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DIVISION II

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STATE OF WASHINGTON
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COURT OF APPEALS,
DIVISION II
OF THE STATE OF WASHINGTON

LAMTEC CORPORATION,

Appellants,

v.

DEPARTMENT OF REVENUE OF THE STATE OF WASHINGTON,

Respondent.

REPLY BRIEF OF APPELLANT

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A. INTRODUCTION

The Department of Revenue (the “Department”) has failed to cite a single case of precedential authority with a similar set of facts, in which a court has found that a nexus exists. This is not surprising because no case exists that establishes nexus for an out-of-state manufacturer, with no physical presence in the state, with no employees in the state, nor any dealer or sales representatives permanently based in the state. The Department’s over-emphasis of Lamtec’s occasional visits to Washington State do not change these facts. Moreover, the Department’s attempt to dismiss the most factually analogous case, *City of Tacoma v. Fiberchem*, fails.

B. ARGUMENT

1. The Department Has Failed to Show a Nexus.

None of the cases cited by the Department in its argument as mandatory authority for a nexus are factually analogous to the present case. In fact, each case cited by the Department as examples of a nexus includes crucial factual elements that are not present here.

The Department agrees with Lamtec that the test for whether a nexus exists between the state and the taxpayer is “whether the activities performed in state on behalf of the taxpayer are significantly associated with the taxpayer’s ability to establish and maintain a market in state for the sales.” *Tyler Pipe Indus., Inc. v. Washington Dep’t of Revenue*, 483

U.S. 232, 250, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987). The Department has not found any case of precedential value that indicates that a nexus justifying the imposition of tax exists under the facts here.

For example, in *Standard Pressed Steel*, the court emphasized that the appellant had a full-time employee within the state. *Standard Pressed Steel Co. v. Washington Dep't of Revenue*, 419 U.S. 560, 562, 95 S. Ct. 706, 42 L. Ed. 2d 719 (1975). Lamtec does not employ anyone within the state. In *Standard Pressed Steel*, the U.S. Supreme Court cited *General Motors Corp. v. Washington*, 377 U.S. 436, 84 S. Ct. 1564, 12 L. Ed. 2d 430 (1964), and noted that General Motors also had employees who lived and worked in Washington, as well as dealers, which, while being independently owned, were under the control of General Motors:

[D]istrict managers lived and operated within Washington. Each operated from his home, having no separate office. Each had from 12 to 30 dealers under supervision. He called on each of these dealers, kept tabs on the sales forces, and advised as to promotional and training plans. He also advised on used car inventory control. He worked out with the dealer estimated needs over a 30-, 60-, and 90-day projection of orders. General Motors also had in Washington service representatives who called on dealers regularly, assisted in any troubles experienced, and checked the adequacy of the service department's inventory. They conducted service clinics, teaching dealers and employees efficient service techniques. We held that these activities served General Motors as effectively when administered from 'homes' as from 'offices' and that those services were substantial 'with relation to the

establishment and maintenance of sales,
upon which the tax was measured[.]’

Standard Pressed Steel, 419 U.S. at 563 (discussing and quoting *General Motors Corp*, 377 U.S. at 447). None of these factors are present here. Lamtec has no in-state sales teams or dealers in Washington. Lamtec sells directly to its Washington Customers from out-of-state. It employs no one in Washington state. Unlike General Motors, Lamtec supports no Washington State dealers, who are responsible for selling its products in Washington.

The Department cites another case in which General Motors was the tax payer. *General Motors Corp. v. City of Seattle*, 107 Wn. App. 42, 25 P.3d 1022 (2001). Although the Court noted that no direct selling activities were required for nexus, the Department again ignores important distinctions between that case and the present one. Again, here Lamtec has no in-state employees. General Motors and Chrysler supported its in-state dealerships, with approximately 500 visits per year to Seattle dealerships by sales, service, and parts representatives. *General Motors Corp. v. City of Seattle*, 107 Wn. App. at 46. Lamtec made nowhere near that many contacts to its customers within Washington State. The auto manufacturers also directed advertising to Seattle and required dealerships to buy or lease their signs. *General Motors Corp. v. City of Seattle*, 107 Wn. App. at 46. They also sold warranty programs, which obligated the auto manufacturers to provide service to Seattle customers. *General Motors Corp. v. City of Seattle*, 107 Wn. App. at 47. The Court held that

GM and Chrysler's extensive activity supporting their Seattle dealerships made irrelevant the fact that the auto manufacturers did not engage in direct sales in Seattle. *General Motors Corp. v. City of Seattle*, 107 Wn. App. at 48.

Here, however, Lamtec has no equivalent sales structure. Lamtec is not reliant on dealerships to sell its product to Washington customers. Instead, Lamtec's customers purchase Lamtec's products directly from Lamtec's offices out-of-state. In stark contrast to the 500 annual visits of GM and Chrysler's sales, service and parts representatives, Lamtec employees made only around three visits to Washington per year. Lamtec employees were not selling warranties or service contracts. The Department would like *General Motors Corp. v. City of Seattle* to simply stand for the proposition that a nexus may exist where there are no direct sales to in-state customers, but the Department ignores the rest of the factual context for the Court's holding. Lamtec simply has nowhere near the threshold of significant contacts with Washington that existed in the *General Motors* cases.

Similarly, in another case the Department erroneously relies upon, *National Geographic Society v. Cal. Bd. of Equalization*, the National Geographic Society had much more substantial contact with the state of California than Lamtec has with Washington. *National Geographic Society v. Cal. Bd. of Equalization*, 430 U.S. 551, 97 S. Ct. 1386, 51 L. Ed. 2d 631 (1977). National Geographic maintained two offices within

California. In-state employees solicited advertising for the magazine out of those California offices, totaling approximately one million dollars annually. *National Geographic*, 430 U.S. at 552, 556. Not surprisingly, the Court held that these in-state sales staff established a substantial nexus with California. *National Geographic*, 430 U.S. at 556. Here, Lamtec has no physical presence within Washington whatsoever. In essence, the activities of its in-state advertising sales staff made inconsequential the fact that National Geographic made no direct magazine subscription sales to Californians from its in-state offices. Here, no such similar facts exist. Lamtec's contacts with Washington do not directly result in any sales, and there are no additional contacts within the state that would outweigh this fact.

a. The Department Misstates *Quill*.

The Department engages in a superficial and inaccurate reading of *Quill Corp. v. North Dakota*, 504 U.S. 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992), a case where the U.S. Supreme Court unequivocally upheld the bright-line rule that a physical presence in a state is required for a nexus under a Commerce Clause analysis. *Quill*, 504 U.S. at 315-18. The Court's statement that "contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today," was not a signal that future cases should be decided differently, as the Department implies. Just the opposite is true. The Court took pains to

explain very clearly that *stare decisis* and the benefits to commerce of a clear, predictable rule required continued adherence to its prior decisions, principally *National Bellas Hess v. Department of Revenue of Ill.*, 386 U.S. 753, 87 S. Ct. 1389, 18 L. Ed. 2d 505 (1967). The Court explained that it disagreed that “evolution [of the Court’s cases] indicates that the Commerce Clause ruling of *Bellas Hess* is no longer good law.” *Quill*, 504 U.S. at 314.

The Department treats the bright-line rule for mail-order businesses recognized by *Bellas Hess* and *Quill* as a mere deviation to the Department’s opinion that any minor and tangential connection with Washington must be taxable. But this reflects a misreading of *Quill*. There is no support in *Quill* for the idea that the bright-line test for mail-order businesses somehow contradicts basic dormant Commerce Clause principles. In fact, the Court explained that “the bright-line rule of *Bellas Hess* furthers the ends of the dormant Commerce Clause.” *Quill*, 504 U.S. at 314. The safe harbor for mail-order businesses is not an exception to the principles behind the dormant Commerce Clause; it is an example of them. “*Bellas Hess* . . . stands for the proposition that a vender whose only contacts with the taxing State are by mail or common carrier lacks the ‘substantial nexus’ required by the Commerce Clause.” *Quill*, 504 U.S. 311. This proposition is a fixed point which serves as a guide for lower courts when conducting a more flexible balancing analysis in factual

situations to which the safe harbor does not explicitly apply, such as the present case.

Using the *Quill* case as a fixed point for this Court's analysis of Lamtec's contacts with Washington shows that no taxable nexus exists here. As explained in Lamtec's opening brief, Lamtec's contacts with Washington were even less direct than catalogues mailed into the state, because Lamtec's contacts with Washington did not involve solicitations for new business. In fact, no sales solicitations occurred during any of the visits to Washington by Lamtec employees. CP 25; 37-45. Instead, all orders were placed by customers to Lamtec's customer service department in Flanders, New Jersey. CP 25; 37-45. Other than these short, infrequent visits, Lamtec had no contact with Washington. CP 25; 37-45.

The *Quill* Court also rejected the formal distinction between a sales or use tax and a tax on the privilege of doing business. *Quill*, 504 U.S. at 314 (“formal distinction between taxes on the ‘privilege of doing business’ and all other taxes served no purpose within our Commerce Clause jurisprudence, but stood ‘only as a trap for the unwary draftsman.’”) (quoting *Complete Auto Transit v. Brady*, 430 U.S. 274, 279 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977)). Thus, the analysis of the Commerce Clause nexus requirement in *Quill* applies to the present case, even though *Quill* involved a use tax and the present case involves a B&O tax on the privilege of doing business in Washington.

b. The Department Fails to Understand the Significance of *Fiberchem* and *KMS*.

The Department wrongly argues that *City of Tacoma v. Fiberchem, Inc.*, 44 Wn. App. 538, 722 P.2d 1357 (1986) did not conduct a commerce-related analysis and suggests that this Court overrule *Fiberchem* because *Quill* clarified and refined the analysis under both the Due Process Clause and the dormant Commerce Clause. *Fiberchem* was decided under both Due Process Clause principles and dormant Commerce Clause principles. In *Fiberchem*, the Court recognized the analogy of Tacoma's ability to impose tax with "decisions of the United States Supreme Court in cases involving state taxation of interstate commerce." *Id.* at 543. The *Fiberchem* Court also considered this analysis consistent with "Washington rules of Fourteenth Amendment due process . . ." *Id.* at 544.

Quill later explained that due process concerns and commerce concerns give rise to distinct, but overlapping analyses. *Quill*, 504 U.S. at 305-06. However, even if *Fiberchem* was decided only based on a due process analysis, as the Department asserts, *Fiberchem* is still instructive given its facts, which failed to show a nexus under a due process analysis. *Quill* established that the due process concerns create a lower threshold for nexus than concerns of commerce:

There may be more than sufficient factual connections, with economic and legal effects, between the transaction and the

taxing state to sustain the tax as against due process objections. Yet it may fail because of its burdening effect upon the commerce.

Quill, 504 U.S. at 305-06. Because nexus under a due process requires a lower threshold than under the dormant Commerce Clause, the facts of *Fiberchem* also necessarily fail to meet higher threshold for nexus under the dormant Commerce Clause. As explained in Lamtec's opening brief, in *Fiberchem*, the City of Tacoma attempted to impose its B&O tax on Fiberchem, as a nonresident corporation. Fiberchem did not have an office in Tacoma. It employed only one sales representative who spent approximately one-and-a-half days per month (about 12 hours per month) contacting customers in Tacoma. Some of Fiberchem's largest customers were contacted in person by sales personnel, but sales orders were handled by Fiberchem's Tukwila office. Fiberchem delivered its goods to customers in Tacoma by common carrier and even its own delivery trucks. The Court of Appeals held that Fiberchem's activities in Tacoma were so minimal that it could not be said to be engaging in business there.

The contacts that Fiberchem had with Tacoma were much more significant and substantial than Lamtec's contacts with Washington. Unlike Fiberchem, Lamtec has not made monthly calls on its Washington customers, and Lamtec does not make deliveries in Washington. Lamtec's contacts with Washington are well below the threshold set out in *Fiberchem*, and are therefore far less than "substantial" for imposing Washington B&O tax on Lamtec.

The Department also disputes the significance of *KMS Financial Services v. City of Seattle*, 135 Wn. App. 489, 146 P.3d 1195 (2006). Although *KMS* addressed apportionment, which is not directly at issue here, the *KMS* court clearly stated that the Department has constitutional limits on its “power to tax activities occurring outside its boundaries.” *KMS*, 135 Wn. App. at 503. *KMS* is therefore significant here because it countermands the Department’s opinion that it has virtually unlimited jurisdiction to tax even the most minimal and tangential of connections Washington.

The nexus analysis anticipates that some contacts will not meet the constitutional threshold. However, if Lamtec’s contacts with Washington in this case are taxable, it is difficult to imagine what minimal contacts would not be taxable. If the constitutional nexus requirement has any meaning, it must limit the Department’s jurisdiction to tax an out-of-state corporation such as Lamtec, that merely sells to Washington customers, and that has employees who occasionally visit this state without selling any products during those visits. These minimal contacts with Washington are simply insufficient to give the Department jurisdiction to impose a B&O tax on Lamtec.

c. The Department Fails to Cite Precedential Authority for a Nexus Under the Facts of This Case.

The Department cites to decisions by the Washington Board of Tax Appeals and courts in other jurisdictions. They have no precedential value to this Court. The Department admits that these opinions are not binding on this Court. Br. of Respondent, p. 22 n. 12. Tax Board decisions are reviewed *de novo* under chapter 34.05 RCW. *Stuewe v. State Dept. of Revenue*, 98 Wn. App. 947, 949, 991 P.2d 634 (2000). The fact that the Washington Board of Tax Appeals has found sufficient nexus in cases such as *Carr Lane Manufacturing Co. v. State Dep't of Revenue*, should have no bearing on the outcome of this case, especially when they have not been subject to *de novo* review.

2. Lamtec's Minimal Visits to Washington are Disassociated from Washington Sales and Are Therefore Not Subject to B&O Tax.

The Department claims that a dissociation analysis is not valid under "modern-day Commerce Clause analysis." Br. of Respondent, p. 33. Yet, In *Tyler Pipe*, the U.S. Supreme Court affirmed that for a constitutional nexus to exist, "the activities performed in this state on behalf of taxpayer [must be] significantly associated with the taxpayer's ability to establish *and* maintain a market in this state for the sales." *Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987) (quoting and affirming, in

part, *Tyler Pipe Indus., Inc. v. Dep't of Revenue*, 105 Wn.2d 318, 323, 715 P.2d 123 (1986).

The Department also argues that *Norton Co. v. Dep't of Revenue of Illinois*, is no longer valid law, but cites to no direct authority for this other than an article by a “commentator.” No case has expressly overruled the U.S. Supreme Court’s holding in *Norton*, and it therefore remains good law. Lamtec’s activities in occasionally visiting existing customers located in Washington were disassociated with establishing new customers and Lamtec is entitled to a refund of the B&O tax it has paid.

3. Lamtec’s Washington Customers Received Lamtec’s Products Outside of Washington.

The Department embraces the analysis in *Ford Motor Co. v. City of Seattle*, 160 Wn.2d 32, 156 P.3d 185 (2007), but seemingly ignores that *Ford* addressed only the propriety of two municipal B&O tax schemes, which did not require determining where a sale was made or where goods were received for assessment. *Ford* addressed the broad constitutional requirements. In contrast, the present case squarely addresses the requirement in WAC 458-20-193(7), which states “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.” (Emphasis added). This requirement is explicit and is in addition to the nexus requirement. *Field Enterprises v. State* was decided in 1955,

before the promulgation of WAC 458-20-193. *Field Enterprises v. State*, 47 Wn.2d 852, 289 P.2d 1010 (1955).

Neither *Field Enterprises* nor *Ford* speak to this specific regulatory requirement, which is squarely before the Court in the present case. As explained in Lamtec's opening brief, *McLeod* and *Weyerhaeuser* required locating the transfer of title of the goods to determine whether the tax was proper. See *Ford*, 160 Wn.2d at 44. *McLeod* and *Weyerhaeuser* are persuasive here.

The Department argues that *Ford* stands for the proposition that it is immaterial whether the purchaser agrees to accept the Lamtec's product FOB Flanders, New Jersey. This argument also fails because the *Ford* court's comment that "it does not matter in which jurisdiction the actual sales at wholesale occur," (*Ford*, 160 Wn.2d at 43) clearly was not in regard to the specific requirement in WAC 458-20-193(7) that to be taxable, the good must be "*received by the purchaser in this state.*" WAC 458-20-193(7). *Ford* is therefore inapplicable. Therefore, if this Court holds that Lamtec's minimal contacts with Washington somehow give rise to a nexus sufficient to justify imposing B&O tax, this Court must then move to the next step of the analysis and decide whether Lamtec's customers' agreements to take possession of Lamtec's products in New Jersey is immaterial to whether Lamtec should be subject to Washington B&O tax. Based on the arguments here and in Lamtec's

opening brief, FOB agreements are material, and the Department has not met this requirement.

C. CONCLUSION

The Department's B&O tax assessment against Lamtec is invalid because Lamtec has virtually no contact with the State of Washington. Lamtec ships all goods to Washington as FOB Flanders, New Jersey, which means that all of Lamtec's customers receive the Lamtec goods it purchases in New Jersey, not Washington. The Department's imposition of B&O taxes upon Lamtec is also improper because Lamtec's minimal contacts with Washington are disassociated with the sale its goods to customers located in Washington. The trial court erred when it denied Lamtec's motion for summary judgment because Washington law and United States Supreme Court precedent do not support the Department's position that Lamtec is subject to Washington B&O taxes. Lamtec is entitled to be reimbursed by the Department for prior taxes paid plus costs.

If the Department's assessment of B&O taxes were adopted and followed throughout the United States, Lamtec and other corporations like it, would have to fill out tax returns for every state. Imposing B&O taxes upon Lamtec violates existing case law from the State of Washington and the United States Supreme Court.

RESPECTFULLY SUBMITTED 16th day of October, 2008.

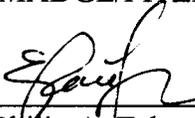
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I hereby certify under penalty of perjury under the laws of the State of Washington that I served a copy of the Reply Brief of Appellant on October 16, 2008, pursuant to RAP 18.6(c), via U.S. Mail as follows:

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