audit Division, applying its theory, determined the taxpayer's total gross sales, subtracted the gross sales reported by the taxpayer, and calculated the amount of the underreported sales. It then calculated the amount of the underpayment of retail sales and B&O taxes. Thus, in the example above, the Department found that the taxpayer underreported the sale by $5.56 ($100 - $94.44) and calculated the retail sales tax ($.44) and B&O tax ($.04). The taxpayer agrees that, if the Audit Division's position is sustained, the tax assessment was properly calculated.

The Department issued the tax assessment on October 6, 1993. Prior to the final issuance of the tax assessment, the Department provided the taxpayer with copies of the workpapers and the proposed tax assessment. The taxpayer paid the proposed tax assessment prior to issuance and requests a refund.

ISSUES:

1. Whether the taxpayer properly calculated its total sales to Washington customers.

1. Where the taxpayer pays retail sales and B&O taxes totaling the amount of collected retail sales tax, by underreporting its gross receipts, may the Department assess additional retail sales tax for the audit period.

1. Whether the taxpayer has substantial nexus with the state of Washington.

1. Whether the taxpayer was making retail sales or sales for resale.

DISCUSSION:

1. Total Sales to Washington Customers.

The taxpayer collected retail sales tax on all sales made in Washington. The retail sales tax is imposed on the buyer. The seller is required to collect and remit it to the Department. RCW 82.08.050. The measure of the retail sales tax is the selling price. RCW 82.08.020(1). The selling price is defined in RCW 82.08.010(1) as:

. . . the consideration, whether money, credits, rights, or other property except trade-in property of like kind, expressed in the terms of money paid or delivered by a buyer to a seller without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes other than taxes imposed under this chapter if the seller advertises the price as including the tax or that the seller is paying the tax, or any other expenses whatsoever paid or accrued and without any deduction on account of losses; but shall not include the amount of cash discount actually taken by a buyer . . . .

(Emphasis added.)

The B&O tax is imposed by chapter 82.04 RCW and, therefore, it is not deductible from the measure of the retail sales tax. Thus, the measure of the retail sales tax is the total amount received from the customer less retail sales tax.

[1] Likewise, the B&O tax is not deductible from the measure of the B&O tax. The B&O tax is imposed by RCW 82.04.220. In the case of items sold, the measure is the gross proceeds of sale which is defined as:

the value proceeding or accruing from the sale of tangible personal property and/or for services rendered, without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

RCW 82.04.070. (Emphasis added.)

Certain taxes are excluded from the measure of the tax because they are imposed on the taxpayer's customer. For example, retail sales tax collected from a customer is excluded from the measure of tax because the tax is imposed on the buyer and the seller receives the tax in trust. WAC 458-20-195 (Rule 195). However, the B&O tax is never excluded from the measure of state taxes. Rule 195.

2. Calculation of underpayment of taxes.

The taxpayer argues that the Department assessed the wrong taxes. Specifically, the taxpayer argues that it remitted all the retail sales tax that it collected. Therefore, if any tax was underpaid, it was only the B&O tax. Thus, argues the taxpayer, the Department's assessment of retail sales tax was in error.

As stated above, the taxpayer underreported its gross income to the Department because of a miscalculation that was solely within the taxpayer's ability to correct. The Department properly determined the taxpayer's gross sales then subtracted the amount the taxpayer had reported to determine the amount of the underreported sales. The Department then properly calculated the amount of the underpayment. There was no error by the Department.

Because we find that the Department properly assessed the retail sales tax, it is unnecessary to address the taxpayer's argument that RCW 82.32.050 requires the Department to refund the assessed additional retail sales taxes for tax years 1989 and 1990.

3. Substantial nexus with the state of Washington.

The ability of a state to tax the activities of a nonresident corporation's business activities is limited by the Commerce Clause of the U. S. Constitution. The United States Supreme Court, in Complete Auto Transit v. Brady, 430 U.S. 274 (1977), listed the four conditions that must exist before a state may tax a nonresident business. The Washington Supreme Court restated the Complete Auto test as:

Under this test, state taxation of interstate business must (1) tax only interstate activities having a sufficient connection to the taxing state (nexus requirement); (2) . . .

American National Can v. Dept. of Rev., 114 Wn.2d 236, 241 (1990).

The U.S. Supreme Court has further clarified the nexus requirement to mean "substantial nexus". Quill Corp. v. North Dakota, 504 U.S. 298 (1992). See, also, Det. No. 92-262E, 12 WTD 431 (1992).

[2] Substantial nexus has three elements. First, there must be some activity in Washington. See, Standard Pressed Steel Co. v. Department of Rev., 419 U.S. 560 (1975) and Tyler Pipe Industries, Inc. v. Washington State Dept. of Rev., 483 U.S. 232 (1987). Second, there must be a physical presence related to that activity in the state. Quill Corp., supra and Norton Co. v. Department of Rev. of Ill., 340 U.S. 534 (1951). Third, the activity's purpose is to establish or maintain a position in Washington's marketplace. Det. No. 92-262E, supra.

The taxpayer clearly has engaged in an activity in Washington -- The sale of its products.

Physical presence means more than a slight presence. Quill Corp., supra, and National Geographic Society v. California Bd. of Equalization, 430 U.S. 551 (1977). Physical presence may be established through employees or independent contractors. Scripto, Inc. v. Carson, 362 U.S. 207 (1960). The taxpayer has established a network of agents in this state which satisfy this requirement. The sole purpose of these agents is to sell the taxpayer's products. The agents use the taxpayer's forms commit the taxpayer to pay Supervisors and Demonstrators commissions.

These agents represent the taxpayer's interests and are paid for the purpose of establishing and maintaining a market for the taxpayer's products in Washington. This is no different than the facts in Tyler Pipe, supra, where the Court said:

The trial court found that the in-state sales representative engaged in substantial activities that helped Tyler to establish and maintain its market in Washington. The State Supreme Court concluded that those findings were supported by the evidence, and summarized them as follows:

The sales representatives acted daily on behalf of Tyler Pipe in calling on its customers and soliciting orders. They have long-established and valuable relationships with Tyler Pipe's customers. Through sales contacts, the representatives maintain and improve the name recognition, market share, goodwill, and individual customer relations of Tyler Pipe.

Tyler Pipe sells in a very competitive market in Washington. The sales representatives provide Tyler Pipe with virtually all their information regarding the Washington market, including: product performance; competing products; pricing, market conditions and trends; existing and upcoming construction products; customer financial liability; and other critical information of a local nature concerning Tyler Pipe's Washington market. The sales representatives in Washington have helped Tyler Pipe and have a special relationship to that corporation. The activities of Tyler Pipe's agents in Washington have been substantial." 105 Wash. 2d, at 325, 715 P.2d, at 127.

As a matter of law, the Washington Supreme Court concluded that this showing of a sufficient nexus could not be defeated by the argument that the taxpayer's representative was properly characterized as an independent contractor instead of as an agent. We agree with this analysis.

Tyler Pipe, at 249-50.

The taxpayer cites three cases that it believes support its claim that nexus does not exist. In Care Computer Systems v. Arizona Dept. of Rev., Arizona Board of Tax Appeals, Docket No. 1049-93-S, the Board held that where a nonresident corporation has no office, no employees, and no regular presence in the state, there is not substantial nexus.

In Florida Dept. of Rev. v. Share International, Inc., 667 So. 226 (Fla. Dist. Ct. App., 1995), the court held that the presence in the state of two corporate officers for three days a year at a seminar

was insufficient to demonstrate substantial nexus. Share International collected and remitted retail sales tax on sales made during that three-day period. It was the additional mail-order sales that were at issue.

In NADA Services Corp., State of New York-Division of Tax Appeals, DTA 810592(1996), the Division of Taxation attempted to assess a retail sales tax collection responsibility on a foreign corporation through two theories. The state argued that it could pierce the corporate veil and attribute the activities of NADA, Inc (the taxpayer's parent) to NADA Services Corp. and thereby establish nexus. The Administrative Law Judge (ALJ) rejected that position as not supported by the facts. Additionally, the state claimed that a total of 20 trips to New York by employees over a 39 month period was sufficient to establish nexus. These trips were for the purposes of educational seminars (15), receipt of an honorary judging role (1), research for article to be published (2), visit an independent contractor whose work was unrelated to the New York market (1), and one trip to solicit advertising. The ALJ said the sporadic visits by a nonresident independent contractor performing nontaxable services did not establish nexus. This case likewise does not support the taxpayer's position because the taxpayer's presence in Washington is significant and is for the purpose of soliciting sales of taxpayer's products.

As discussed above, the taxpayer has a substantial physical presence in this state, while in each of the cited decisions there is a conspicuous lack of significant physical presence relating to the taxable activity. Therefore, none of the cited cases apply to taxpayer's appeal.

4. Retail sales versus sales for resale.

There is no evidence that the taxpayer took any resale certificates from the hostesses. Therefore it has the burden to show that the sales were not at retail. RCW 82.04.470. The taxpayer argues that the sales made at the parties were made to the Hostess for the purpose of resale to his or her guests. The taxpayer bases this argument on the fact that all orders are submitted on a master order form (without the names of the ultimate customer) and the Hostess is responsible for delivering the products to the ultimate customers. However, the Hostess collects money from the customers and submits it to the Taxpayer, and is paid in products based on the sales made. The Hostesses do not purchase and then resell the product. The Hostesses are the taxpayer's agents.

The definition of a retail sale includes the sale of tangible personal property except "purchases for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person". RCW 82.04.050(1)(a).[2] There is no evidence that the Hostesses are engaged in any business when they host a party for the taxpayer. Therefore, they could not have purchased the goods for resale in the ordinary course of business. Further, there is no evidence that the Hostesses purchase anything. It is, at best, inconsistent for the taxpayer to collect the retail sales tax, yet claim that it was engaged in a wholesale business.

The taxpayer is bound by its agreements, which state that the Hostesses will receive "free" merchandise, if a party is held. As such, they are acting on behalf of the taxpayer. Further, the Hostess collected the retail sales tax and remitted it to the taxpayer per taxpayer's requirements. Therefore, the taxpayer must have assumed that the sales were made to the party guests.

The Hostesses are acting as the taxpayer's agents when they are compensated for using their homes or other location, collect money for the products, remit that money to the taxpayer, and deliver the goods to the customers.

DECISION AND DISPOSITION:

The taxpayer's request for a refund is denied.

DATED this 29th day of August 1996.

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[2] There are other exceptions. The taxpayer relies solely on the resale exemption, therefore it is the only one which will be addressed. We have not addressed the possible use of the Direct Seller's Representative exemption from the B&O tax because the taxpayer has not only refused to provide the names of its agents or the actual contracts with those agents, but has also declined to argue that issue.

APPENDIX F

Cite as Det No. 08-0158ER, 29 WTD 10 (2010)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of . . .	FINAL EXEC LEVEL DETERMINATION No. 08-0158ER Registration No. . . . Document No. . . . Docket No. . . .

Rule 193: B&O TAX – SUBSTANTIAL NEXUS – AFFILIATED CORPORATION AS TAXPAYER'S REPRESENTATIVE. In order for the activities of an in-state affiliate to establish nexus for an out-of-state mail order company, the in-state affiliate must act on the out-of-state company's behalf as an agent or representative, and the activity must be significantly associated with the out-of-state company's ability to establish or maintain a market in Washington for its sales. Here, an out-of-state mail order retailer was found to have substantial nexus with Washington where an in-state affiliate distributed the out-of-state company's brochures and made representations about the out-of-state company's quality to its customers.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

DIRECTOR'S DESIGNEE: Ronald J. Rosenbloom, Policy and Operations Manager

Chartoff, A.L.J. – An out-of-state limited liability company engaged in selling prescriptions by mail order to [an affiliate's] health and pharmacy benefit plan subscribers, requests executive reconsideration of Det. No. 08-0158, which sustained an assessment of retailing B&O tax on mail order pharmacy sales delivered to subscribers in this state. In dispute is whether the actions of the taxpayer's affiliate in this state establish nexus for the taxpayer. We conclude the taxpayer's affiliate performs activities on behalf of the taxpayer that are significantly associated

with the taxpayer's ability to establish and maintain a market in this state for the sales, and therefore, establish nexus for the taxpayer in this state. We sustain the assessment.[1]

ISSUE

Under WAC 458-20-193, does an out-of-state mail order pharmacy have substantial nexus to Washington where an in-state insurance company promotes the use of the mail-order pharmacy in its health plan promotional materials?

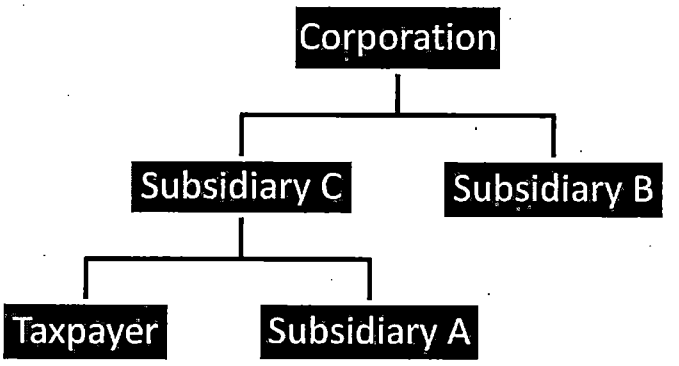
FINDINGS OF FACT

[Corporation] is a publicly traded corporation headquartered [outside of Washington], offering . . . health insurance products and related services, including medical [and] pharmacy . . . plans.

[Corporation] offers these products and services nationwide through its many subsidiaries. [Corporation] and many of its subsidiaries are licensed to do business in this state with the Washington Department of Licensing (DOL). [Several of the] subsidiaries are registered with the Washington State Office of the Insurance Commissioner (OIC) to sell insurance in this state. [Subsidiary A] is a wholly owned subsidiary of [Corporation] that sells health insurance plans in this state. [Subsidiary A] has resident agents and employees who solicit sales in Washington State. . . .

The taxpayer in this case is [an out of state] limited liability company, and a wholly owned subsidiary of [Corporation]. [The taxpayer] is a pharmacy with offices [outside of Washington] that sells pharmacy items by mail order, phone, or internet to subscribers of [Corporation's] health and pharmacy benefit plans. [The taxpayer] ships orders to customers in Washington by common carrier. [The taxpayer] is licensed by DOL to do business in this state, and has a nonresident pharmacy license from the Washington State Department of Health (DOH).

The following diagram illustrates the ownership structure of the . . . companies discussed herein. The subsidiaries of [Corporation] in the diagram are all wholly owned subsidiary corporations or companies.



[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410. Nonprecedential portions of this determination have been deleted.

As illustrated in the diagram, [the taxpayer and Subsidiary A] are brother-sister companies. As of [early 2008, the taxpayer and Subsidiary A] each had [several] officers in common with the other. The taxpayer represents that [the taxpayer and Subsidiary A] do not share employees. [The Corporation's name] is the brand name used for products and services provided by one or more of the [Corporation's] group of subsidiary companies.

The taxpayer provides services pursuant to an agreement . . . between [the taxpayer] and [Subsidiary B], "on behalf of itself and its Affiliates." [Subsidiary B] is a wholly owned subsidiary of [Corporation], licensed to do business in Washington by DOL, and authorized to sell insurance in Washington by the Office of Insurance Commissioner (OIC). "Affiliate" is defined in the agreement as "any corporation, partnership or other legal entity (including any plan) directly or indirectly owned or controlled by, or which owns or controls, or which is under common ownership or control with [Subsidiary B]." Therefore this one agreement binds [the taxpayer] to every . . . subsidiary and affiliate [of Corporation], including [Subsidiary A].

The agreement states that [the taxpayer] will provide pharmacy services to [Subsidiary A] health and/or pharmacy benefit plan members, and describes compensation terms, data access and sharing, and service standards. With respect to the relationship of the parties, the agreement states: "The relationship between [Subsidiary B] and [the taxpayer] and their respective employees and agents is that of independent contractors, and none shall be considered an agent or representative of the other for any purpose, nor shall any party or its agents or employees hold themselves out to be an agent or representative of any other party for any purpose." . . .

With respect to advertising, the agreement states: "Pharmacy consents to the use of Pharmacy's name and other identifying and descriptive material in provider directories and in other materials and marketing literature of Company." . . . The Agreement further states: "Company will include Pharmacy in the applicable Provider Directory(s) and will make the directory available to Members." . . . The agreement contains no further obligation for [Subsidiary B] or its affiliates to market [the taxpayer].

[Corporation, which] purchased [the taxpayer] . . . explains . . . that it purchased the facility [to manage drug expenditures for clients, grow its pharmacy business, and more effectively integrate health care and pharmacy benefits].

[At that time, a briefing for Corporation brokers] describes the reasons for acquiring the pharmacy and explains that all members will be required to switch to [the taxpayer]. [The reasons include process management and integrating member information. The briefing goes on to give effective dates for members to switch to the taxpayer, and notes that the taxpayer's mail-order brochures are available.]

While [Corporation's health and pharmacy benefit plan subscribers] are free to use any participating retail pharmacy, mail order benefits are generally only available through [the taxpayer]. . . . [The taxpayer] provides services only to [Corporation's health and pharmacy benefit plan subscribers]. . . .

[Subsidiary A] has employees and representatives in Washington who solicit sales of [Corporation's] health plans. As part of their solicitation activities, they distribute brochures regarding the health plans which contain descriptive material regarding [the taxpayer], and which refer members to [Corporation's website] where there is additional descriptive material regarding [the taxpayer]. During the audit period, [that website] had a link to [the taxpayer's] website. Currently, it appears that members can order drugs from within the [Corporation] member secure website. The [Corporation] website . . . currently [describes the taxpayer as saving subscriber time and money by ordering through them; and offering convenience, ease of use, quality of service and cost savings. It also offers a view of a sample 90-day prescription.]

The taxpayer represents that the relationship of [Corporation] and its affiliates to [the taxpayer] is no different from [Corporation's] relationship to [many other] participating providers in the [Corporation] network. The taxpayer states that [Subsidiary A] provides information to subscribers on all participating pharmacies. The taxpayer provided copies of . . . documents [that] merely list the names of participating pharmacies but do not provide additional descriptive material. We also note that [the taxpayer] is not included in the list of participating pharmacies. The [Corporation] website lists participating pharmacies but does not provide web links or make representations about the quality of services they provide. [Corporation's] webpage further explains [that Corporation offers a network of pharmacies, but that subscribers may be able to maximize pharmacy benefits by getting medications through the taxpayer; and that they may choose retail pharmacies which typically only provide 30-day supplies of prescription medications.]

In Det. No. 08-0158, we noted that certain plan documents contained the following disclosure: "With the exception of [the taxpayer], all participating . . . health care providers are independent contractors and are neither agents nor employees of [Corporation]."[2] Based on this evidence, we find that the relationship of [Corporation] and its affiliates to [the taxpayer] is different from [Corporation's] relationship to other participating providers in the [Corporation's] network. [The taxpayer] is the only service provider promoted by [Corporation] and referred to as [Corporation's] service provider.

The taxpayer states it "does not pay a direct fee to [Subsidiary A] to compensate [Subsidiary A] for market making activities performed within the state of Washington." . . . The taxpayer represents that [Subsidiary A] benefits when subscribers purchase drugs from [the taxpayer] versus independent pharmacies due to negotiated price discounts and other cost efficiencies.

In 2006, Compliance investigated whether the taxpayer had nexus to Washington, and concluded that nexus in Washington was established for [the taxpayer] through the use of [Subsidiary A] representatives calling on Washington customers. On June 5, 2007, Compliance issued an

[2] The taxpayer represents that this statement is to provide notice to third parties that [the taxpayer] and [Subsidiary A] are both owned by [Corporation]; that [the taxpayer] and [Subsidiary A] are related parties; and that health care providers are independent contractors who are solely responsible for health care services provided to [Corporation] members. The taxpayer represents the statement "was not intended to create or document a principal-agent relationship between [Subsidiary A] and [the taxpayer]."

assessment for $. . ., consisting of $. . . retailing B&O tax, $. . . interest, $. . . delinquent return penalty, $. . . unregistered business penalty, and $. . . assessment penalty.

On July 2, 2007, the taxpayer appealed asserting it has no nexus to Washington. The taxpayer argued that [Subsidiary A's] activities cannot be attributed to [the taxpayer] because there is no agency relationship between the two companies. The taxpayer further argued that [Subsidiary A] does not perform any activity on behalf of [the taxpayer] that helps [the taxpayer] establish or maintain a market in this state.

On June 24, 2008, we issued Det. No. 08-0158 denying the taxpayer's petition for correction of assessment. Det. No. 08-0158 concluded that [Subsidiary A's] marketing of the taxpayer to subscribers in this state is significantly associated with the taxpayer's ability to establish and maintain a market in this state and therefore confers nexus. We were not persuaded by the taxpayer's claim that [Subsidiary A] markets the taxpayer in this state solely on its own behalf, and not pursuant to some agency or representative relationship or agreement with the taxpayer.

On September 8, 2008, the taxpayer requested executive reconsideration of Det. No. 08-0158, which was granted. . . . On reconsideration, the taxpayer reasserts its original arguments. The taxpayer also argues that [Subsidiary A] is not paid a direct fee for marketing [Taxpayer] and is not under [Taxpayer's] control. The taxpayer argues that [Subsidiary A] is not a pharmacy and is not in the business of selling prescription drugs. The taxpayer also raises *Barnesandnoble.com LLC v. State Board of Equalization*, California Super. Ct., No., CGC-06-456456, (October 11, 2007), which held that an in-state affiliate was not the online store's agent because the store was not authorized to bind or control the online store in any way.

ANALYSIS

Washington imposes the B&O tax on every person for the act or privilege of engaging in business activities in Washington. RCW 82.04.220. The tax is measured by applying particular rates against the value of products, gross proceeds of sales, or gross income of the business as the case may be. RCW 82.04.220. The gross proceeds from the sale of prescription drugs to consumers in this state are taxable under the retailing classification of the B&O tax. WAC 458-20-18801(2); WAC 458-20-103. However, the sale of prescription drugs is exempt from retail sales tax. RCW 82.08.0281.

WAC 458-20-193 (Rule 193) explains Washington's B&O tax application to interstate sales of tangible personal property. It states, in relevant part:

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

(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. Once nexus has been established, it will continue throughout the statutory period of RCW 82.32.050 (up to five years), notwithstanding that the instate activity which created the nexus ceased. Persons taxable under the service B&O tax classification should refer to WAC 458-20-194. The following activities are examples of sufficient nexus in Washington for the B&O tax to apply:

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

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

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

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

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

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

. . . With respect to the duty to collect retail sales tax or use tax, "substantial nexus" includes a requirement of some physical presence (more than the "slightest presence") in the state. *Quill Corp., supra.* In Det. No. 96-144, *supra,* we concluded that, once the activities of a company go beyond purely mail order activities, and it has demonstrably more than the slightest presence in the state, substantial nexus is established.

Nexus may be established through the activities of the seller's employees or independent contractor representatives. Rule 193(7); *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960); *Tyler Pipe Industries, Inc., supra.*[3]

[3] In *Scripto,* a Georgia corporation's only connection with Florida was that it had ten wholesalers, jobbers, or "salesmen" conducting continuous local solicitation in Florida and forwarding the orders from Florida to the Georgia seller for shipment. The court held that Florida could constitutionally impose upon the Georgia seller the duty of collecting Florida's use tax upon goods shipped to customers in Florida. In *Tyler Pipe,* the court held that Washington had sufficient nexus with an out-of-state seller whose only connection with Washington was the use of

It is not necessary for the employee or independent contractor to be engaged in the direct solicitation of orders for nexus purposes. Any activity performed in this state on behalf of the seller that is significantly associated with the seller's ability to establish and maintain a market in this state for the sales establishes nexus over the seller. Rule 193(7); *Standard Pressed Steel Co. v. Department of Rev.*, 419 U.S. 560 (1975); *National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551 (1977).

The applicable example of sufficient nexus listed under Rule 193(7)(c) in this case is example (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.'" Services in the state in relation to sales that fit that description will also meet the demonstrably more than the slightest presence requirement of *Quill*.

In the present case, [the taxpayer] does not have a sales office in Washington State. . . . The taxpayer takes orders from Washington customers by phone, internet, or mail order, and delivers the orders solely by common carrier. The taxpayer has no employees or stock of goods in this state.

The issue presented in this appeal is whether the activities performed in this state by [Subsidiary A] are sufficient to establish nexus to tax [the taxpayer]. The mere existence of an affiliate doing business in this state is insufficient to establish nexus for an out-of-state affiliate. *See, e.g., SFA Folio Collections, Inc. v. Tracy*, 73 Ohio St.3d 119, 652 N.E.2d 693 (1995) (Saks Fifth Avenue's retail store does not establish tax nexus for Saks Fifth Avenue's out-of-state mail-order subsidiary); *Bloomingdale's by Mail, Ltd. v. Commonwealth Dep't of Revenue*, 130 Commw.190, 567 A2d 773 (1989), *aff'd per curiam*, 527 Pa. 347, 591 A 2d 1047 (1991), *cert. denied*, 504 US 955, 112 S. Ct. 2299 (1992). In order for the activities of [Subsidiary A] to establish nexus for [the taxpayer], [Subsidiary A] must act on [the taxpayer's] behalf as an agent or representative, and the activity must be significantly associated with [the taxpayer's] ability to establish or maintain a market in Washington for its sales.

The facts clearly establish that representatives of [Subsidiary A] perform activities significantly associated with [the taxpayer's] ability to maintain a market in Washington for its sales. [Subsidiary A] has employees and representatives soliciting sales of insurance in this state. These agents and representatives distribute brochures to customers containing information about the benefits of ordering from [the taxpayer]. The brochures also direct subscribers to [Corporation's website], which contains additional descriptive information about [the taxpayer] and a link to [the taxpayer's] website... Currently ... subscribers can order drugs from within [Corporation's] secure site. The distribution of this information and making representations about its quality is a significant service in relation to the establishment and maintenance of sales into this state.

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independent contractors in the state who acted daily on its behalf to solicit sales, call on customers, and maintain and improve the seller's goodwill, customer relations, and name recognition.

[The taxpayer] argues that [Subsidiary A's] activities in this state are in relation to establishing and maintaining a market for [Corporation's] health plans, and that [Subsidiary A] is not performing services on behalf of [the taxpayer] at [the taxpayer's] direction and control. [The taxpayer] argues it is one of [many] independent participating providers in [Corporation's] network. [The taxpayer] further argues that the written agreement between [the taxpayer] and its affiliates does not authorize nor require the affiliates to act on behalf of [the taxpayer], other than to list [the taxpayer] in the provider directory distributed to subscribers.

The creation of an agency or representative relationship is not dependent solely on the existence of a written agreement, and can be implied based on conduct, circumstances, or ratification. *Scholastic Book Clubs, Inc., v. State Bd. of Equalization,* 207 Cal.App.3d 734 (1989); *Borders Online, LLC v. State Bd. of Equalization*, 129 Cal.App.4th 1179 (2005). For example, in *Scholastic Book Clubs*, the appellant was an out-of-state mail order book-seller with no physical presence in California. The taxpayer maintained a market in California by mailing catalogs to teachers, who distributed offer sheets to students, and then forwarded orders to the appellant. The court held that "[b]y accepting the orders, the payment and shipping the merchandise, appellant clearly and unequivocally ratified the acts of the teachers and confirmed their authority as appellant's agents or representatives." *Scholastic Book Clubs*, at 738; *But see, Scholastic Book Clubs, Inc. v. State Dep't of Treasury, Revenue Div.*, 223 Mich. App. 576, 567 N.W.2d 692 (1997) (Held teachers were not company's agents where they were not company's employees, had no authority to bind company, and were not controlled by the company).

More recently, in *Borders Online, LLC v. State Bd. of Equalization*, the California Court of Appeals held that Borders retail stores in California (Borders) were engaged in selling property as authorized representatives of Borders Online (Online), an out-of-state internet retailer, and therefore established nexus for Online. While there was no written agreement between Borders and Online evidencing an agency or representative relationship, the court found that such agreement was implied, reasoning, in part: "Online announced on its website that Borders was authorized to accept Online's merchandise for return, or that Borders would provide customers with an exchange, store credit, or a credit card credit. By accepting Online's merchandise for return, Borders acted on behalf of Online as its agent or representative in California." *Id.* at 1190. Additional factors evidencing an agent or representative relationship were that "Borders encouraged its store employees to refer customers to Online's website; and ... receipts at Borders stores sometimes invited patrons to 'Visit us online at www.Borders.com.'" *Id.* at 1189. *But see, St. Tammany Parish Tax Collector v. Barnesandnoble.com*, 481 F. Supp.2d 575 (2007) (Held internet bookseller, which was affiliated with in-state retailer, did not have substantial nexus with state for sales and use tax, despite existence of close corporate relationship, common corporate name, participation in joint gift card program with several retailers, including bookseller, and bookseller's preferential policy of accepting returns from taxpayer's customers.)

In the present case, the contract between [the taxpayer] and [Subsidiary A], and affiliates, evidences only that [the taxpayer] will provide mail order drug services to [Subsidiary A] subscribers as an independent contractor, and that [Subisidary A] will list [the taxpayer] in its directory of preferred providers. However, other evidence, including the practice of the parties, suggests that [Subsidiary A] is authorized to represent the taxpayer in this state. Unlike with

other participating providers who are merely listed in the provider directory, [the taxpayer] is referred to in [Corporation's] advertising as "[Corporation's] mail order prescription drug service" and [Corporation] makes representations regarding the quality of service and benefits of ordering from [the taxpayer]. The . . . [Corporation's] affiliates instructed most members that [the taxpayer] would be the sole mail order provider, and distributed [the taxpayer] brochures to members. Because [Subsidiary A] holds itself out as a representative of [the taxpayer], we conclude [Subsidiary A] markets [the taxpayer] as an authorized representative of [the taxpayer] in this state.

On reconsideration, the taxpayer argues that [Subsidiary A] is not paid a direct fee for marketing [the taxpayer]. While a direct fee for marketing [the taxpayer] would be clearer evidence of an agency or representative relationship, we cannot conclude that the absence of a direct fee precludes such a relationship. In *Borders Online*, the court concluded Borders acted as Online's agent despite there being no direct fee or commission for services provided to Online.

On reconsideration, the taxpayer cites *Barnesandnoble.com LLC v. State Board of Equalization*, California Super. Ct., No., CGC-06-456456, (October 11, 2007), which held that an in-state retail store was not the online store's agent because the retail store was not authorized to bind or control the online store in any way. We note that this Superior Court decision conflicts with *Borders Online*, the California Court of Appeals Decision, which did not require the in-state store to be able to bind or control the out-of-state affiliate. The fact that Borders retail store adopted the Borders online return policy was sufficient to show Borders acted as Online's representative.

Finally, on reconsideration, the taxpayer contends that the *Borders Online* case in not applicable because it involved two booksellers, while the present appeal involves a health insurer and a mail order pharmacy. We disagree. While there are factual differences, the agency and nexus principles discussed in the case are applicable to the present case.

We conclude that [Subsidiary A's] marketing of the taxpayer to subscribers in this state is significantly associated with the taxpayer's ability to establish and maintain a market in this state and therefore confers nexus. We are not convinced by the taxpayer's argument that [Subsidiary A] markets the taxpayer in this state solely on its own behalf, and not pursuant to some agency or representative relationship or agreement with the taxpayer. Accordingly, we sustain the assessment and deny the petition for reconsideration.

DECISION AND DISPOSITION

Taxpayer's petition for reconsideration is denied.

Dated this 25th day of September 2009.