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BY RONALD R. CARPENTER

**SUPREME COURT
OF THE STATE OF WASHINGTON**

CLERK

DOT FOODS, INC.,

Petitioner-Appellant,

vs.

DEPARTMENT OF REVENUE, STATE OF WASHINGTON,

Respondent-Appellee.

**AMICUS CURIAE BRIEF OF
MELALEUCA, INC.**

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I. STATEMENT OF INTEREST OF THE AMICUS CURIAE

Melaleuca, Inc. is a consumer direct marketing company, incorporated in Idaho and operating from its headquarters in Idaho Falls, Idaho and a member of the Direct Selling Association (DSA). Its only connection to Washington comes from a network of independent contractors working as commissioned sales agents, i.e. direct seller's representatives (DSRs), who solicit sales of Melaleuca products to Washington residents. For several years Melaleuca has claimed the business and occupation (B&O) tax exemption for direct sellers set forth in RCW 82.04.423. *See* Appendix A. In September 2006, the Washington Department of Revenue (DOR) assessed Melaleuca for \$79,209.32 of B&O taxes and interest, claiming that Melaleuca did not qualify for the exemption. DOR based this assessment on its reinterpretation of the statute, as set forth in WAC 458-20-246 (Rule 246) and Excise Tax Advisory 2041.04.246 (ETA 2041). Respectively, Appendices B and D. After Melaleuca paid this contested assessment in 2007, it brought a refund action in Thurston County Superior Court: *Melaleuca, Inc. v. State of Washington Department of Revenue*, Docket No. 08-2-00864-6. This action is now pending, awaiting the Supreme Court's decision for Dot Foods. Because of DOR's audit instructions,

Melaleuca continues to pay contested B&O taxes on its current Washington revenues. Many of the issues DOR raised against Dot Foods, Inc., which the Court of Appeals addressed in its decision, is pertinent to Melaleuca's pending action and to the question of Melaleuca's on-going tax liability.

II. ARGUMENT

In *Dot Foods, Inc. v. Dep't of Revenue*, 141 Wn.App. 874, 173 P.3d 309 (2007), Division 2 of the Washington Court of Appeals made two rulings adverse to the taxpayer: (1) A direct seller must exclusively sell consumer products in Washington in order to qualify for the B&O tax exemption contained in RCW 82.04.423. 141 Wn.App. at 882. (2) If anyone downstream of the direct seller ever sells any consumer product in a permanent retail establishment, the direct seller loses its tax exemption. 141 Wn.App. at 887-888. Both of these rulings arose from DOR's interpretation of RCW 82.04.423(1)(d)'s requirement that a direct seller "[m]akes sales in this state exclusively to or through a direct seller's representative" and RCW 82.04.423(2)'s definition of the term "direct seller's representative." Melaleuca requests that the Supreme Court bear in mind the following three points as it considers how these two statutory provisions should be interpreted.

A. A STATUTORY INTERPRETATION CANNOT BE
“REASONABLE” IF IT VIOLATES THE BASIC
RULES OF STATUTORY CONSTRUCTION.

RCW 82.04.423 (2)’s definition of “direct seller’s representative”

is more easily understood when it is portrayed graphically, as follows:

For purposes of this section, the term ‘direct seller’s
representative’ means a person

[A] who buys consumer products on a buy-sell basis or
a deposit-commission basis for resale

[1] **by the buyer or any other person,**

[2] in the home or otherwise than in a
permanent retail establishment,

or

[B] who sells, or solicits the sale of, consumer products

[2] in the home or otherwise than in a
permanent retail establishment.

(Brackets, numbering, and emphasis added.)

DOR interpreted this definition to mean Alternative A was
describing wholesale sales from the direct seller to the DSR and
Alternative B was describing retail sales from the direct seller to a third
party customer, who had been solicited by the DSR. Dot Foods agreed
with DOR’s description of Alternative A, but argued that nothing in the
statutory language limited Alternative B to retail sales. The Court of
Appeals concluded: “Both of the offered interpretations of RCW
82.04.423 rely on the statute’s plain language and both are reasonable.”
141 Wn.App. at 883.

In fact, neither the Court of Appeals nor DOR gave a correct or “reasonable” interpretation to the statutory language because they failed to follow three basic rules of statutory construction. (1) “[W]here the Legislature uses certain statutory language in one instance, and different language in another, there is a difference in legislative intent.” *Agrilink Foods, Inc. v. Dep’t of Revenue*, 153 Wn.2d 392, 103 P.3d 1226 (2005). “Just as it is true that the same words used in the same statute should be interpreted alike, it is also well established that when different words are used in the same statute, it is presumed that a different meaning was intended to attach to each word.” *Simpson Investment Co. v. Dep’t of Revenue*, 141 Wn.2d 139, 3 P.3d 741 (2000). (2) “[W]e cannot add words or clauses to an unambiguous statute when the legislature has chosen not to include that language.” *State v. J.P.*, 149 Wn.2d 444, 450, 69 P.3d 318 (2003). (3) “[T]he court should assume that the legislature means exactly what it says. Plain words do not require construction.” *City of Snohomish v. Joslin*, 9 Wn.App. 495, 498, 513 P.2d 293 (1973). The reason why DOR’s interpretation violates these three rules is self-evident. DOR did not “interpret” the language of RCW 82.04.423, it rewrote it.

DOR’s interpretation seeks to impose the “or any other person” restriction on sales occurring under Alternative B when that alternative has no such requirement. DOR’s interpretation can only reach its conclusion

by stretching all the way back to the introductory words of the exemption, which say this B&O tax exemption applies equally to “gross income derived from the business of making sales at wholesale or retail.” But sales made under Alternative B could just as easily be subject to wholesaling B&O tax as retailing B&O tax. Any interpretation of statutory language that violates these basic rules cannot be “reasonable.”

More importantly, the Court and both parties were all wrong together because they failed to follow the most basic of all the rules of statutory construction: “Statutes are to be construed, wherever possible, so that no clause, sentence or word shall be superfluous, void, or insignificant.” *United Parcel Service, Inc. v. Dep’t of Revenue*, 102 Wn.2d 355, 361-362, 687 P.2d 186 (1984) (quotation marks and citations omitted). Both interpretations fail to give full meaning to the word “sell” in Alternative B and the words “a buy-sell basis or a deposit-commission basis” in Alternative A.

RCW 82.04.040(1) defines “sale” as “any transfer of the ownership of, title to, or possession of property for a valuable consideration.” A DSR cannot transfer the “ownership of” or “title to” consumer products she does not own. But in Alternative B, RCW 82.04.423(2) states that a DSR is someone “who sells, or solicits the sale of, consumer products.” Thus, not only does Alternative B allow the sales to be either at retail or

wholesale, it allows the sales to be made by either a DSR who “sells” products it purchased from the direct seller, or by the direct seller when the DSR “solicits” sales on the direct seller’s behalf. Thus, under Alternative B, a direct seller can truly make sales either “to or through” the DSR. *See* RCW 82.04.423(1)(d).

Alternative A, on the other hand, is much narrower than either the Court of Appeal or the parties imagined. It does not cover every instance where a DSR “buys consumer products ... for resale.” There are important limiting words between the “buy” and the “resale” in this provision. Alternative A only applies to those instances when a DSR buys consumer products “on a buy-sell basis or deposit-commission basis”.

These are technical terms that have special meanings in the world of direct sales companies. This is as demonstrated by an example, the diagram of Corporation’s DSR structure, that we found in Appendix E, Governor Spellman’s Legislative File 1983 SB 3909. *See* Appendix E-2. Under a buy-sell arrangement, the DSR buys consumer products from the direct sales company at an established price and is required to resell them at the same price. Cash payments for the products are sent to the direct sales company with each order. Based upon the total volume of sales made in a given period of time by both the individual DSR and other DSRs in her organization, the direct sales company then sends the DSR a

“bonus” or “sales rebate” that effectively reduces the DSR’s original purchase price and allows the DSR to achieve a gross margin on her sales. Under the “deposit-commission basis”, the DSR solicits orders from customers and receives a direct payment of a certain percentage of the total purchase price. This is the “deposit” from which the DSR will later withdraw her “commission”. The remainder of the purchase price is forwarded to the direct sales company before the products are shipped to the DSR. Once again, the actual amount the DSR is allowed to retain is based on some formula that takes into account the sales at each level of the DSR’s organization.

Under both the buy-sell and the deposit-commission systems, the direct sales company has control over the sales activities of both the direct DSR as well as all of the lower tiered DSRs in her organization. See the discussion of an unpublished tax decision, identified as “Unknown Decision” in the December 3, 1981 letter from William T. Robinson to Glenn Pascall, DOR Director, found in the SB 3909 File, Appendix E-16. It is, no doubt, for this reason that Alternative A includes the significant restriction that “the buyer [DSR] or any other person” are prohibited from reselling the consumer products in a “permanent retail establishment.” In Alternative B situations, the direct sales company has no control over the products or marketing techniques used by downstream parties after the

DSR “sells or solicits the sales of” consumer products, so no such requirement is placed on the DSR under Alternative B.

Not only does this interpretation of RCW 82.04.423(2) give significance to every word in the statute, it is also consistent with RCW 82.04.423’s legislative history. In 1983, there was a great deal of confusion about the power of states to assert taxable nexus against out-of-state companies with minimal contacts inside the state. In 1959, Congress had passed Public Law 86-272 (15 U.S.C. § 381), which held that no state could impose income taxes on a non-resident company whose only activity within the state was the solicitation of sales. At the time of its enactment, Public Law 86-272 was seen as reining in state income tax power to match the limitations traditionally imposed on state excise tax power. In 1983, no Washington court decision had yet ruled that the mere presence of independent contractors soliciting orders within the state was sufficient to allow DOR to impose B&O taxes on their sales. Although the United States Supreme Court had ruled in *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), that the in-state presence of independent contractor sales agents was sufficient to require the out-of-state seller to collect and remit sales tax, it was not until four years after enactment of RCW 82.04.423, with the decision in *Tyler Pipe Industries, Inc. v Dep’t of Revenue*, 483 U.S. 232 (1987), that the U.S. Supreme Court for the first time upheld the

right of a state to impose a direct tax on an out-of-state company for the same reason.

Under these circumstances, when DOR began imposing retailing and wholesaling B&O tax on out-of-state companies whose only presence in the state was independent contractors, it was described as "taxation by ambush". See Appendix E-3, Governor Spellman Legislative File 1983 SB 3909. DOR Director Burrows admitted:

The major justification advanced on behalf of the bill was that it would clarify the state's taxing jurisdiction over these out-of-state manufacturers, thus bringing stability and predictability to the conduct of their business in Washington. This justification exists. There are uncertainties in the area of whether this state has the jurisdiction, consistent with the Due Process clause, to impose the B&O tax on out-of-state manufacturers who do not have employees or property in this state.

DOR Director Donald R. Burrows letter to Governor John Spellman, dated June 6, 1983. Appendix G, SB 3244 File, page G-20.

During the 1983 legislative session, House Bill 566 would have granted a B&O tax exemption equivalent to Public Law 86-272 to anyone whose only activity within the state was the solicitation of sales. See Appendix F, HB 566 File. With an estimated cost of \$34,000,000, Appendix F-6, HB 566 was deemed too expensive. Members of the Senate then proposed amending SSB 3909 to contain a less costly version. Appendix F-3. To block that effort, DOR proposed the current language

of RCW 82.04.423 as an addition to SB 3244. Appendix G-5, SB 3244 File. It was this version the Legislature passed. Even then, in his letter to Governor Spellman, Director Burrows asked the governor to veto that portion of SB 3244. Appendix G-19 through G-23. However, by limiting the tax exemption to companies who only used independent contractors (rather than employees) to solicit sales, the estimated cost per biennium was reduced to \$1,200,000. Appendix G-21. Thus, even though Alternative B only required DSRs to restrict their sales activities to places “otherwise than in a permanent retail establishment,” RCW 82.04.423’s primary requirement that the DSR not be an employee of the direct seller was anticipated to keep the cost at a reasonable level. Nevertheless, in his letter to Governor Spellman, DOR Director Burrows warned: “Where it will end no one knows at this time. This uncertainty is compounded by the fact that ‘direct selling’ is a relatively new form of doing business.” Appendix G-20.

In *Dot Foods*, the Court of Appeals admitted, “Dot Foods’ interpretation [of the statutory language] does seem more literal than the Department’s.” 141 Wn.App. at 886. But one of the reasons the Court accepted DOR’s interpretation was because Dot Foods was unable to explain why the “or any other person” requirement was only found in Alternative A. (The Court of Appeals referred to this as the “wholesale or

retail” distinction.) *Id.* However, a proper interpretation of all of the words in the statute makes it understandable that the Legislature only imposed restrictions on sales activities to the extent that the direct sales company could have some control over them. This is not only logical, it is undoubtedly required by the Due Process Clauses of both the United States and the Washington Constitutions. U.S. Const., Amend. XIV, § 1; Wash. Const., Art. I, § 3. A state cannot impose taxes on someone based upon the actions of another person, who is not the seller’s agent, and whose actions are beyond the taxpayer’s control.

B. SALES ARE MADE “THROUGH” A DSR IF THE SALES ARE MADE “BY THE MEANS OF” OR “BY THE AGENCY OF” A DSR, EVEN IF THE CUSTOMER COMMUNICATES THE SALES ORDER DIRECTLY TO THE OUT-OF-STATE DIRECT SELLER.

The 1983 Legislature enacted RCW 82.04.423 to give tax relief to out-of-state companies who have minimal tax nexus with the state. That nexus arises primarily “through” the in-state activities of independent contractors acting as sales representatives on the company’s behalf. Therefore, in order to qualify for the tax exemption, RCW 82.04.423(1)(d) requires that the direct seller “[m]akes sales in this state exclusively to or *through* a direct seller’s representative.” (Emphasis added.) In ETA 2041, DOR claims this requirement is not met and the tax deduction is lost

if the direct seller fills any order received “directly” from a customer via telephone, fax, mail order, or internet. In such instances, DOR claims the sale is not made “through” a DSR even if the DSR recruited the customer, made sales presentations concerning the consumer products, was instrumental in inducing the customer to place the order, and received a full sales commission for the sale. One of the reasons DOR gave for denying Dot Foods’ tax deduction was because the Washington customers contacted by Dot Foods’ DSR transmitted their orders either electronically or telephonically to Dot Foods’ headquarters in Illinois. 141 Wn.App. at 878. Although the Court of Appeals noted these facts as one of DOR’s grounds for denial of Dot Foods’ claims, *id.*, the Court of Appeals did not enter a specific ruling on this issue.

“When a statutory term is undefined, we may look to a dictionary for its ordinary meaning.” *Port of Seattle v. Dep’t of Revenue*, 101 Wn.App. 106, 1 P.3d 607, *review denied*, 142 Wn.2d 1012, 16 P.3d 1264 (2000). The general dictionary gives two primary meanings for the word “through” when it is used as a preposition: “1a(1) – used as a function word to indicate penetration of or passage within, along, or across an object, substance, or space usu. from one side or surface to the opposite”, or “2a(1) – by means of: by the help or agency of”. Webster’s Third New International Dictionary (Unabridged), p. 2384 (Merriam-Webster, Inc.

2002). In the context of RCW 82.04.423, however, the word “through” is used in a business or legal sense; therefore, it is technical language.

“Technical language should be given its technical meaning when used in its technical field.” *City of Spokane ex rel. Wastewater Management*

Department v. Dep’t of Revenue, 145 Wn.2d 445, 452, 38 P.3d 1010

(2002). The technical meaning of “through” is set forth in West’s Law and Commercial Dictionary in Five Languages, p. 652 (1985): “By means of, in consequence of, by reason of; in, within; over; from end to end, or from one side to the other. By the intermediary of; in the name or as agent of; by the agency of”. Although the Law and Commercial Dictionary goes on to note that “‘Through’ is [a] function word capable of several meanings depending on its use”, it is obvious that the primary meaning of the word in a commercial/business setting is “by means of, in consequence of, ... [or] by the agency of.” This is consistent with the fact that corporations are legal fictions that can only operate *through* the actions of their officers, employees and agents.

The proper meaning of the word “through,” in a business context, is further demonstrated by the Supreme Court’s own use of the term in *Tyler Pipe Industries, Inc. v. Dep’t of Revenue*, 105 Wn.2d 318, 715 P.2d 123 (1986), *reversed on other grounds*, 483 U.S. 232 (1987). The Supreme Court described the nature of this case as “The majority of sales

were transacted *through* sales representatives who were independent contractors residing in Washington.” 105 Wn. 2d at 319. Later in the decision, the Court described the taxpayer’s actions as follows: “Tyler Pipe markets its products *through* these two [sales] departments.” 105 Wn. 2d at 320(emphasis added.) The Court of Appeals’ own statement of facts concerning Dot Foods’ business operations went even further: “Since receiving the private letter ruling, Dot Foods’ Washington sales have been *exclusively through* its wholly-owned subsidiary” 141 Wn.App. at 878 (emphasis added). This was so, even though the Court knew the actual orders traveled directly from customer to out-of-state seller. *Id.*

Because the word “through” has more than one definition (like virtually all words in the English language), we must anticipate that DOR will respond by claiming the statutory language is “ambiguous,” that ambiguity must be resolved by giving the word any other meaning that might give a contrary result, and tax exemptions are narrowly construed in favor of taxation and against exemption. In the context of RCW 82.04.423, however, such arguments overstate the case. “While a statute is ambiguous if it is susceptible to two or more reasonable interpretations, it is not ambiguous merely because different interpretations are conceivable.” *State v. Tili*, 139 Wn.2d 107, 115, 985 P.2d 365 (1999).

“The courts are not obliged to discern any ambiguity by imagining a variety of alternative interpretations.” *State v. Keller*, 143 Wn.2d 267, 276-277, 19 P.3d 1030 (2001) (quotations omitted). The court should avoid any interpretation leading to an absurd result. *Id.*, 143 Wn.2d at 277. The Court of Appeals correctly noted that Dot Foods’ “sales have been *exclusively through*” its DSR, even though the customers sent the orders solicited by that DSR directly to the seller’s out-of-state office. Because the Court of Appeals made no specific ruling on this issue, however, we request that the Supreme Court rule that direct receipt of a customer’s orders via telephone, fax, mail order, or internet does not cause a direct seller to lose the tax exemption if the customer was previously contacted or enlisted by a DSR, and the DSR receives a sales commission on the sales made to the customer.

**C. EVEN IF DSRs ARE REQUIRED TO SELL
“EXCLUSIVELY” CONSUMER PRODUCTS; THE
DIRECT SELLER DOES NOT LOSE THE TAX
EXEMPTION WHEN IT SELLS MARKETING
MATERIALS AND SALES AIDS TO ITS DSRs.**

In response to its self-posed question of “What product the direct seller must be selling”, in Rule 246(4)(b)(ii) the Department states: “The direct seller must be selling a consumer product” In *Dot Foods*, the Court of Appeals stated, somewhat differently:

Despite Dot Foods' arguments to the contrary, the plain language of the exemption illustrates that it should only apply where *direct seller's representatives* exclusively sell consumer products. Because Dot Foods admits that a portion of its sales in Washington consist of non-consumer products, the exemption does not apply to them.

141 Wn.App. at 877 (emphasis added). The Court of Appeals explained its reasoning as follows:

RCW 82.04.423(1)(d) states that the exemption applies only to sellers who make sales "exclusively to or through a direct seller's representative." Subsequently, RCW 82.04.423(2) specifically limits the definition of "direct seller's representative" to one who buys or sells consumer products. Therefore, construing the statute as a whole properly imputes the exclusivity requirement to the consumer products requirement.

141 Wn.App. at 881-882. This analysis was then mistakenly imputed to the direct seller as well as the DSR, resulting in the Court of Appeals asserting "a direct seller must exclusively sell consumer products in Washington in order to qualify for the exemption." 141 Wn.App. at 882.

Marketing materials and sales aids are not "consumer products" because they are not used for "personal, family, household, or other nonbusiness purposes." See Rule 246(4)(b)(ii). Such materials are used in the DSRs' business activities, to assist them in selling the consumer products. All direct sales companies sell marketing materials and sales aids to their DSRs. If they did not do so, it would be virtually impossible for their DSRs to perform their own selling activities. Thus, the Court of

Appeals' statement would lead to the absurd result that, in order to qualify for the deduction, DSRs must be deprived of the marketing and sales materials they need to perform their sales services. But, in any analysis of statutory language, "the court must remain careful to avoid unlikely, absurd or strained results." *Berrocal v. Fernandez*, 155 Wn.2d 585, 590, 121 P.3d 82 (2005) (citations and quotation marks omitted). Or, as the Supreme Court stated in another case: "[I]n construing a statute, a reading that results in absurd results must be avoided because it will not be presumed that the legislature intended absurd results. *State v. J.P.*, 149 Wn.2d 444, 450, 69 P.3d 318 (2003) (citations and quotation marks omitted).

An overly broad reading of the exclusivity requirement would mean that no direct sales company would qualify for the tax deduction. No tax deduction should be so interpreted as to render the statute a nullity. *John H. Sellen Construction Co. v. Dep't of Revenue*, 87 Wn.2d 878, 883, 558 P.2d 1342 (1976). This is because "the legislature does not engage in unnecessary or meaningless acts, and we presume some significant purpose or objective in every legislative enactment. *Id.*

Fortunately, a proper reading of the statute does not lead to such a result. RCW 82.04.423(1)(d) requires the *direct seller* to "Make sales in this state exclusively to or through a direct seller's representative". But

RCW 82.04.423(2) only defines the *direct seller's representative* as someone who sells "consumer products". Thus, even if the combination of these two provisions could create a requirement that the DSR sell exclusively consumer products to third parties, the statute does not forbid the direct seller from selling necessary marketing materials and sales aids to its DSRs. As required by Paragraph (1)(d), the direct seller sells the marketing materials and sales aids exclusively "to" its direct seller's representatives. Then, as required by Paragraph (2), the direct seller's representative only sells "consumer products" to third party customers. We request a ruling clarifying that this tax exemption is not lost when a direct seller sells marketing materials and sales aids to its direct seller's representatives.

III. CONCLUSION

Amicus Curiae, Melaleuca, Inc., respectfully requests the Supreme Court to reverse the decision of the Court of Appeals and to enter the following three rulings:

1. The requirement in RCW 82.04.423(2) that neither the direct seller's representative nor "any other person" may conduct sales activities "in a permanent retail establishment" only applies in those instances when the direct seller's representative buys consumer products on a buy-sell

basis or a deposit-commission basis. In all other instances, the requirements of RCW 82.04.423(2) are met if only the direct seller's representative sells, or solicits the sales of, consumer products in the home or otherwise than in a permanent retail establishment. This is so, regardless of whether the sale is at retail or at wholesale.

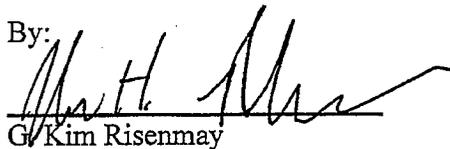
2. A direct seller's direct receipt of a customer's orders via telephone, fax, mail order, or internet does not cause a direct seller to lose the tax exemption set forth in RCW 82.04.423 if the customer was previously contacted or enlisted by a direct seller's representative and the direct seller's representative receives a sales commission on the sales made to that customer.

3. A direct sales company does not lose the tax exemption set forth in RCW 82.04.423 when it sells marketing materials and sales aids to its direct seller's representatives in the state.

Dated this 19th day of December, 2008.

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PROOF OF SERVICE

I am a citizen of the United States and employed in King County, Washington. I am over the age of 18 years and not a party to the within-entitled action. My business address is 600 University Street, Suite 3600, Seattle, Washington 98101. On December 19th, 2008, pursuant to Fed. R. App. P. 25(d)(2), I filed *via legal messenger* at Olympia, Washington, the foregoing *Motion of Melaleuca, Inc. for Leave to File a Brief of Amicus Curiae* as follows:

Washington State Supreme Court
1206 Quince Street SE
P.O. Box 41170
Olympia, WA 98504-1170

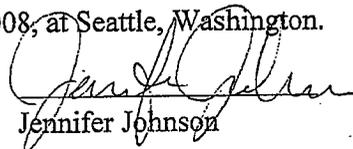
And to the following parties, on December 19th, 2008 I served true and correct copies of *Motion of Melaleuca, Inc. for Leave to File a Brief of Amicus Curiae via legal messenger* to the last known office address of the attorneys of record.

Attorneys for Petitioner	Howard Goodfriend Edwards Sieh Smith & Goodfriend PS 1109 1st Ave. Suite 500 Seattle, WA 98101-2988	<input checked="" type="checkbox"/> hand delivery via legal <input type="checkbox"/> facsimile transmission <input type="checkbox"/> overnight delivery <input type="checkbox"/> U.S. Mail <input type="checkbox"/> Electronic mail
	Jacquelyn A. Beatty 1201 3rd Ave. Suite 2900 Seattle, WA 98101-1313	<input checked="" type="checkbox"/> hand delivery via legal <input type="checkbox"/> facsimile transmission <input type="checkbox"/> overnight delivery <input type="checkbox"/> U.S. Mail <input type="checkbox"/> Electronic mail

Attorneys for Respondent	Cameron Comfort Attorney Generals Office Revenue Division 7141 Cleanwater Dr. SW Olympia, WA 98504-0123	<input checked="" type="checkbox"/> hand delivery via legal <input type="checkbox"/> facsimile transmission <input type="checkbox"/> overnight delivery <input type="checkbox"/> U.S. Mail <input type="checkbox"/> Electronic mail
Attorneys for Amicus Curiae (URM Stores, Inc.)	Dirk Giseburt Davis Wright Tremaine LLP 1201 3rd Ave. Suite 2200 Seattle, WA 98101-3045	<input checked="" type="checkbox"/> hand delivery via legal <input type="checkbox"/> facsimile transmission <input type="checkbox"/> overnight delivery <input type="checkbox"/> U.S. Mail <input type="checkbox"/> Electronic mail

I declare under penalty of perjury under the laws of the state of Washington that the foregoing is true and correct.

Dated this 19th day of December, 2008, at Seattle, Washington.


Jennifer Johnson

APPENDIX

A-1	RCW 82.04.423
B-1 through B-3	WAC 458-20-246
C-1 through C-13	Dot Foods, Inc. v. Dep't of Revenue, 141 Wn.App. 874, 173 P.3d 309 (2007), <i>review granted</i> , 163 Wn.2d 1052, 187 P.3d 751 (2008)
D-1 through D-2	Excise Tax Advisory 2041.04.246
E-1 through E-22	Governor Spellman's Legislative File 1983 SB 3909
F-1 through F-9	HB 566 File
G-1 through G-27	SB 3244 File
H-1 through H-2	Webster's Third New International Dictionary (Unabridged) (Merriam- Webster Inc. 2002)
I-1 through I-2	West's Law and Commercial Dictionary in Five Languages (West Publishing Co. 1985)

RCW 82.04.423

Exemptions — Sales by certain out-of-state persons to or through direct seller's representatives.

(1) This chapter shall not apply to any person in respect to gross income derived from the business of making sales at wholesale or retail if such person:

(a) Does not own or lease real property within this state; and

(b) Does not regularly maintain a stock of tangible personal property in this state for sale in the ordinary course of business; and

(c) Is not a corporation incorporated under the laws of this state; and

(d) Makes sales in this state exclusively to or through a direct seller's representative.

(2) For purposes of this section, the term "direct seller's representative" means a person who buys consumer products on a buy-sell basis or a deposit-commission basis for resale, by the buyer or any other person, in the home or otherwise than in a permanent retail establishment, or who sells, or solicits the sale of, consumer products in the home or otherwise than in a permanent retail establishment; and

(a) Substantially all of the remuneration paid to such person, whether or not paid in cash, for the performance of services described in this subsection is directly related to sales or other output, including the performance of services, rather than the number of hours worked; and

(b) The services performed by the person are performed pursuant to a written contract between such person and the person for whom the services are performed and such contract provides that the person will not be treated as an employee with respect to such purposes for federal tax purposes.

(3) Nothing in this section shall be construed to imply that a person exempt from tax under this section was engaged in a business activity taxable under this chapter prior to the enactment of this section.

[1983 1st ex.s. c 66 § 5.]

Notes:

Reviser's note: The effective date of 1983 1st ex.s. c 66 is August 23, 1983.

458-20-245 << 458-20-246 >> 458-20-247

WAC 458-20-246

No agency filings affecting this section since 2003

Sales to or through a direct seller's representative.

(1) **Introduction.** RCW 82.04.423 provides an exemption from the business and occupation (B&O) tax on wholesale and retail sales by a person who does not own or lease real property in the state, is not incorporated in the state, does not maintain inventory in this state, and makes sales in this state exclusively to or through a "direct seller's representative." This rule explains the statutory elements that must be satisfied in order to be eligible to take this exemption.

(2) **Background.** The statutory language describing the direct seller's representative is substantially the same language as contained in the federal Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982, PL 97-248. See 26 USC 3508. The federal law designates types of statutory nonemployees for social security tax purposes. The purpose of the direct seller provision in the federal tax law is to provide that a direct seller's representative is not an employee of the direct seller, thereby relieving the direct seller of a tax duty. Under the federal law, the direct seller is a business that sells its products using a representative who either purchases from the direct seller and resells the product or sells for or solicits sales on behalf of the direct seller. Retail sales are limited to those occurring in the home or in a temporary retail establishment, such as a vendor booth at a fair.

The 1983 Washington state legislature used the same criteria to delineate, for state tax purposes, the necessary relationship between a direct seller and a direct seller's representative.

(3) **The direct seller's exemption.** The exemption provided by RCW 82.04.423 is limited to the B&O tax on wholesaling or retailing imposed in chapter 82.04 RCW (Business and occupation tax). A direct seller is subject to other Washington state tax obligations, including, but not limited to, the sales tax under chapter 82.08 RCW, the use tax under chapter 82.12 RCW, and the litter tax imposed by chapter 82.19 RCW.

(4) **Who may take the exemption.** The B&O tax exemption may be taken by a person (the direct seller) selling a consumer product using the services of a representative who sells or solicits the sale of the product as outlined in statute. There are ten elements in the statute that must be present in order for a person to qualify for the exemption for Washington sales. The person must satisfy each element to be eligible for the exemption. The taxpayer must retain sufficient records and documentation to substantiate that each of the ten required elements has been satisfied. RCW 82.32.070.

(a) The four statutory elements describing the direct seller. RCW 82.04.423 provides that a direct seller:

(i) Cannot own or lease real property within this state. For example, if the direct seller's representative is selling vitamins door to door for the direct seller, but the direct seller owns or leases a coffee roasting factory in the state, the direct seller is not eligible for this exemption; and

(ii) Cannot regularly maintain a stock of tangible personal property in this state for sale in the ordinary course of business. This provision does not, however, prohibit the direct seller from holding title to the consumer product in the state. For instance, the direct seller owns the consumer products sold by the direct seller's representative when the representative is making retail sales for the direct seller. However, the personal property must not be a stock of goods in the state that is for sale in the ordinary course of business. The phrase "sale in the ordinary course of business" means sales that are arm's length and that are routine and reasonably expected to occur from time to time; and

(iii) Is not a corporation incorporated under the laws of this state; and

(iv) Makes sales in this state exclusively to or through a direct seller's representative. This provision of the statute describes how sales by the direct seller may be made. To be eligible for the exemption, all sales by the direct seller in this state must be made to or through a direct seller's representative. The direct seller may not claim any B&O tax exemption under RCW 82.04.423 if it has made sales in this state using means other than a direct seller's representative. This requirement does not, however, limit the methods the direct seller's representative may use to sell these products. For example, the representative can use the mail or the internet, if all other conditions of the exemption are met. The direct seller's use of mail order or internet, separate from the representative's use, may or may not be found to be "sales in this state" depending on the facts of the situation. If the direct seller's use of methods other than to or through a direct seller's representative constitutes "sales in this state," the exemption is lost. Additionally, a direct seller does not become ineligible for the exemption due to action by the direct seller's representative that is in violation of the statute, such as selling a product to a permanent retail establishment, if the department finds by a review of the facts that the ineligible sales are irregular, prohibited by the direct seller, and rare.

If a seller uses a direct seller's representative to sell "consumer products" in Washington, and also has a branch office, local outlet, or other local place of business, or is represented by any other type of selling employee, selling agent, or selling representative, no portion of the sales are exempt from B&O tax under RCW 82.04.423. For example, a person

who uses representatives to sell consumer products door to door and who also sells consumer products through retail outlets is not eligible for the exemption. The phrase "sales exclusively to ... a direct seller's representative" describes wholesale sales made by the direct seller to a representative. The phrase "sales exclusively ... through a direct seller's representative" describes retail sales made by the direct seller to the consumer. The B&O tax exemption provided by RCW 82.04.423 is limited to these types of wholesale and retail sales.

(b) The six statutory elements describing the direct seller's representative. RCW 82.04.423 provides the following elements that relate to the direct seller's representative:

(i) How the sale is made. A direct seller's representative is "a person who buys consumer products on a buy-sell basis or a deposit-commission basis for resale, by the buyer or any other person, in the home or otherwise than in a permanent retail establishment, or who sells, or solicits the sale of, consumer products in the home or otherwise than in a permanent retail establishment." The direct seller sells the product using the services of a representative in one of two ways, which are described by two clauses in the statute. The first clause ("a person who buys ... for resale" from the direct seller) describes a wholesale sale by the direct seller. The second clause (a person who "sells or solicits the sale" for the direct seller) describes a retail sale by the direct seller.

(A) A transaction is on a "buy-sell basis" if the direct seller's representative performing the selling or soliciting services is entitled to retain part or all of the difference between the price at which the direct seller's representative purchases the product and the price at which the direct seller's representative sells the product. The part retained is remuneration from the direct seller for the selling or soliciting services performed by the representative. A transaction is on a "deposit-commission basis" if the direct seller's representative performing the selling or soliciting services is entitled to retain part or all of a purchase deposit paid in connection with the transaction. The part retained is remuneration from the direct seller for the selling or soliciting services performed by the representative.

(B) The location where the retail sale of the consumer product may take place is specifically delineated by the terms of the statute. The direct seller may take the exemption only if the retail sale of the consumer product takes place either in the home or otherwise than in a permanent retail establishment. The resale of the products sold by the direct seller at wholesale is restricted by the statute through the following language: "For resale, by the buyer or any other person, in the home or otherwise than in a permanent retail establishment." This restrictive phrase requires the product be sold at retail either in the home or in a nonpermanent retail establishment. Regardless of to whom the representative sells, the retail sale of the product must take place either in the buyer's home or in a location that is not a permanent retail establishment. Examples of permanent retail establishments are grocery stores, hardware stores, newsstands, restaurants, department stores, and drug stores. Also considered as permanent retail establishments are amusement parks and sports arenas, as well as vendor areas and vendor carts in these facilities if the vendors are operating under an agreement to do business on a regular basis. Persons selling at temporary venues, such as a county fair or a trade show, are not considered to be selling at a permanent retail establishment.

(ii) What product the direct seller must be selling. The direct seller must be selling a consumer product, the sale of which meets the definition of "sale at retail," used for personal, family, household, or other nonbusiness purposes. "Consumer product" includes, but is not limited to, cosmetics, cleaners and soaps, nutritional supplements and vitamins, food products, clothing, and household goods, purchased for use or consumption. The term does not include commercial equipment, industrial use products, and the like, including component parts. However, if a consumer product also has a business use, it remains a "consumer product," notwithstanding that the same type of product might be distributed by other unrelated persons to be used for commercial, industrial, or manufacturing purposes. For example, desktop computers are used extensively in the home as well as in businesses, yet they are a consumer product when sold for nonbusiness purposes.

(iii) How the person is paid. The statute requires that "substantially all of the remuneration paid to such person, whether or not paid in cash, for the performance of services described in this subsection is directly related to sales or other output, including the performance of services, rather than the number of hours worked." The remuneration must be for the performance of sales and solicitation services and it must be based on measurable output. Remuneration based on hours does not qualify. A fixed salary or fixed compensation, without regard to the amount of services rendered, does not qualify.

Remuneration need not be in cash, and it may be the consumer product itself or other property, such as a car.

(iv) How the contract is memorialized. The services by the person must be performed pursuant to a written contract between the representative and the direct seller. The requirement that the contract be in writing is a specific statutory condition of RCW 82.04.423.

(v) What the contract must contain. The sale and solicitation services must be the subject of the contract. The contract must provide that the representative will not be treated as an employee of the direct seller for federal tax purposes.

(vi) The status of the representative. A person satisfying the requirements of the statute should also be a statutory nonemployee under federal law, since the requirements of RCW 82.04.423 and 26 U.S.C. 3508 are the same. The direct seller must maintain proof the representative is a statutory nonemployee.

(5) **Tax liability of the direct seller's representative.** The statute provides no tax exemption with regard to the "direct seller's representative." The direct seller's representative is subject to the service and other activities B&O tax on commission compensation earned for services described in RCW 82.04.423. Likewise, a direct seller's representative who buys consumer products for resale and does in fact resell the products is subject to either the wholesaling or retailing B&O tax upon the gross proceeds of these sales. Retail sales tax must be collected and remitted to the department on retail sales unless specifically exempt by law. For example, certain food products are statutorily exempt from retail sales tax (see WAC 458-20-244).

(a) Subject to the agreement of the representatives, the direct seller may elect to remit the B&O taxes of the representatives and collect and remit retail sales tax as agents of the representatives through an agreement with the department. The direct seller's representative should obtain a tax registration endorsement with the department unless otherwise exempt under RCW 82.32.045. (See also WAC 458-20-101 on tax registration.)

(b) Every person who engages in this state in the business of acting as a direct seller's representative for unregistered principals, and who receives compensation by reason of sales of consumer products of such principals for use in this state, is required to collect the use tax from purchasers, and remit the same to the department of revenue, in the manner and to the extent set forth in WAC 458-20-221. (Collection of use tax by retailers and selling agents.)

(6) **The retail sales and/or use tax reporting responsibilities of the direct seller.** A direct seller is required to collect and remit the tax imposed by chapter 82.08 RCW (Retail sales tax) or 82.12 RCW (Use tax) if the seller regularly solicits or makes retail sales of "consumer products" in this state through a "direct seller's representative" even though the sales are exempt from B&O tax pursuant to RCW 82.04.423.

[Statutory Authority: RCW 82.32.300, 99-24-007, § 458-20-246, filed 11/19/99, effective 12/31/99; 84-24-028 (Order 84-3), § 458-20-246, filed 11/30/84.]

Westlaw

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Court of Appeals of Washington, Division 2.
 DOT FOODS, INC., Appellant,

v.

DEPARTMENT OF REVENUE, State of Washing-
 ton, Respondent.
 No. 35733-0-II.

Nov. 27, 2007.

Background: Out-of-state business sought refund of business and occupation (B&O) taxes. The Superior Court, Thurston County, Richard D. Hicks, J., granted summary judgment to Department of Revenue. Plaintiff appealed.

Holdings: The Court of Appeals, Joel Penoyar, J., held that:

- (1) for an out-of-state business to qualify for the "direct seller's representative" exemption from the business and occupation tax, the products of the out-of-state business, sold by the out-of-state business to or through the direct seller's representative, must be consumer products, and
- (2) the direct seller's representative need not be a natural person.

Affirmed.

West Headnotes

[1] Appeal and Error 30 ⚡893(1).

30 Appeal and Error
 30XVI Review
 30XVI(F) Trial De Novo
 30k892 Trial De Novo
 30k893 Cases Triable in Appellate Court
 30k893(1) k. In General. Most

Cited Cases

Rulings on summary judgment are reviewed de novo.

[2] Appeal and Error 30 ⚡893(1)

30 Appeal and Error
 30XVI Review
 30XVI(F) Trial De Novo
 30k892 Trial De Novo
 30k893 Cases Triable in Appellate Court
 30k893(1) k. In General. Most

Cited Cases

Issues of statutory interpretation are reviewed de novo.

[3] Statutes 361 ⚡181(1)

361 Statutes
 361VI Construction and Operation
 361VI(A) General Rules of Construction
 361k180 Intention of Legislature
 361k181 In General
 361k181(1) k. In General. Most

Cited Cases

Statutes 361 ⚡188

361 Statutes
 361VI Construction and Operation
 361VI(A) General Rules of Construction
 361k187 Meaning of Language
 361k188 k. In General. Most Cited

When interpreting a statute, a court's fundamental duty is to give effect to the legislature's intent, which is primarily derived from the statutory language.

[4] Statutes 361 ⚡190

361 Statutes
 361VI Construction and Operation
 361VI(A) General Rules of Construction
 361k187 Meaning of Language
 361k190 k. Existence of Ambiguity.

Most Cited Cases

Where the statutory language is plain and unam-

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biguous, the court derives the meaning of the statute solely from that language.

[5] Taxation 371 ⇨ 2392

371 Taxation

371III Property Taxes

371III(F) Exemptions

371III(F)2 Proceedings to Establish and Enforce Exemption

371k2390 Evidence

371k2392 k. Presumptions and Burden of Proof. Most Cited Cases

A tax exemption presupposes a taxable status, and the burden is on the taxpayer to establish eligibility for the benefit of the exemption.

[6] Taxation 371 ⇨ 2300

371 Taxation

371III Property Taxes

371III(F) Exemptions

371III(F)1 In General

371k2298 Construction and Operation of Exemptions in General

371k2300 k. General Rules of Construction. Most Cited Cases

In interpreting the scope of a tax exemption, the court resolves ambiguities in favor of taxation and against exemption.

[7] Taxation 371 ⇨ 2300

371 Taxation

371III Property Taxes

371III(F) Exemptions

371III(F)1 In General

371k2298 Construction and Operation of Exemptions in General

371k2300 k. General Rules of Construction. Most Cited Cases

Ambiguous tax exemptions are construed strictly, though fairly, and in keeping with the statutory language.

[8] Licenses 238 ⇨ 19(3)

238 Licenses

238I For Occupations and Privileges

238k19 Exemptions

238k19(3) k. Occupations and Privileges in General. Most Cited Cases

For out-of-state business to qualify for "direct seller's representative" exemption from business and occupation (B&O) tax, the products of the out-of-state business, sold by the out-of-state business to or through the direct seller's representative, must be consumer products, exclusively. West's RCWA 82.04.423(1)(d), (2); WAC 458-20-246.

[9] Statutes 361 ⇨ 219(1)

361 Statutes

361VI Construction and Operation

361VI(A) General Rules of Construction

361k213 Extrinsic Aids to Construction

361k219 Executive Construction

361k219(1) k. In General. Most Cited Cases

Where an agency is charged with the administration and enforcement of a statute, the agency's interpretation of an ambiguous statute is accorded great weight in determining legislative intent.

[10] Statutes 361 ⇨ 190

361 Statutes

361VI Construction and Operation

361VI(A) General Rules of Construction

361k187 Meaning of Language

361k190 k. Existence of Ambiguity.

Most Cited Cases

A statute is "ambiguous" if it has more than one reasonable interpretation.

[11] Administrative Law and Procedure 15A ⇨ 416.1

15A Administrative Law and Procedure

15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents

15AIV(C) Rules and Regulations

15Ak416 Effect

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[17] Licenses 238 ↪28

238 Licenses

- 2381 For Occupations and Privileges
- 238k27 License Fees and Taxes
- 238k28 k. In General. Most Cited Cases

The legislature's intent in enacting the business and occupation (B&O) tax was to impose the tax upon virtually all business activities carried on within the state, and to leave practically no business and commerce free of tax. West's RCWA 82.04.220.

[18] Licenses 238 ↪34

238 Licenses

- 2381 For Occupations and Privileges
- 238k27 License Fees and Taxes
- 238k34 k. Refunding or Recovering. Most Cited Cases

Taxpayer's argument in its summary judgment motion in action seeking refund of business and occupation (B&O) taxes, that Department of Revenue's special notice informing taxpayers that Department had updated its interpretation of business and occupation tax was insufficient to defeat taxpayer's continued reliance upon exemption approved in Department's private letter ruling, did not preserve for appellate review a claim that the special notice was a "significant legislative rule" which did not comply with Administrative Procedure Act's (APA) notice requirements for significant legislative rules. West's RCWA 34.05.328, 82.04.423(1)(d), (2); WAC 458-20-246; RAP 2.5(a).

[19] Appeal and Error 30 ↪169

30 Appeal and Error

30V Presentation and Reservation in Lower Court of Grounds of Review

- 30V(A) Issues and Questions in Lower Court

R0k169 Necessity of Presentation in General. Most Cited Cases

Generally, issues not raised in the trial court may not be raised for the first time on appeal. RAP 2.5(a).

[20] Licenses 238 ↪19(3)

238 Licenses

- 2381 For Occupations and Privileges
- 238k19 Exemptions
- 238k19(3) k. Occupations and Privileges in General. Most Cited Cases

The "direct seller's representative" exemption, for out-of-state businesses, from the business and occupation (B&O) tax does not require that the direct seller's representative to whom or through whom the out-of-state business makes sales must be a natural person, as opposed to a corporation. West's RCWA 82.04.010, 82.04.030, 82.04.423(1), (2)(a, b).

**310 Jacquelyn A. Beatty, Attorney at Law, Howard Mark Goodfriend, Edwards Sieh Smith & Goodfriend PS, Seattle, WA, for Appellant.
 Cameron Gordon Comfort, Atty. Gen. Office, Olympia, WA, for Respondent.

PENoyAR, J.

*876 ¶ 1 Dot Foods sought a refund of business and occupation (B & O) taxes paid between 2000 and 2006, claiming that the Department of Revenue (Department) improperly denied them an exemption. During this time period, Dot Foods produced food products out-of-state that *877 it sold (through a wholly-owned subsidiary) to dairies, meat packers, and other food processors located in Washington, who then used the products as ingredients in other products that were sold to various retail outlets in Washington. Dot Foods appealed to the trial court for a refund of the taxes, claiming that it qualified for a statutory exemption for out-of-state persons selling consumer goods only to or through a "direct seller's representative." RCW 82.04.423. The trial court disagreed, and Dot Foods appeals. Despite Dot Foods' arguments to the contrary, the plain language of the exemption illustrates that it should only apply where direct seller's representatives exclusively sell consumer products. Because Dot Foods admits that a **311 portion of its sales in Washington consist of non-consumer products, the exemption does not apply to them. We affirm.

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FACTS

¶ 2 Washington law imposes a B & O tax “for the act or privilege of engaging in business activities” in the state. RCW 82.04.220. This tax is subject to several exemptions, including an exemption for sales by certain out-of-state persons to or through a direct seller's representative. RCW 82.04.423(1)(d). Specifically, RCW 82.04.423(1) states that the B & O tax does not apply to gross income derived from wholesale or retail sales in the state if the person:

- (a) Does not own or lease real property within this state; and
- (b) Does not regularly maintain a stock of tangible personal property in this state for sale in the ordinary course of business; and
- (c) Is not a corporation incorporated under the laws of this state; and
- (d) Makes sales in this state exclusively to or through a direct seller's representative.

Additionally, RCW 82.04.423(2) defines “direct seller's representative” in relevant part as:

[A] person who buys consumer products on a buy-sell basis or a deposit-commission basis for resale, by the buyer or any other *878 person, in the home or otherwise than in a permanent retail establishment, or who sells, or solicits the sale of, consumer products in the home or otherwise than in a permanent retail establishment.

¶ 3 Dot Foods is an Illinois corporation that sells food and other products to food processors and food service distributors in Washington. The Department concedes that Dot Foods meets the first three requirements for the exemption (contained in RCW 82.04.423(1)(a)-(c)). The only requirement at issue here is whether Dot Foods “[m]akes sales in this state exclusively to or through a direct seller's representative.” Clerk's Papers (CP) at 65; RCW 82.04.423(1)(d).

¶ 4 The Department issued a private letter ruling to

Dot Foods in October 1997, stating that Dot Foods qualified for the direct seller's representative exemption under RCW 82.04.423. The letter ruling specified that it was binding on both Dot Foods and the Department but that it would only remain binding until: “the facts change; the law (either by statute or court decision) changes; the applicable rule(s) change; the Department of Revenue publicly announces a change in the policy upon which this ruling is based; or Dot Foods, Inc. is notified in writing that this ruling is not valid.” CP at 69.

¶ 5 Since receiving the private letter ruling, Dot Foods' Washington sales have been exclusively through its wholly-owned subsidiary, Dot Transportation, Inc. (DTI). While neither Dot Foods nor DTI have sold any products in Washington from a permanent retail establishment, food processors purchase Dot Foods' products and use the products as ingredients in products that are then sold in permanent retail establishments in Washington. Additionally, DTI employed salesmen who solicited sales of Dot Foods' products in Washington. The salesmen personally called on businesses in Washington to solicit sales of Dot Foods' products, but they did not take orders for such products—all orders were transmitted either electronically to Dot Foods' headquarters in Illinois or telephonically to sales representatives located in Illinois.

*879 ¶ 6 The Department issued a “Special Notice for Direct Sellers” in February 2000, which informed taxpayers that the Department had updated its interpretation of the B & O tax. CP at 73. The notice directed taxpayers to WAC 458-20-246,^{FN1} and it specifically**312 stated that “[i]f a consumer *880 product is sold by *anyone* in a permanent retail establishment, the direct sellers' exemption is not available to the direct seller.” CP at 73. The Department sent a copy of the notice to Dot Foods, which Dot Foods received.

FN1. The Department states in WAC 458-20-246 that “[t]his rule explains the statutory elements that must be satisfied in order to be eligible [for the direct seller's

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exemption].’ The rule states that there are ten statutory elements that must be satisfied in order for a seller to be eligible for the exemption: the four statutory elements in RCW 82.04.423(1) (the seller cannot own or lease real property in Washington, must not maintain a stock of tangible personal property in Washington, is not incorporated in Washington, and makes all sales in the state through a direct seller’s representative) and the six statutory elements in RCW 82.04.423(2) defining a direct seller’s representative:

(i) How the sale is made.... The direct seller sells the product using the services of a representative in one of two ways, which are described by two clauses in the statute. The first clause (‘a person who buys ... for resale’ from the direct seller) describes a wholesale sale by the direct seller. The second clause (a person who ‘sells or solicits the sale’ for the direct seller) describes a retail sale by the direct seller.

(A) A transaction is on a ‘buy-sell basis’ if the direct seller’s representative ... is entitled to retain part or all of the difference between the price at which [he or she] purchases the product and the price at which [he or she] sells the product.... A transaction is on a ‘deposit-commission basis’ if the direct seller’s representative ... is entitled to retain part or all of a purchase deposit paid in connection with the transaction....

(B) The location where the retail sale of the consumer product may take place.... The direct seller may take the exemption only if the retail sale of the consumer product takes place either in the home or otherwise than in a permanent retail establishment. The resale of the products sold by the direct seller at wholesale is

restricted by the statute through the following language: ‘For resale, by the buyer or any other person, in the home or otherwise than in a permanent retail establishment.’ This restrictive phrase requires the product be sold at retail either in the home or in a nonpermanent retail establishment. Regardless of to whom the representative sells, the retail sale of the product must take place either in the buyer’s home or in a location that is not a permanent retail establishment....

(ii) What product the direct seller must be selling. The direct seller must be selling a consumer product ...

(iii) How the person is paid. The statute requires that ‘substantially all of the remuneration paid to such person ... is directly related to sales or other output, including the performance of services, rather than the number of hours worked....’

(iv) How the contract is memorialized. The services by the person must be performed pursuant to a written contract between the representative and the direct seller....

(v) What the contract must contain. The sale and solicitation services must be the subject of the contract. The contract must provide that the representative will not be treated as an employee of the direct seller for federal tax purposes.

(vi) The status of the representative. A person satisfying the requirements of the statute should also be a statutory nonemployee under federal law, since the requirements of RCW 82.04.423 and 26 U.S.C. 3508 are the same....

WAC 458-20-246(4)(b).

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Foods, Inc. v. Dep't of Revenue, 153 Wash.2d 392, 397-98, 103 P.3d 1226 (2005), is misplaced. In that case, the court refused to impute a "perishable finished product requirement" to subsection (4) of RCW 82.04.260 where several other subsections included the "finished product" language, but subsection (4) did not. Conversely here, subsection (2) merely defines a term in subsection (1)—it is not delineating an entirely different category.

¶ 14 Under our interpretation of RCW 82.04.423, a direct seller must exclusively sell consumer products in Washington in order to qualify for the exemption. Therefore, Dot Foods does not qualify for the exemption, and we affirm.

II. Statutory Interpretation

¶ 15 The Department and Dot Foods also offer two different interpretations of the remaining language of the direct seller's exemption. The Department argues that RCW 82.04.423, when construed as a whole, limits the direct seller's exemption to those whose products are *never* sold in a permanent retail establishment. The Department stresses the parallel structure of a wholesale/retail distinction in RCW 82.04.423(1), which exempts "gross income derived from the business of making sales at *wholesale or retail* if such person ... (d) [m]akes sales in this state exclusively *to or through* a direct seller's representative." (Emphasis added). According to the Department, a sale *to* a direct seller's representative refers to a wholesale sale, where the representative may resell the products *to another seller* outside of a permanent retail establishment. This corresponds to the first clause of RCW 82.04.423(2), which applies to a person who buys consumer products on a buy-sell basis or a deposit-commission basis for resale, by *883 the buyer or any other person, outside of a permanent retail establishment.

¶ 16 Conversely, the Department contends that a sale *through* a direct seller's representative refers to retail sales where the representative sells *to the*

consumer outside of a permanent retail establishment. This corresponds to the second clause of RCW 82.04.423(2), which applies to a person who sells or solicits the sale of consumer products outside of a permanent retail establishment. The Department points out that the "or any **314 other person" language is unnecessary in this clause because the clause refers to the final sale of a product to the consumer, not the sale of a product to another re-seller. Resp't Br. at 19.

¶ 17 Dot Foods, on the other hand, argues that the two clauses of RCW 82.04.423(2) create "two alternative and disjunctive definitions" of the direct seller's representative: (1) a person who buys consumer products on a buy-sell basis or a deposit-commission basis for resale, by the buyer or any other person, outside of a permanent retail establishment; and (2) a person who sells, or solicits the sale of, consumer products outside of a permanent retail establishment. Appellant's Br. at 17. Under this interpretation, Dot Foods claims that it satisfies the requirements of the second clause—DTI does not buy Dot Foods' products on a buy-sell or deposit-commission basis, but it does sell or solicit the sale of those products outside of permanent retail establishments.

¶ 18 Both of the offered interpretations of RCW 82.04.423 rely on the statute's plain language, and both are reasonable. Clearly, the statute is written ambiguously. As stated above, we resolve ambiguities in favor of taxation and against exemption. Additionally, the ambiguous language of the statute demands that we give some deference to the Department's interpretation. However, we note that further litigation regarding this statute will undoubtedly ensue if it is not amended to clarify the legislature's intent. Also, as a matter of public policy, the legislature may wish to clarify its intent in this area of taxation instead of *884 leaving the result to interpretation by the Department and the courts.

A. Deference to the Agency's Interpretation

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[9][10] ¶ 19 Whether an agency's construction of the statute is accorded deference depends on whether the statute is ambiguous. *Waste Mgmt. of Seattle, Inc. v. Utils. & Transp. Comm'n*, 123 Wash.2d 621, 628, 869 P.2d 1034 (1994). Where an agency is charged with the administration and enforcement of a statute, the agency's interpretation of an ambiguous statute is accorded great weight in determining legislative intent. *Waste Mgmt.*, 123 Wash.2d at 628, 869 P.2d 1034; *City of Pasco v. Pub. Employment Relations Comm'n*, 119 Wash.2d 504, 507, 833 P.2d 381 (1992); *Cowiche Canyon Conservancy v. Bosley*, 118 Wash.2d 801, 813-14, 828 P.2d 549 (1992). A statute is ambiguous if it has more than one reasonable interpretation. *McLane Co.* 105 Wash.App. at 413, 19 P.3d 1119.

[11][12] ¶ 20 Both the Department's and Dot Foods' interpretations of the statute appear reasonable, based on the plain language of the statute. Under the *Waste Management* rule, therefore, the agency's interpretation of the statute should be given "great weight." *Waste Mgmt.*, 123 Wash.2d at 628, 869 P.2d 1034. However, in *Ass'n of Wash. Bus. v. Dep't of Revenue*, 155 Wash.2d 430, 446-47, 120 P.3d 46 (2005), the Washington Supreme Court delineated different levels of deference for agency's legislative rules and interpretive rules:

Therein lies the true difference between interpretive and legislative rules: their effect on the courts. Legislative rules bind the court if they are within the agency's delegated authority, are reasonable, and were adopted using the proper procedure. See *Weyerhaeuser Co. v. Dep't of Ecology*, 86 Wash.2d 310, 314-15, 545 P.2d 5 (1976). Interpretive rules, however, are not binding on the courts at all: 'Reviewing courts are not required to give any deference whatsoever to the agencies' views on that subject [correctness and desirability of the agencies' interpretations]. Legislative rules therefore have greater finality than interpretive rules because courts are *885 bound to give some deference to agency judgments embodied in the former, but they need not defer to

agency judgments embodied in the latter.'

Ass'n of Wash. Bus., 155 Wash.2d at 446-47, 120 P.3d 46 (quoting Arthur Earl Bonfield, State Administrative Rule Making § 6.9.1, at 281-82 (1986)).

¶ 21 Accordingly, Dot Foods argues that "[t]o the extent that the Department's 2000 revision to WAC 458-20-246 was merely an 'interpretive rule,' " we should afford it no **315 deference. Appellant's Br. at 22-23. It contends that the Department radically departed from its longstanding interpretation of the statute, and therefore it was required to articulate a substantive basis for the change.^{FN2}

FN2. Dot Foods also claims that the statute is not ambiguous as it contains no references to "wholesale" or "retail" direct seller's representatives. However, this is the incorrect ambiguity standard—a statute is ambiguous if it lends itself to at least two reasonable interpretations. *McLane Co.*, 105 Wash.App. at 413, 19 P.3d 1119. As stated above, the Department's interpretation is reasonable. Therefore, we consider the statutory language ambiguous even though the Department's labels of the two categories of representatives (wholesale and retail) are not themselves contained within the statute.

[13] ¶ 22 Dot Foods' argument overstates the court's holding in *Ass'n of Wash. Bus.* While the court stated that interpretive rules are not binding on the courts "at all," it also stated that courts are not required to give deference to the agency's interpretation. *Ass'n of Wash. Bus.*, 155 Wash.2d at 447, 120 P.3d 46. Furthermore, the court clarified this statement by noting that:

When a statute is ambiguous (i.e., subject to more than one reasonable interpretation), the agency's adoption of one of the possible reasonable choices is entitled to some deference. Even so, the agency's interpretation is not binding on the

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courts.

Ass'n of Wash. Bus., 155 Wash.2d at 447, n. 17, 120 P.3d 46 (citing *Weyerhaeuser Co.*, 86 Wash.2d at 315, 545 P.2d 5). Therefore, regardless of whether the rule is interpretive or legislative (see below), we may still afford some deference to the Department's reasonable interpretation of the ambiguous statutory language in RCW 82.04.423.

*886 B. Rules of Statutory Interpretation

[14][15][16] ¶ 23 The rules of statutory interpretation also support the Department's position regarding RCW 82.04.423. As the Washington Supreme Court summarized in *Whatcom County v. Bellingham*:

If the statute is ambiguous, the courts must construe the statute so as to effectuate the legislative intent. In so doing, we avoid a literal reading if it would result in unlikely, absurd or strained consequences. The purpose of an enactment should prevail over express but inept wording. The court must give effect to legislative intent determined within the context of the entire statute. Statutes must be interpreted and construed so that all the language used is given effect, with no portion rendered meaningless or superfluous.

Whatcom County v. Bellingham, 128 Wash.2d 537, 546, 909 P.2d 1303 (1996) (internal citations and quotations omitted).

¶ 24 While Dot Foods' interpretation does seem more literal than the Department's, it does not construe the statute as a whole. It does not address the "wholesale or retail" distinction in RCW 82.04.423(1), nor does it offer an explanation for the statute's differentiation between sales "to or through" a direct seller's representative. See Appellant's Br. at 24-25; RCW 82.04.423.

¶ 25 Conversely, the Department's interpretation does incorporate and give meaning to all phrases in the statute. Additionally, the Department points out

that permitting Dot Foods, and other sellers like them, to take the direct seller's exemption even though their products are ultimately sold in permanent retail establishments, renders the statute's "otherwise than in a permanent retail establishment" requirement meaningless. See RCW 82.04.423(2). It simply does not stand to reason that the legislature would have prohibited the exemption for representatives who buy products for resale (by the buyer or any other person) in a permanent retail establishment but allowed the exemption *887 for representatives who sell or solicit the sale of products to others who then sell them in a permanent retail establishment (as Dot Foods apparently contends).

¶ 26 Furthermore, in *Stroh*, we agreed with the Department's interpretation of the statute (at least as it pertains to the first clause), holding that "in order for a direct seller who sells to wholesalers to qualify for the exemption, neither the ... direct seller's representative, nor 'any other person' may resell the direct seller's products in a permanent retail establishment." *Stroh*, 104 Wash.App. at 241, 15 P.3d 692. While both parties in that case conceded that the Department's **316 interpretation of the exemption was reasonable, *Stroh* argued that it was but one reasonable interpretation of the statute, and not a fair one. *Stroh*, 104 Wash.App. at 241-42, 15 P.3d 692. The opinion resolved this argument by stressing that "fairly and consistently interpreted, the exemption does not apply if either the direct seller's representative or anyone else sells the direct seller's products in a permanent retail establishment." *Stroh*, 104 Wash.App. at 242, 15 P.3d 692.

C. Legislative Intent

[17] ¶ 27 Finally, the sweeping language of RCW 82.04.220 indicates that the legislature's intent in enacting the tax was to impose the tax upon "virtually all business activities carried on within the state" and to "leave practically no business and commerce free of ... tax." *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wash.2d 139, 149, 3 P.3d

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741 (2000) (quoting *Budget Rent-A-Car of Wash.-Or., Inc. v. Dep't of Revenue*, 81 Wash.2d 171, 175, 500 P.2d 764 (1972); *Time Oil Co. v. State*, 79 Wash.2d 143, 146, 483 P.2d 628 (1971)).

¶ 28 We construe ambiguous tax exemptions strictly, though fairly, and in keeping with the statutory language. *Stroh*, 104 Wash.App. at 240, 15 P.3d 692 (quoting *Safeway, Inc.*, 96 Wash.App. at 160, 978 P.2d 559). The Department's interpretation of the exemption complies with this standard: it is reasonable; it construes the statute as a whole, giving meaning to every word; and it complies with the legislature's intent to apply *888 the B & O tax as broadly as possible. We affirm the trial court's ruling and endorse the Department's interpretation of the direct seller's exemption.

III. Interpretive or Legislative Rule-Raised for the First Time on Appeal

[18] ¶ 29 Dot Foods also argues that the Department's special notice failed to comply with Administrative Procedure Act (APA) notice requirements, as it contends that the revision of WAC 458-20-246 was not an interpretive rule but, instead, a "significant legislative rule." Appellant's Br. at 30; see RCW 34.05.328. The Department responds that this argument is barred because (1) Dot Foods did not raise this issue at the trial court; (2) the APA has a two-year statute of limitations for challenging a rule on procedural grounds (RCW 34.05.375); and (3) Dot Foods violated RCW 82.32.180 by neglecting to raise this argument in superior court. In the alternative, the Department asserts that Dot Foods' argument has no merit.

¶ 30 In its reply brief, Dot Foods contends that it did preserve its APA argument at the trial court by arguing in its motion for summary judgment that the Department's special notice "was insufficient to defeat 'Dot's continued reliance upon the exemption approved in its [private letter ruling].'" Appellant's Reply Br. at 18 (quoting CP at 57). For support, Dot Foods cites the following language

from *Nickerson v. City of Anacortes*, 45 Wash.App. 432, 437, 725 P.2d 1027 (1986): "[I]t is not necessary to cite all supporting authority in the trial court in order to preserve a substantive issue for appeal. It is only necessary that the issue be raised."

¶ 31 Dot Foods' arguments at the trial court fail to meet even this broad standard. Dot Foods' notice argument below stressed only that the Special Notice was insufficient to prevent Dot Foods from relying on the private letter ruling—it raised a reliance argument, not an administrative law argument. Nothing in Dot Foods' briefings or motions apprised the trial court that it may contest the Department's*889 rulemaking procedure in enacting its revisions to WAC 458-20-246.

[19] ¶ 32 Generally, issues not raised in the trial court may not be raised for the first time on appeal. RAP 2.5(a). Dot Foods did not raise the issue of the Department's compliance with APA notice requirements on appeal; therefore, we need not address the merits of Dot Foods' interpretive/significant legislative rule argument.^{FN3}

FN3. Even if we were to examine this issue, Dot Foods' arguments are not persuasive. RCW 34.05.328(5)(c)(iii) defines "significant legislative rule" as a rule "other than a procedural or interpretive rule" that, in part, "adopts substantive provisions of law pursuant to delegated legislative authority, the violation of which subjects a violator of such rule to a penalty or sanction." RCW 34.05.328(5)(c)(iii). However, *Ass'n of Wash. Bus.*, 155 Wash.2d at 447, 120 P.3d 46, clarified this distinction:

Technically, interpretive rules are not binding on the public. They serve merely as advance notice of the agency's position should a dispute arise and the matter result in litigation. The public cannot be penalized or sanctioned for breaking them.... Accuracy and logic are the only

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clout interpretive rules wield. If the public violates an interpretive rule that accurately reflects the underlying statute, the public may be sanctioned and punished, not by authority of the rule, but *by authority of the statute*. This is the nature of interpretive rules.

Dot Foods contends that the Department's statement (in its audit of Dot Foods) that the revised rule "has the same effect as [the] Revenue Act" constituted an admission that the regulation was a significant legislative rule. Appellant's Br. at 31. However, according to *Ass'n of Wash. Bus.*, the Department's statement that the rule carried the same weight as the Revenue Act was not necessarily an admission that the rule was not interpretive-as stated above, the Department's interpretation accurately reflects RCW 82.04.423. Dot Foods was not being sanctioned or punished because it violated the rule, but because it violated the *statute*.

**317 IV. Natural Person

[20] ¶ 33 Finally, the Department argues that Dot Foods does not qualify for the direct seller's exemption because DTI (its purported direct seller's representative) is a corporation, not a natural person. Dot Foods disagrees, pointing out that RCW 82.04.030 includes "corporation" in its definition of "person" and that RCW 82.04.010 applies that definition to the entire chapter.

¶ 34 The Department's argument is based on its contention that the requirements of RCW 82.04.423(2)(a) and (b) (requiring that substantially all remuneration paid to the *890 direct seller's representative be directly related to output, and that the representative's services must be performed pursuant to a contract that makes clear that the representative is not an employee) "strongly imply that a direct seller's representative must be a natural per-

son." Resp't Br. at 29. Additionally, the Department points out that RCW 82.04.010 contains limiting language ("Unless the context clearly requires otherwise, the definitions set forth in [sections including RCW 82.04.030] apply throughout this chapter").

¶ 35 Dot Foods is correct-the statutory language is not ambiguous here. RCW 82.04.010 specifically applies the RCW 82.04.030 definition of "person" to RCW 82.04.423 "unless the context clearly requires otherwise." Here, the context does not do so. Remuneration paid to a corporation may be directly related to output just as simply as remuneration paid to a natural person, and the contract requirement (making clear that the representative is not an employee) does not meet the standard of "clearly requir[ing] otherwise." RCW 82.04.010. We decline to endorse the Department's "natural person" requirement to the direct seller's exemption.

V. URM Stores' Amicus Brief

¶ 36 In an amicus brief, URM Stores, Inc. raised several arguments pertaining to differences between the federal and state statutes, the exclusivity of the consumer products requirement, and the Department's natural person argument. Specifically, URM first argues that the Department's reliance on federal law is misplaced, as the legislative intent behind 26 U.S.C. § 3508 and RCW 82.04.423 is substantially different: Congress enacted its "direct seller" definition to reduce disputes regarding employment status and allocate liability for payroll taxes, and the Washington Legislature enacted the direct seller's exemption "to provide a break from [B & O] tax to out-of-state sellers." Amicus Br. at 4.

¶ 37 The Department agrees that the legislative intent behind the federal and state law differed, but it contends *891 that it is reasonable to assume that, when the legislature used language ("direct seller") identical to that in the federal statute to describe which out-of-state businesses qualified for the ex-

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emption, the legislature therefore intended to exempt from B & O taxes those sellers engaged in similar activities as federal "direct sellers." Reply to Amicus Br. at 4-5. This argument is persuasive—the legislature would not have used language identical to the federal statute had it not intended that the state's exemption apply to sellers who acted in a manner similar to the federal statute's direct seller. The different purpose of the federal tax statute did not preclude the legislature from borrowing its language, and it **318 does not blind us to the obvious similarities between the two statutes.

¶ 38 Additionally, both URM and the Department introduce legislative history that, on the whole, indicates that the legislature intended the exemption as a narrow one. URM included a colloquy between two senators regarding the exemption where they expressed concern that it would include sellers at the Seattle Trade Center. The Department included in its brief a memorandum to one of those senators stating that the Trade Center was not a permanent retail establishment and, therefore, the exemption would still apply to its sellers. The Department also notes that an original draft of the exemption, limiting B & O taxes to only those who own or lease property in Washington or who maintain a stock of personal property in Washington, was not passed (possibly because of the massive loss of revenue that would ensue). The exemption was not passed until the language was changed to its current form.

¶ 39 URM's attacks on the Department's use of federal law in its interpretation are unpersuasive, and neither of the briefs presented novel arguments regarding the "exclusivity" and "natural person" issues. We affirm the trial court.

We concur: HOUGHTON, C.J., and BRIDGEWATER, J.
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Excise Tax Advisory

Excise Tax Advisories (ETAs) are interpretive statements issued by the Department of Revenue under authority of RCW 34.05.230. ETAs explain the Department's policy regarding how tax law applies to a specific issue or specific set of facts. They are advisory for taxpayers; however, the Department is bound by these advisories until superseded by Court action, Legislative action, rule adoption, or an amendment to or cancellation of the ETA.

Number: 2041.04.246

Issue Date:

July 1, 2008

Direct Seller's Use of the Internet, Mail Orders, Direct Calls, etc.

RCW 82.04.423 provides a business and occupation (B&O) tax exemption for wholesale and retail sales by certain out-of-state businesses that make sales in this state exclusively to or through a "direct seller's representative." This exemption is often referred to as the "direct seller's exemption" and the person claiming the exemption is referred to as the "direct seller." This exemption is limited to the B&O tax and does not extend to the retail sales tax.

The requirements necessary to qualify for the exemption are set forth in RCW 82.04.423 and WAC 458-20-246. The exemption is only available to businesses that do not own or lease real property in the state, are not incorporated in the state, do not maintain inventory in this state, and make sales in this state exclusively to or through a direct seller's representative. Readers should refer to WAC 458-20-246 (Sales to or through a direct seller's representative) for additional information about this exemption.

This Excise Tax Advisory (ETA) discusses the use of the internet, mail orders, direct calls, and other methods used by direct sellers to make sales directly to customers in this state. The ETA explains when these methods satisfy or fail to satisfy the statutory requirement that the direct seller make "sales in this state exclusively to or through a direct seller's representative."

Background:

Rule 246(4)(a)(iv) provides in relevant part:

To be eligible for the exemption, all sales by the direct seller in this state must be made to or through a direct seller's representative. The direct seller may not claim any B&O tax exemption under RCW 82.04.423 if it has made sales in this state using means other than a direct seller's representative. This requirement does not, however, limit the methods the direct seller's representative may use to sell these products. For example, the representative can use the mail or the internet, **if all other conditions of the exemption are met.** The direct seller's use of mail order or internet, separate from the representative's use, may or may not be found to be "sales in this state" depending on the facts of the situation. If the direct seller's use of methods other than to or through a direct seller's representative constitutes "sales in this state," the exemption is lost. (emphasis added.)

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APPENDIX D 1

As explained in Rule 246(4)(a)(iv), the direct seller's **representative** may use the internet in making sales in this state. In addition, the representative may use the internet to advertise the products or provide contact information.

However, the direct seller may not make sales in this state directly to a customer by means other than "to or through" a direct seller's representative. This means the sale must be either to a direct seller's representative or made by means of, by reason of, or as a result of the representative. Internet sales, mail orders, and similar sales directly to customers are not made "to or through" a direct seller's representative even if the representative is involved in recruiting or enrolling the customer into the direct seller's program but is not otherwise involved in soliciting the sale, placing the order, or distributing the merchandise.

What activities are allowed/not allowed when the direct seller has, for example, an internet site?

A direct seller is not precluded from using the internet, but the direct seller's use of the internet cannot conflict with the statutory requirement that the direct seller make "sales in this state exclusively to or through a direct seller's representative." Examples of internet use by a direct seller that do not themselves cause the direct seller to be ineligible for RCW 82.04.423's B&O tax exemption include:

- Advertising its products; and
- Providing interested persons with contact information for making purchases from or through its direct seller's representatives.

In each of the above examples, the direct seller's use of the internet is not to make sales directly to customers in Washington.

On the other hand, examples of when a direct seller's use of the internet causes the direct seller to be ineligible for RCW 82.04.423's B&O tax exemption includes activities such as:

- Allowing any interested persons to order or purchase directly from the direct seller. The exemption is not available even if only persons outside the sales area of a direct seller's representative are allowed to order and purchase directly from the direct seller; or
- Having direct seller's representatives enroll customers, via the internet, that allows those customers to place order with or make purchases directly from the direct seller.

These latter two examples illustrate that the direct seller is making sales directly to customers and not exclusively to or through the direct seller's representative.

What is the tax result if the direct seller does not qualify for the exemption?

When a direct seller fails to comply with the requirements of the exemption, all tax relief granted by the exemption is lost, and the direct seller is subject to the B&O tax. Therefore, the direct seller is responsible for remitting B&O tax on all sales made in Washington, those made through a direct seller's representative or made via the internet, catalogs, and other means. In addition, retail sales tax must also be collected on all sales to consumers, unless a specific exemption applies.

**Governor Spellman's
Legislative File
1983 SB 3909**

Day's version { 3244
Robinson's version } 3909

ISSUE - Defining "engaging in business in this state" for B&O tax purposes

1. Problem: The Department of Revenue has attempted to tax out-of-state business whose products are sold through the efforts of independent contractors and distributors, even though the out-of-state business has no real property, inventory, employees or representatives who are not independent contractors in this state.

The statutes do not presently define what is meant to do business in this state. The result has been a policy of "taxation by ambush" and setting tax policy through the courts instead of the legislature.

The amendment is at the request of the Joint Agency Rules Revenue Committee which held four lengthy hearings on the subject. Senate Ways and Means had two more hearings.

2. Definition: The amendment provides that a company is doing business in Washington if it has: (1) real property, (2) inventory or (3) employees or other representatives who are not independent contractors. Common sense tells us that a business has to be present or have control over someone in this state to be doing business here. That is all the bill provides because the key test of whether a person is an independent contractor is control.

Shaklee }
Mary Kay } Bill Robinson

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Dec 3,
~~November~~ 30, 1981

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Mr. Glenn Pascall, Director
Washington State Department
of Revenue
General Administration Building
Olympia, Washington 98504

Re: Taxation of Direct Selling Companies - the "Nexus" Issue

Dear Mr. Pascall:

We have appreciated the time taken by members of your staff to respond to our request that the department outline its general approach and "ground rules" for the taxation of direct selling companies, products of which are sold in the state of Washington.

BACKGROUND

This letter addresses the position of the Department as outlined in a letter by Jerry Hammond to me dated August 24, 1981, a copy of which is attached. Mr. Hammond's letter is in response to my July 20, 1981, letter to Don McCuiston, a copy of which is also attached. That letter reiterated the need to identify a consistent set of criteria to be applied to the direct selling industry.

Since we initiated these discussions last spring, at least two other companies have considered retaining counsel with respect to essentially the same issues as concerned my original client,

Action against one of those companies, which we also represent, has been held in abeyance pending the outcome of these discussions. The assessment against the other company was not large enough to justify retention of counsel and was paid despite the taxpayer's belief that it conducted no activities within the state which would provide sufficient nexus for taxation.

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Washington State Department
of Revenue
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The Department has, as has been noted at recent Bar Association seminars on taxation, adopted an overly broad view of what is required to establish nexus by relying on legally and factually tenuous premises in actions taken against relatively small taxpayers which have lacked the resources to fully litigate those issues.

A comment by the Department at a recent House Revenue Committee hearing illustrates the conceptual and legal problem:

. . . direct selling companies, such as Amway and Shaklee, are competing with Washington businesses

. . . .
The people referred to are operating as Washington businesses to whom ownership, title or possession and risk of loss is transferred and who bear the direct burdens and reap the rewards of their efforts. If nexus exists with respect to the national corporation, as it does with Amway, it hinges on its activities and property, not those of the independent businesses operated by Washington residents.

This lack of understanding is exacerbated by the Department's continuing use of inappropriate prejudicial terms such as "pyramid sales organization" in written determinations and oral discussions with Department staff -- despite significant litigation and other actions at the federal level which assured the independent status of direct selling distributors by denying the national companies the control which could create an illegal sales pyramid.

We believe the correct perspective to be that the out-of-state seller does not "perform significant services in relation to establishment and maintenance of sales into the state," rather, independent contractors/businesses are motivated to create and meet market needs for their own benefit in the same manner as any other retail or wholesale seller -- it is the only way to produce incomes.

At this point, it is not necessary to repeat the details of the operation of a direct selling company as already outlined in our letter of March 12, 1981, to you. Reduced to the most basic considerations, we have asked the Department to address application of the B&O tax to a corporation which: (1) is incorporated and located out-of-state; (2) has no employees or offices in this

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state; (3) neither holds title to inventory, nor owns or leases real property in this state; (4) has an adequately developed concept of marketing through independent contractors in the various states to whom ownership, title or possession of property is transferred; and (5) does not have the requisite degree of control or other indicia over either the independent contractors or any other persons which would establish an agency relationship under Washington statutory or case law.

THE NEXUS ISSUE: "LABELS" OR FUNCTIONAL ANALYSIS?

Sufficient local nexus for application of the business and occupation tax depends on an out-of-state seller engaging in business "in the state." That physical presence can occur only two ways -- either directly or through an agent. If nexus depends on the seller's agent, then the traditional rules defining the agency relationship apply, and include brokers, consignees, bailees, and factors. If the Department finds the label determinative, then we will argue nexus on that basis.

If the Department does not find labels or characterization of a person as an agent of a direct seller determinative in order to find that seller present in the state, then the only alternative is to decide each case under a functional analysis, with each result depending upon the facts.

In the case of direct sellers, Washington cases generally support the independent contractor status of the persons who comprise the sales organizations of national direct sellers. The central issue in determining whether a person is an independent contractor or an agent is the application of the right to control test: Where the person for whom services are performed retains the right to control the manner and means by which the result is to be accomplished, the relationship is one of employment, but where control is reserved only as to the results sought, the relationship is that of an independent contractor. Where a corporation chooses to stay at home in all respects it cannot be found "present" through the activities of persons over whom it has no legal control, actual or constructive. We will address the independent contractor or agent question as to each client when it becomes relevant.

The foregoing is not to say that a person cannot be an independent contractor and that there may not be some other factual circumstance which could establish nexus. It is clear,

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however, that Mr. Hammond's statement that "all agents are either employees or independent contractors" is a gross oversimplification which provides little guidance. Neither is the converse of his statement necessarily true, i.e., all independent contractors are agents. However, the implication is that everyone in a chain of distribution other than a consumer level customer is a representative of an out-of-state seller, without regard to the wholesale and retail activities of the separate economic units.

Counsel attempting to advise out-of-state clients must approach the problem as one of "taxation by ambush." The essence of Mr. Hammond's letter is that the mere fact that activities of independent contractors which create a market for the sale of products of a national manufacturer is sufficient to create nexus for taxation of the out-of-state seller. We do not believe that to be the law; the remainder of this letter will outline the more definitive guidelines which are of constitutional significance.

STATUTES AND CASES

The Department is required to recognize separate economic units within the chain of distribution to which ownership, title or possession of property is transferred (i.e., a "sale" occurs), unless an agency relationship exists between the out-of-state direct seller and the Washington distributor. (RCW 82.04.040 defines "sale" in part as "any transfer of the ownership of, title to or possession of property for valuable consideration. . .".)

The transfer of property between most direct sellers and Washington distributors is a "sale" within the statute which is of the same nature as other sales by out-of-state suppliers to Washington retailers or wholesalers.

RCW 82.04 clearly provides that a person may be determined to be engaging in business "in the state" either directly or through an agent. RCW 82.04.360 further recognizes the distinction between persons in the capacity of an employee or servant as distinguished from that of an independent contractor. RCW 82.04.480 provides that every consignee, bailee, factor or auctioneer have in possession a personal property or possession of the documents of title with power to sell such property in his or its own name shall be deemed the seller of such property when it is sold. The same section further provides that the burden is upon the taxpayer in every case to establish the fact that he is not engaged in the business of selling tangible personal property but

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is acting merely as broker or agent in promoting sales for principal. WAC 458-20-159 further recognizes the importance of identifying the relationship where it states, with respect to agents and brokers: "Any person who claims to be acting merely as agent or broker in promoting sales for a principal or in making purchases for a buyer, will have such claim recognized only when the contract or agreement between such persons clearly establishes the relationship of principal and agent and when the following conditions are complied with. . .".

Each of the terms used in the foregoing brief references to the statute have well-defined and generally understood definitions in the context of legal and business relations, either by statute or Washington case law.

"Representative" is not defined in the Washington statute or case law. "(A)gent or other representative" (of an out-of-state seller) is used in WAC 458-20-193(b) to describe the persons performing activities which would provide sufficient nexus for application of the B & O tax. "Agent" is used in the statute and is well understood through case law regarding agency. We also know the criteria a court would apply to distinguish between an agent and an independent contractor. But what is a "representative"? It is not used in the statute; it is not defined by departmental regulation; it has no special meaning in a legal or contractual context than perhaps a synonym for "agent." I asked Jerry Hammond what "representative" meant, and he indicated that he was not certain, but that it might include "broker." "Broker" is also used in the statute and has a commonly understood meaning which includes a subset of the definition of "agent." If the department intends to decide nexus issues on the basis of labels, then it should be bound by the common and accepted definitions attached to those labels.

We do not expect the Department to rely on labels, which leads to the need to look beyond merely deeming a Washington resident a "representative," and then attributing all of his/her activities to the out-of-state seller. If these cases are to be decided by a fact pattern or functional analysis based on constitutional criteria, there is no judicial authority to support the Department's position with respect to most direct selling companies who make sales to independent contractors.

Mr. Hammond's letter states that "court challenges to the principles defining nexus in WAC 458-20-193(b) have consistently

(2)

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upheld these principles." We disagree. The fact pattern in each of the United States Supreme Court cases cited include identifiable activities and criteria which are simply not present in the instance of many direct sellers which sell their products to bona-fide wholesalers, retailers and independent contractors. Each of the cases includes consideration of one or more of the following as the basis for nexus:

- (1) employees;
- (2) property or an office in the state;
- (3) control of the out-of-state company over the persons in-state;
- (4) title, ownership and possession of property passing directly from the out-of-state manufacturer to the consumer;
- (5) orders direct to the manufacturer;
- (6) a broker or agent of the manufacturer in-state;
- (7) assigned territories;
- (8) the ability to obligate the out-of-state seller; and/or
- (9) the lack of identified "discrete business enterprises."

We will address each of the cases cited by Department staff as supporting the principles defining nexus in WAC 458-20-193B. We have restated Mr. Hammond's comments so that the Department's position may be easily compared to our view of each case.

1. Norton v. Dept. of Revenue of Illinois, 340 U.S. 534 (1951).

Hammond: "The court held that a taxpayer must meet the burden of disassociating its local solicitation from its sales or the sales are subject to the tax."

Analysis: We do not challenge placement of the burden of proof. However, the statement is essentially incomplete as to the principles articulated by the Court in Norton. The presence of

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the taxpayer's local retail outlet was sufficient to sustain the gross receipts tax on all income derived from Illinois sales to that outlet but not on orders sent directly by customers to the out-of-state head office and shipped directly to the customers from the head office. The Court stated:

Where 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, filling, and delivery back to the buyer, it is obvious that the state of the buyer has no local grip on the seller. Unless some local incident occurs sufficient to bring the transaction within its taxing power, the vendor is not taxable. (Cite omitted.) Of course, a state imposing a sales or use tax can more easily meet this burden, because the impact of those taxes is on the local buyer or user. Cases involving them are not controlling here, for this tax falls on the vendor. (Emphasis added.)

Supra at 537. The court noted that in this case the corporation had gone into the state to do local business by state permission and had submitted itself to the taxing power of the state.

2. Scripto, Inc. v. Carson, 362 U.S. 207 (1960).

Hammond: "The court held that there is no constitutional significance between resident employees of a seller and its independent contractors, brokers, or agents for the purposes of determining if nexus has been established. It was held that the activities of any of these representatives served to establish nexus."

Analysis: The foregoing excerpt from court dictum means nothing more than that the court looked beyond the "labels" attached to persons and used a "functional analysis." Even in so doing, the court recognized the implicit importance of an agency relationship, however denominated: "Moreover, we cannot see, from a constitutional standpoint, that it was important that the agent worked for several principals." The test is simply the nature and extent of the activities of the appellant in Florida." (Emphasis ours.) Supra at 211-212.

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The facts in Scripto varied from most direct sellers in at least four respects: Sales were solicited on strictly commission basis; they did not have title or possession of the property held for sale; the "dealers" under the Florida statute were each assigned territories; and no dollars flowed between the salesmen and purchasers. In addition, the tax in question was a use tax, which requires the state to meet a lighter burden with respect to nexus than the "presence" required to support imposition of gross receipts taxes. The Florida statute included a very broad definition of "dealer":

"Dealer" also means and includes every person who solicits business either by representatives or by distribution of catalogs or other advertising matter and by reason thereof receives and accepts orders from consumers in the state. . .

Supra at 208. The reasoning in Scripto supports imposition of use tax on out-of-state companies regardless of the method of solicitation of sales in-state; it has no relevance to application of a gross receipts tax to direct sellers except to reinforce the points which we have already argued.

3. General Motors Corp. v. Washington, 377 U.S. 36 (1964).

Hammond: "The court held that unless a tax fails on one of the three tests (i.e., the tax is discriminatory, it produces multiple burdens, or it is unfairly apportioned to the business activity occurring within the taxing state) it is not constitutionally prohibited."

Analysis: The foregoing summary misstates the case; the court refrained from passing on the question of "multiple taxation" because the corporation did not show what definite burden in the constitutional sense was placed on identical interstate shipments. It clearly did not hold that failure to meet one of the three "tests" cited above had anything to do with establishing a basis for nexus.

Of interest to these discussions, the court held that the bundle of corporate activities, or "incidents" in Washington warranted the finding of a nexus between the corporation's in-state activities and its sales here, especially when its taxable business

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was so enmeshed with what it claimed was nontaxable. Supra at 442-448.

General Motors admitted entering the state and engaging in activities, including: (a) having district managers and other representatives who are clearly employees; (b) a division of the corporation had a branch office in Washington; (c) out-of-state zone office personnel visited dealers in the state; and (d) the parts division maintained warehouses in the state.

The court favorably cited Norton regarding the differences between sales from an in-state warehouse versus an out-of-state warehouse, and that those from the out-of-state warehouse were clearly nontaxable. The General Motors court stated: "It is difficult . . . to distinguish between the in-state activities of the representatives here involved and the in-state activities of solicitors or traveling salesmen - activities which this court has held are insufficient to constitute a basis for imposing a tax on interstate sales." Supra at 456.

The fact situation in General Motors is analogous to that wherein a direct selling company would have a warehouse and/or employees in this state (as some do), and is taxed appropriately. Again, this case cited by the Department relies on the physical presence of a corporation in the form of offices and employees for nexus.

4. Standard Pressed Steel v. Department of Revenue, 419 U.S. 560 (1975).

Hammond: "The court held that the taxpayer's representatives in Washington need only to act so as to make possible the realization and continuance of valuable contractual relationships between the taxpayers and its customers in order to establish taxable nexus. Standard Pressed Steel argued that its representatives made no solicitation in the state of Washington, but the court said that this argument was frivolous."

Analysis: The summary is inaccurate and misleading. The court held that the out-of-state manufacturer's business activities through an engineer/employee residing in Washington was sufficient contact to impose the B&O tax. Payments and orders were sent directly to the manufacturer. Also, unlike most direct sellers, there was no transfer of ownership, title or possession to

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the employee which would constitute a sale. The following excerpt from the opinion demonstrates the significance of the presence of an employee and his relationship to the taxpayer, rather than whether his activities included a "solicitation" per se was determinative:

Appellant argues that imposition of the tax violates due process because the in-state activities were so thin and inconsequential as to make the tax on activities occurring beyond the borders of the state one which has no reasonable relation to the protection of benefits conferred by the taxing State. (Cite omitted). In other words, the question is "whether the state has given anything for which it can ask return." Id. at 444. We think the question in the context of the present case verges on the frivolous. For appellant's employec, Martinson, with a full-time job within the state, made possible the realization and continuance of valuable contractual relations between appellant and Boeing.

Supra, at 562.

5. Tauza v. Susquehanna Coal Co., 220 N.Y. 259, 115 N.Y. 915 (1917).

Hammond: "A corporation is 'present' if it is represented in the state by those activities which they set in motion."

Analysis: The Hammond summary is a mischaracterization which ignores both the facts and the rationale of the case. The New York court held that a Pennsylvania corporation was doing business within the state for the purpose of service of process by maintaining an office within the state which had nine sales agents in addition to other employees which solicited orders resulting in shipments from Pennsylvania to New York. The rationale used by the court in Tauza directly supports our position by again focusing on employees, an office and the agency relationship.

When a foreign corporation comes into this state, the Legislature, by virtue of its control over the law of remedies, may define the agents of the corporation on whom process may be served. (Cite omitted.) If persons named are true agents, and if their positions

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are such to lend a just presumption that notice to them will be notice to the principal, the corporation must submit. (Cites omitted)

Supra at 918.

6. Princess House, Inc. v. State of Washington Department of Revenue, Docket 188.

Hammond: " The State of Washington Board of Tax Appeals . . . alluded to this principal (referring to Tauza) when they confirmed the Department's assessment of business and occupation tax on Princess House, Inc.'s sales into Washington. Princess House is another direct selling company. The Board of Tax Appeals based its decision on the modus operandi of Princess House."

Analysis: The reasoning in Princess House is as defective as the Department's prior interpretations. The case was an example of the situation referenced earlier where the Department has taken a relatively small taxpayer without enough involved to mount a large scale litigation effort. It is apparent that the Department is attempting to extend its success in General Motors and Standard Press Steel, and the Scripto rule by administrative action, even though no judicial authority has been found to support it.

It is not our intention or place to reargue Princess House in this letter. However, a cursory review of the case will illustrate the errors in logic and lack of coherence with other decisions cited herein.

Princess House had contended that it had no right to control the independent contractors involved in the sales of its products. The Department did not dispute the "independent status of consultants," but did

dispute the contention made that consultants are independent contractors and not representatives of Princess House, Inc. . . . Connections or 'nexus' have been shown by meetings between consultants and Princess House 'overwrites' paid to consultants, promotional and advertising gimmicks, business cards and overall direction creating a network or sales force enabling the appellant to market its products in the State of Washington. . . .

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If the foregoing was intended to establish the importance (and conclusion) of an agency relationship, and thereby nexus, it should be made clear. There is an almost casual reliance on the label "representative," and no specific finding with respect to the key element of "control," although the taxpayer had denied control over the independent contractors and the Department had alleged a "pyramid" sales scheme. As I indicated to you in our meeting last spring, such careless references to a "pyramid" sales scheme draw a vehement response from most direct sellers, because several have entered into consent orders with the Federal Trade Commission precisely to establish and guarantee the lack of control and independent contractor status of those selling its products in various states.

The situation is further confused by the Department's contention that:

It is immaterial whether residents who perform services for the taxpayer corporation toward the establishment and maintenance of sales in this state are employees or are under contract as independent consultants. The activities of the unit, area, and divisional agents combined with the efforts of the remainder of the sales organization are sufficient nexus. . . .

It appears that the Department and the Board assumed, without finding, an agency relationship between the direct seller and its "representatives." As stated earlier, if there is no "agency," the direct seller cannot be present (unless otherwise physically present).

The principal authority cited in Princess House was Standard Press Steel, which we have already discussed.

In addition to its confused reasoning, Princess House is disturbing because it ignores key elements of most direct sales organizations: (1) The independent contractor becomes the owner, has title, possession and risk of loss of the property; (2) the independent contractor may sell without limitation to anyone, anywhere, at any price; (3) there is a lack of control of the manufacturer over the independent contractor which meets the criteria in both state and federal cases; (4) independent contractors may sell competing products; (5) the independent contractors pay expenses of meetings and those of management of manufacturers if requested to attend; (6) sellers do not perform

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"significant services" in relation to establishment and maintenance of sales into the state; and most importantly, (7) the independent contractors are motivated to create a market for their own benefit in the same manner as any other retail or wholesale seller.

7. Unknown Determination.

Hammond: (Because the referenced determination was cited at greater length than all of the other cases combined in Mr. Hammond's letter, we requested a copy of the determination so that we could analyze the facts and law contained therein, but were denied further identification or information based on RCW 82.32.330 (the Privacy Act)).

The Department has subsequently (to Princess House) ruled on other direct selling companies The question arose of whether B&O tax was due upon the sales by another direct selling company to seven franchise distributors in the State of Washington. . . . The franchise distributors conducted activities on behalf of and as representatives of the taxpayers which were significantly associated with the taxpayer's ability to establish and maintain a market for its products in this state. . . . The in-state services of those licensed representatives enabled the seller to make sales The activities of these distributors were prescribed, closely monitored, supervised, and controlled by the taxpayer; that the sales methods and promotional efforts of the distributor, as well as those of the dealers recruited by them, were pursuant to detailed plans and instructions of the taxpayer; that the taxpayer sold or furnished through those representatives catalogs, promotional materials, sales aids, incentive prizes, and business forms; that the taxpayer had arranged to furnish automobiles to its distributors and to lease them to the distributors for a nominal charge. The taxpayers' regional managers called on the distributors in this state, the regional managers supervised, motivated, and trained the Washington distributors by frequent telephone contact plus meetings held outside Washington in each year to provide recruiting and selling promotions and techniques. . . . (Emphasis ours.)

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The legal challenge to date has never been carried beyond the Superior Court of Thurston County. . . .

All agents are either employees or independent contractors. We think that the important thing is what the agent does on behalf of the person he represents, that the nature of the formal contractual relationship pursuant to which he does these things is without constitutional significance. An independent contractor can often be as effective -- in some cases more effective -- than an employer representative. (Emphasis ours.)

There remains, however, the question of whether the distributors appointed by the taxpayer pursuant to its contractors are merely customers of the taxpayers or whether they are in addition, representatives of the taxpayer performing significant services here in relation to the establishment and maintenance of the taxpayer's sales into this state. For all of these reasons and activities cited the Department ruled that these distributors truly were representatives of the taxpayers. The closely supervised and directed promotional recruitment and dealer training activities of these representatives were the key . . ." (Emphasis ours.)

Analysis: We are unable to comment on the accuracy of Mr. Hammond's comments on the legal and factual issues in the referenced "unknown determination." The mere fact that it is cited at such length as "authority" for the Department's present position is illustrative of the "taxation by ambush" issue raised earlier. Therefore, we can comment only on the issues as presented by Mr. Hammond.

The most important consideration in the facts described were the supervision and control by the taxpayer of the representatives. The fact that the sales methods and promotional materials were developed and/or distributed by the out-of-state seller has little to do with the nexus issue. The statement that "all agents are either employees or independent contractors" is not a correct statement of the law. The general rule is that "independent contractors" are not "agents" for a principal except under limited and specified circumstances. Here, "agent" (or "representative" in an agency context), is used and stated as a conclusion, without applying the test to determine whether an agency relationship

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does in fact exist. In other words, an independent contractor may be an agent for the purposes of the statute if the criteria, including the control test discussed earlier, are met.

8. PVO International, Inc. v. Dept. of Revenue, State of Washington, Thurston County Superior Court No. 79-2-00732-1 (1980).

Hammond: (This is the case referenced in Mr. Hammond's discussion of the foregoing "Unknown Determination.") This case was referenced as support for the present position of the Department as previously outlined, but without further explanation. Mr. Hammond provided copies of the Stipulation of Facts and Findings of Fact and Conclusions of Law which we have reviewed.

Analysis: PVO contained the following elements which we agree are adequate to establish nexus: (1) employment; (2) control of activities by the taxpayer; (3) agency relationship; (4) inventory in Washington; and (5) ownership, title or possession of the goods retained by the taxpayer until transferred directly to the ultimate consumer.

PVO markets its products in Washington through brokers (agents), and had already submitted to jurisdiction and paid wholesale B&O tax for 1974 through 1977. The case concerned assessment of additional tax on those products shipped to Washington customers from locations outside the state. PVO also had inventory stored and owned in the state. The only difference between sales protested and those not protested was where the shipment of the product originated. It was stipulated that a food broker is a "sales force for hire," indicating an agency or employee relationship. The brokers were allowed to accept orders only under prescribed conditions, the products were then shipped directly to buyers.

The relevant findings of fact included that the brokers were "employed by PVO" and were "under the control of PVO." The conclusions of law included:

5. There exists an agency relationship between PVO and each of its Washington brokers, M&S and Raymer-Brand.

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6. For the purpose of determining the existence of nexus under the due process and commerce clauses of the U.S. Constitution, there is no constitutional significance to be assigned to the label used to describe the relationships between PVO and Raymer-Brand or between PVO and M&S, whether those labels be 'employees' or 'independent contractor' or 'broker.' (Emphasis curs.)

The significance of the foregoing is obvious, the court made its determination based on the agency relationship, which hinges on control, regardless of the "labels" used.

9. Other Cases. Recent cases and authorities not cited in Mr. Hammond's letter also support our position that the existence of an agency relationship or the failure to identify discrete business enterprises would serve to establish nexus. The absence of agency and the identification of discrete business enterprises would preclude nexus in the absence of employees, inventory or real property in the taxing state.

A. Exxon v. Wisconsin, 447 U.S. 207 (1980). This U.S. Supreme Court case is perhaps the most far reaching with respect to taxation of interstate sales, yet adheres to principles in support of our position. Exxon's marketing operations in Wisconsin were sufficient nexus for apportioning its total income under Wisconsin's income tax statute. The marketing operations were an integral part of one unitary business, and Exxon conceded that it had availed itself of "the substantial privilege of carrying on business" through its marketing operations. It contested, and lost, the Wisconsin position that nexus was sufficient to permit inclusion of all of Exxon's corporate income within the apportionment formula. Significant to direct sellers is the court's dictum:

We agree with the Wisconsin Supreme Court that Exxon is such a unitary business and that Exxon has not carried its burden of showing that its functional departments are "discrete business enterprises" whose income is beyond the apportionment statute of the state. While Exxon may treat its operational departments as independent profit centers, it is nonetheless true that this case involves a highly integrated business which benefits from an umbrella of centralized management and controlled interaction.

Supra at 224.

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The concept of "discrete business enterprises" is consistent with direct selling sales organizations, and that "controlled interaction" is not consistent with independent contractor status, liability and operations of direct sellers.

Also, the court found that:

Exxon's use of separate functional accounting, and its decision for purposes of corporate accountability to assign wholesale market values to interdepartmental transfers of products and supplies, does not defeat the clear and sufficient nexus between appellant's interstate activities and the taxing state.

Supra at 225. The foregoing would not apply to a direct seller where there are distinct economic entities.

B. Wilbur-Ellis Co. d/b/a H.R. Spinner Co. v. Department of Revenue, (Washington), Board of Tax Appeals, Docket No. 80-24, (1981). This recent Board of Tax Appeals case involved a taxpayer acting as an intermediary between a manufacturer and consumer to guarantee payment to the manufacturer and arbitrate disputes for a fee of 5% of the sales price. The Board found that RCW 82.04.480, which imposes a Business and Occupation Tax on persons acting as agents or brokers in promoting sales, does not apply to the taxpayer's business because the taxpayer rarely has possession of the goods or title to them and receives only 5% for his services.

We believe the reasoning in the foregoing decision is correct because it recognizes the importance of a taxpayer not having "possession, ownership, evidence of ownership, of ability to sell the goods or to set the price therefor," all of which are present with respect to most direct sellers. State Tax Cases Reporter CCH ¶ 201-427. Therefore, the Board treated the transactions as one involving a true agency relationship. The transfer of ownership, title or possession would, of course, support an opposite result.

C. Public Law 86-272. In oral discussions, Mr. Hammond stated that the Department had rejected the application of Public Law 86-272 to states with a gross receipts (income) tax by analogy. Public Law 86-292 provides protection from multiple taxation with those states with an income tax by providing, among other things, that tax can be applied only where the taxpayer

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has employees or property in the taxing state. While one might query whether it is logical but the business tax of the state of origin and the state of destination have to be identically structured before multiple taxation can be shown, we do not have to go as far, or have a similar statute with respect to gross receipts taxes to reach the same result for direct sellers.

Few thought that states would attempt to double tax gross receipts at the time Public Law 86-272 was originally passed; actions such as those in this state have prompted proposals in Congress to extend the law to gross receipts. Until that occurs, or the Department agrees to provide a predictable and constitutional basis for taxing direct sellers, it is impossible to identify a level of activity other than sales from an out-of-state seller directly to the consumer which would not trigger the characterization of the buyer as a "representative" of the seller.

SUMMARY

We know of no cases supporting nexus except those where the seller was present either through holding title to inventory, real property, employees, or through the activities of persons with a true agency relationship with a seller. Other significant factors, some of which are implicit in the foregoing statement, include control; title, ownership and possession of property passing directly from the out-of-state manufacturer to the consumer; liability and risk of loss or non-payment; assigned territories and markets; the ability to obligate the out-of-state seller; and/or the lack of identified "discrete business enterprises."

As noted in our letter to you of March 12, 1981, we recognize and support the application of the Business and Occupation Tax at both the retail and wholesale levels. We continue to believe that the application and collection of the tax should be as suggested therein. We did not argue the nexus issue at that time, because we hoped that through its examination of the sales organization as described the Department would gain a clear understanding of the direct selling industry, and recognize the practical and legal futility of characterizing the independent contractors as "agents or other representatives" of out-of-state direct sellers. Subsequent correspondence revealed the depth of disagreement with respect to the applicable law, and which we have addressed at length herein.

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We would appreciate hearing from you and having the opportunity to meet again once you and your staff have had the opportunity to review this material. Our clients would obviously prefer reaching an accommodation with the Department without the necessity of either litigation or legislation. We will be pleased to participate if the Department chooses to address the issues raised herein through the revision or promulgation of existing or new rules.

Thank you again for your consideration and cooperation.

Very truly yours,

CARNEY, STEPHENSON, BADLEY,
SMITH & MUELLER

William T. Robinson

WTR:jew

cc: Don Burrows w/enclosures
Bob Munzinger w/enclosures

USE BILL NO. 566

By: Prince, Walk, Sanders, Todd, Miller

BRIEF TITLE:

Defining engaging in business "within this state" for certain B&O tax purposes.

2-14-83 Filed w/Chief Clerk for introduction
2-15-83 Read first/Referred to Committee on
WAYS & MEANS

MAJORITY: Do Pass
Do pass w/amendment
Substitute House Bill be substituted therefor & substitute do pass

MINORITY: Do Not Pass
Without recommendation

Referred to Committee on:
Reported w/recommendation:

Rules 2
Rules suspended/Advanced to 2nd Rdg.
Read 2nd time. HELD
Amended Ordered Engrossed Substituted

Rules 3
Rules Suspended/Advanced to 3rd Rdg.
Read 3rd time. HELD

PASSED AS AMENDED
PASSED YEARS NAYS
NOTICE OF RECONSIDERATION

This agreed to/sent to SENATE
Chief Clerk

SENATE RECORD: Floor #

Received from House
Read first/Referred to Committee on:
Reported w/recommendation:

Referred to Committee on:
Reported w/recommendation:

Rules Suspended/Advanced to 2nd Rdg.
Read 2nd time. Held Amended

Rules Suspended/Advanced to 3rd Rdg.
Read 3rd time. HELD

PASSED AS AMENDED
PASSED YEARS NAYS
NOTICE OF RECONSIDERATION

This agreed to/returned to HOUSE.
Secretary of Senate

HOUSE RECORD:

Received from Senate
Do Not Concur
Do Concur w/Exception

PASSED AS SENATE AMENDED
YEAS NAYS

Chief Clerk

ENROLLED
Speaker of House signs
President of Senate signs
Delivered to Governor
Governor signs
PARTIAL VETO
Filed w/Secretary of State

HOUSE RECORD:

Rules 3
Received from Senate
Referred to Committee or
Reported w/recommendation

Rules suspended/Placed on 2nd Rdg.
Amended Ordered Engrossed Substituted
Read 2nd time. HELD

Rules Suspended/Advanced to 3rd Rdg.
Read 3rd time. HELD

PASSED YEARS NAYS
NOTICE OF RECONSIDERATION

Title agreed to/sent to SENATE

Chief Clerk

See back of cover

1 AN ACT Relating to business and occupation taxation of out-of- CR83B
 2 state businesses; amending section 82.04.270, chapter 15, Laws of P .
 3 1961 as last amended by section 4, chapter 172, Laws of 1981 and RCW H
 4 82.04.270; amending section 82.04.250, chapter 15, Laws of 1961 as -486;
 5 last amended by section 2, chapter 172, Laws of 1981 and RCW 1
 6 82.04.250; and creating a new section.

PART A

7 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON: ; 2

8 Sec. 1. Section 82.04.270, chapter 15, Laws of 1961 as last 10
 9 amended by section 4, chapter 172, Laws of 1981 and RCW 82.04.270 are 12
 10 each amended to read as follows: 12

(1) Upon every person except persons taxable under subsections 14
 12 (1) or (8) of RCW 82.04.260 engaging within this state in the 14
 13 business of making sales at wholesale; as to such persons the amount 15
 14 of tax with respect to such business shall be equal to the gross 16
 15 proceeds of sales of such business multiplied by the rate of forty- 17
 16 four one-hundredths of one percent. 18

(2) For the purposes of this section: 19

(a) A person is engaged in wholesale business activities "within 20
 19 this state" only if that person: 20

(i) Owns or leases real property within this state; or 21

(ii) Regularly maintains a stock of tangible personal property in 22
 22 this state for sale in the ordinary course of business. 23

(b) A person shall not be considered to be engaged in business 24
 24 "within this state" merely by reason of the solicitation in this 25
 25 state by such person, or by an independent contractor, agent, or 26
 26 representative of such person, of orders for sales to or on behalf of 27
 27 a customer of such person, if the orders are sent outside this state 28
 28 for approval or rejection and, if approved, are filled by shipment or 29
 29 delivery from a point outside this state. 29

1. (3) The tax imposed by this section is levied and shall be
 2 collected from every person engaged in the business of distributing
 3 in this state articles of tangible personal property, owned by them
 4 from their own warehouse or other central location in this state to
 5 two or more of their own retail stores or outlets, where no change of
 6 title or ownership occurs, the intent hereof being to impose a tax
 7 equal to the wholesaler's tax upon persons performing functions
 8 essentially comparable to those of a wholesaler, but not actually
 9 making sales: PROVIDED, That the tax designated in this section may
 10 not be assessed twice to the same person for the same article. The
 11 amount of the tax as to such persons shall be computed by multiplying
 12 forty-four one-hundredths of one percent of the value of the article
 13 so distributed as of the time of such distribution: PROVIDED, That
 14 persons engaged in the activities described in this subsection shall
 15 not be liable for the tax imposed if by proper invoice it can be
 16 shown that they have purchased such property from a wholesaler who
 17 has paid a business and occupation tax to the state upon the same
 18 articles. This proviso shall not apply to purchases from
 19 manufacturers as defined in RCW 82.04.110. The department of revenue
 20 shall prescribe uniform and equitable rules for the purpose of
 21 ascertaining such value, which value shall correspond as nearly as
 22 possible to the gross proceeds from sales at wholesale in this state
 23 of similar articles of like quality and character, and in similar
 24 quantities by other taxpayers: PROVIDED FURTHER, That delivery
 25 trucks or vans will not under the purposes of this section be
 26 considered to be retail stores or outlets.

27 Sec. 2. Section 82.04.250, chapter 15, Laws of 1961 as last
 28 amended by section 2, chapter 172, Laws of 1981 and RCW 82.04.250 are
 29 each amended to read as follows:

30 (1) Upon every person except persons taxable under RCW
 31 82.04.260(8) engaging within this state in the business of making
 32 sales at retail, as to such persons, the amount of tax with respect
 33 to such business shall be equal to the gross proceeds of sales of the
 34 business, multiplied by the rate of forty-four one-hundredths of one
 35 percent.

36 (2) For the purposes of this section:

1 (a) A person is engaged in retail business activities "within 67
 2 this state" only if that person: 67

3 (i) Owns or leases real property within this state; or 68

4 (ii) Regularly maintains a stock of tangible personal property in 69
 5 this state for sale in the ordinary course of business. 70

6 (b) A person shall not be considered to be engaged in business 71
 7 "within this state" merely by reason of the solicitation in this 72
 8 state by such person, or by an independent contractor, agent, or 73
 9 representative of such person, of orders for sales to or on behalf of 74
 10 a customer of such person, if the orders are sent outside this state 75
 11 for approval or rejection and, if approved, are filled by shipment or 76
 12 delivery from a point outside this state. 76

13 NEW SECTION. Sec. 3. Nothing in this act shall be construed as 78
 14 implying that the mere solicitation of orders by independent 79
 15 contractors already constitutes engaging in business within the 79
 16 state, nor that it was the intent of the legislature that activities 80
 17 of distinct economic entities, such as retailers, wholesalers, and 81
 18 independent contractors, be imputed to an out-of-state business for 82
 19 the purpose of determining whether it was engaged in business within 83
 20 the state. 83

L. I. S. BILL DIGEST

House Bill 566

H. B. 566 by Representatives Prince,
Walk, Sanders, Todd, Miller

Defining engaging in business "within
this state" for certain B & O tax
purposes.

Limits the definition of retailers
and wholesalers doing business "within
this state" to retailers and wholesal-
ers who own or lease real property in
the state or who regularly maintain a
stock of tangible personal property in
the state.

--1983 REGULAR SESSION--

Feb 15 First reading, referred to Ways
& Means.

FISCAL NOTE

Department of Revenue
Responding Agency

140
Code No.

REQUEST NUMBER 46

Bill No. SB 3482/ HB 566

February 16, 1983
Date Submitted

Description:

Presently sales to persons in Washington are subject to retail and wholesale business and occupation taxation when the property is shipped from points outside Washington and the seller carries on activity in Washington which is significantly associated with the seller's ability to establish and maintain a market in Washington. Such sales are exempt from B&O taxation only if there is no participation whatsoever by the seller's branch office, local outlet, or by an agent or other representative of the seller. Specifically, orders solicited through independent manufacturer's representatives and salesmen who are employees of the seller are taxable even if the seller carries on no other activity in Washington. The existence of factories, stores, warehouses and stocks of goods in Washington is not necessary for such sales to be subject to taxation.

This bill would impose the wholesaling and retailing B&O taxes only upon persons who either own or lease real property within Washington or who regularly maintain a stock of tangible personal property in Washington for sale in the regular course of business. In addition, the bill would specifically exempt from wholesaling and retailing B&O taxation persons who only solicit sales in Washington through agents, salesmen or independent contractors, if the orders are sent outside Washington and filled by shipment from a point outside the state. The bill would reverse a 1974 revision of WAC 458-20-193B, Sales of Goods Originating in Other States to Persons in Washington, which resulted from a U. S. Supreme Court decision.

Revenue Impact:

The revenue estimate assumes that 20 percent of the out-of-state businesses reporting wholesaling income in Washington and 10 percent of the out-of-state businesses reporting retailing income either do not own or lease real property in Washington or do not maintain a stock of tangible personal property in Washington for sale. This assumption is based on out-of-state audit experience for these types of sales. These businesses would no longer pay wholesaling and retailing B&O tax.

A significant amount of the revenue loss is due to reduced out-of-state audit assessments resulting from the elimination of taxation for the above firms. It should also be noted that the bill gives out-of-state businesses an incentive to alter their marketing structure in order to escape taxation. Any revenue loss resulting from this restructuring is not included in the revenue loss estimate, but could be substantial.

Expenditure Impact:

No impact on state expenditures.

Read first time February 15, 1983 and referred to Committee on Ways & Means.

1 AN ACT Relating to business and occupation taxation of out-of-
2 state businesses; amending section 82.04.270, chapter 15, Laws of
3 1981 as last amended by section 4, chapter 172, Laws of 1981 and RCW
4 82.04.270; amending section 82.04.250, chapter 15, Laws of 1981 as
5 last amended by section 2, chapter 172, Laws of 1981 and RCW
6 82.04.250; and creating a new section.

7 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

8 Sec. 1. Section 82.04.270, chapter 15, Laws of 1981 as last
9 amended by section 4, chapter 172, Laws of 1981 and RCW 82.04.270 are
10 each amended to read as follows:

11 (1) Upon every person except persons taxable under subsections
12 (1) or (8) of RCW 82.04.260 engaging within this state in the
13 business of making sales at wholesale as to such persons the amount
14 of tax with respect to such business shall be equal to the gross
15 proceeds of sales of such business multiplied by the rate of forty-
16 four one-hundredths of one percent.

17 (2) For the purposes of this section:

18 (a) A person is engaged in wholesale business activities "within
19 this state" only if that person:

20 (i) Owns or leases real property within this state; or

21 (ii) Regularly maintains a stock of tangible personal property in
22 this state for sale in the ordinary course of business.

23 (b) A person shall not be considered to be engaged in business
24 "within this state" merely by reason of the solicitation in this
25 state by such person, or by an independent contractor, agent, or
26 representative of such person, of orders for sales to or on behalf of
27 a customer of such person, if the orders are sent outside this state
28 for approval or rejection and, if approved, are filled by shipment or
29 delivery from a point outside this state.

(3) The tax imposed by this section is levied and shall be collected from every person engaged in the business of distributing in this state articles of tangible personal property, owned by them from their own warehouse or other central location in this state to two or more of their own retail stores or outlets, where no change of title or ownership occurs, the intent hereof being to impose a tax equal to the wholesaler's tax upon persons performing functions essentially comparable to those of a wholesaler, but not actually making sales: PROVIDED, That the tax designated in this section may not be assessed twice to the same person for the same article. The amount of the tax as to such persons shall be computed by multiplying forty-four one-hundredths of one percent of the value of the article so distributed as of the time of such distribution: PROVIDED, That persons engaged in the activities described in this subsection shall not be liable for the tax imposed if by proper invoice it can be shown that they have purchased such property from a wholesaler who has paid a business and occupation tax to the state upon the same articles. This proviso shall not apply to purchases from manufacturers as defined in RCW 82.04.110. The department of revenue shall prescribe uniform and equitable rules for the purpose of ascertaining such value, which value shall correspond as nearly as possible to the gross proceeds from sales at wholesale in this state of similar articles of like quality and character, and in similar quantities by other taxpayers: PROVIDED FURTHER, That delivery trucks or vans will not under the purposes of this section be considered to be retail stores or outlets.

Sec. 2. Section 82.04.260, chapter 15, Laws of 1981 as last amended by section 2, chapter 172, Laws of 1981 and RCW 82.04.250 are each amended to read as follows:

(1) Upon every person except persons taxable under RCW 82.04.260(8) engaging within this state in the business of making sales at retail, as to such persons, the amount of tax with respect to such business shall be equal to the gross proceeds of sales of the business, multiplied by the rate of forty-four one-hundredths of one percent.

(2) For the purposes of this section:
 HB 566

(a) A person is engaged in retail business activities "within this state" only if that person:

(i) Owns or leases real property within this state; or
 (ii) Regularly maintains a stock of tangible personal property in this state for sale in the ordinary course of business.

(b) A person shall not be considered to be engaged in business "within this state" merely by reason of the solicitation in this state by such person, or by an independent contractor, agent, or representative of such person, of orders for sales to or on behalf of a customer of such person, if the orders are sent outside this state for approval or rejection and, if approved, are filled by shipment or delivery from a point outside this state.

NEW SECTION. Sec. 3. Nothing in this act shall be construed as implying that the mere solicitation of orders by independent contractors already constitutes engaging in business within the state, nor that it was the intent of the legislature that activities of distinct economic entities, such as retailers, wholesalers, and independent contractors, be imputed to an out-of-state business for the purpose of determining whether it was engaged in business within the state.

House Amendment to SSB 3244 by Representative
Appelwick **01285 5/17/83 ADOPTED**

On page 3, after line 14, insert the following new section:

"NEW SECTION. Sec. 4. There is added to chapter 82.04 RCW a new section as follows:

(1) This chapter shall not apply to any person in respect to gross income derived from the business of making sales at wholesale or retail if such person:

- (a) Does not own or lease real property within this state; and
- (b) Does not regularly maintain a stock of tangible personal property in this state for sale in the ordinary course of business; and
- (c) Is not a corporation incorporated under the laws of this state; and
- (d) Makes sales in this state exclusively to or through a direct seller's representative.

(2) For purposes of this section, the term "direct seller's representative" means a person who buys consumer products on a buy-sell basis or a deposit-commission basis for resale, by the buyer or any other person, in the home or otherwise than in a permanent retail establishment, or who sells, or solicits the sale of, consumer products in the home or otherwise than in a permanent retail establishment; and

- (a) Substantially all of the remuneration paid to such person, whether or not paid in cash, for the performance of services described in this subsection is directly related to sales or other output, including the performance of services, rather than the number of hours worked; and
- (b) The services performed by the person are performed pursuant to a written contract between such person and the person for whom the services are performed and such contract provides that the person will not be treated as an employee with respect to such purposes for federal tax purposes.

(3) Nothing in this section shall be construed to imply that a person exempt from tax under this section was engaged in a business activity taxable under this chapter prior to the enactment of this section."

01285

ADOPTED
5-17-83
AC

establishment; and

2 (a) Substantially all of the remuneration paid to such person,
3 whether or not paid in cash, for the performance of services
4 described in this subsection is directly related to sales or other
5 output, including the performance of services, rather than the number
6 of hours worked; and

7 (b) The services performed by the person are performed pursuant
8 to a written contract between such person and the person for whom the
9 services are performed and such contract provides that the person
10 will not be treated as an employee with respect to such purposes for
11 federal tax purposes.

12 (3) Nothing in this section shall be construed to imply that a
13 person exempt from tax under this section was engaged in a business
14 activity taxable under this chapter prior to the enactment of this
15 section.

Passed the Senate May 22, 1983.

John A. Cherberg
President of the Senate.

Passed the House May 17, 1983.

Wayne Allen
Speaker of the House.

Approved June 13, 1983

Phil Bellman
Governor of the State of Washington

FILED
JUN 13 1983
SECRETARY OF STATE
STATE OF WASHINGTON
4:00 pm

OFM - ENROLLED BILL ANALYSIS
DIRECTOR'S COMMENTS

Bill Number SSB 3244

Date 6/6/83

Comments

Recommended Action

Sign

Do Not Sign - Let Pass

Veto Sections _____

Veto

Joe Traller
(Signature)

9/82/005.2

BR

JUN 21 1983

Shaklee Corporation
Shaklee Terraces 444 Market Street
San Francisco, CA 94111
Telephone 415/954-2688
TWX 910 372 8016

Claude M. Jarman
Vice President
Corporate Communications

OFFICE OF THE GOVERNOR
CORRESPONDENCE DISTRIBUTION

ORIGINAL: GOV
ACTION: BILL FILE ✓
XC'S: _____

June 21, 1983

DATE: 6-27-83

The Honorable John Spellman
Executive Department
Legislative Building
Olympia, WA 98504

Dear Governor Spellman:

I was pleased to learn that you recently signed into law Senate Bill No. 3244, which included a provision clarifying the application of the Business and Occupation Tax for out-of-state manufacturers.

As you know, this provision represents a workable compromise of a long standing legislative issue. I appreciate your recognition of its merit and your support of its enactment.

Sincerely,

Claude M. Jarman
Claude M. Jarman

CMJ:cvc

GOVERNOR'S STAFF - ENROLLED BILL ANALYSIS

I No. SSB 3204
 Title Business and
occupation tax

Rec'd 5-23-83
 Deadline 6-16 Thursday
 Ceremony _____
 To OFM 5-23-83
 From OFM 6-6-83

REVIEWED BY	RECOMMENDED ACTION		
<u>X</u> Joe Toller	<u>X</u> Sign	Veto	PVS
Marilyn Showalter	Sign	Veto	PVS
<u>X</u> Steve Excell	<u>SE</u> Sign	Veto	PVS
Naomi Sanchez	Sign	Veto	PVS
Brian McCauley	Sign	Veto	PVS
Phil Rockefeller	Sign	Veto	PVS
Dave Stevens	Sign	Veto	PVS
<u>X</u> Rollie Schmitt	<u>RS</u> Sign	Veto	PVS
<u>X</u> Richard Allison	<u>A</u> Sign	Veto	PVS
<u>X</u> DOR	Sign	Veto	PVS §5
	Sign	Veto	PVS
	Sign	Veto	PVS

The Governor [Signature] Sign Veto PVS

COMMENTS (PLEASE INITIAL) §§ 1 & 2 ARE THE GOVERNOR'S EXECUTIVE REQUEST BILL ON EXEMPTING
FEDERAL GRANTS TO LOCAL GOV'TS FROM THE B&O TAX. §§ 3-5 ARE OTHER TAX
EXEMPTIONS OF WHICH ONLY § 5 IS IN CONTROVERSY. § 5 ATTEMPTS TO DEFINE
WHICH OUT-OF-STATE MANUFACTURERS ARE EXEMPT FROM STATE TAXATION. MUCH
CONTROVERSY HAS SURROUNDED PYRAMIDAL SALES ORGANIZATIONS. IN-STATE SELLERS
(OF AKON, SHAKLEE, MARY KAY COSMETICS, ETC.) ARE CLEARLY TAXABLE. NOT CLEAR
IS THE SITUATION INVOLVING OUT-OF-STATE FIRMS WHICH MERELY SHIP INTO
THE STATE THEIR PRODUCTS (W/ NO INVENTORY, PROPERTY OR EMPLOYEES) IN
THE STATE). DOR HAS ATTEMPTED TO TAX THEM, SAYING THAT THE IN-STATE
SELLERS ARE THEIR AGENTS. BOTH THE IN-STATE SELLERS & THE MANU-
FACTURERS MAINTAIN THAT THESE IN-STATE SELLERS ARE "INDEPENDENT
CONTRACTORS." IRONICALLY, DOR (MAY COYLE) DRAFTED THE COMPROMISE
SUBJECT IN THIS BILL. AFTER REVIEWING THE ISSUE, I FEEL THE LANGUAGE
IS ALMOST A RESTATEMENT OF EXISTING CASE LAW & A VETO ONLY
RAISES A TEMPEST IN A TEAPOT W/ THE DIRECT SELLERS.

RETURN TO MARILYN SHOWALTER AFTER EACH REVIEW.

OFM - ENROLLED BILL ANALYSIS

Bill Number SSB 3244 Short Title Excise Taxes
 Date Enrolled May 23, 1983 Analyst Claude Lakewold
 Date Due Governor May 26, 1983 Division Program Development

* * * * *

Bill Description

SB 3244 was originally introduced at the request of the Governor. This bill would have exempted community service agencies and local governments from paying B&O tax on federal grant funds.

The Substitute Senate Bill 3244 includes the Governor's requested B&O tax exemption clauses in Sections 1 and 2. The bill also includes three additional sections that pertain to other B&O tax modifications.

(continued)

Analysis (Issue background, analysis of program and fiscal impacts, pro and con arguments, principal proponents and opponents, other comments)

SSB 3244 modifies state law pertaining to the application of B&O tax for various activities.

The first two sections of SSB 3244 adopt the B&O tax exemptions requested by the Governor. The language in these two sections is identical to that originally recommended. (See attached PCAA report.)

Section 3 was added to provide specific exemption from B&O tax imposition to local municipal governments also engaged in similar activities as are exempted in Sections 1 and 2 and other service activities for which they charge a fee. Municipal owned and operated electrical utilities would not be included.

Section 4 of the bill was taken from a Department of Revenue request bill, HB 72. This section removes a "loop hole" in the application of the B&O tax to meat processors. The present law allows a lower B&O tax rate for processed meat sold at wholesale. Some meat processors are also involved in retail sales. Many of these persons pay only the lower wholesale B&O tax rate. The proposed amendment makes clear that the lower rate only applies to wholesale sales. Adoption of this amendment will allow the state to collect approximately \$500,000 more in taxes per year.

Section 5 is a modified version of a bill section originally contained in HB 566. The apparent intent of this section is to exempt from B&O taxes the monies earned by firms such as Avon, Amway, etc. The section was added as a House floor amendment and was later concurred in by the Senate. Initial review of the provisions of this section by the Department of Revenue indicates that implementation may result in a \$1.2 million loss to state revenue from B&O tax. This provision would not exempt the individual sales person ("direct sellers' representative") selling products from firms such as Avon, etc.

Sections 3, 4, and 5 are undergoing analysis by the Department of Revenue. They will provide a separate report. Their report will contain specific information regarding fiscal impacts.

*Sections 1, 2, 3, and 4 should be approved. No specific recommendation is made regarding Section 5; consideration of this section should be made pursuant to Department of Revenue's report.

(continued)

Recommended Action

Sign (X) * *F.H. concurred with the recommendation of the DBR to veto SSB 3244. It would add an additional unutilized loop hole in the tax code. Create an unconstitutional precedent, and is just another tax policy.*
 Do Not Sign - Let Pass ()
 Veto Section(s) _____

NOTE: IF A BILL OR SECTION VETO IS RECOMMENDED, PLEASE COMPLETE OTHER SIDE.

3/83/016

Bill Description (continued)

Section 1 subsection (1) would add community action council to the definition of organizations eligible to be exempted from paying B&O tax. Section 1 subsection (2) would add to the list of activities which are exempted from B&O tax when performed by non-profit organizations engaged in the following:

- (a) weatherization assistance or minor home repair for low-income homeowners or renters;
- (b) assistance to low-income homeowners and renters to offset the rising cost of home heating energy; and,
- (c) community services to low-income individuals, families and groups, which are designed to reduce the causes of poverty in communities of the state.

Section 2 would exempt from the imposition of B&O tax grants received from the state or the United States by municipal corporations or political subdivisions.

Section 3 adds a new section that would exempt counties, cities, towns, school districts and fire districts from B&O tax payments regardless of how they are financed.

Section 4 makes clear that the reduced B&O tax rate paid by meat processors would only apply to wholesale sales and not to retail sales.

Section 5 adds a new section to the B&O tax law. This section would exempt from B&O tax gross income a person derived from wholesale or retail sales if such person: (1) does not own or lease real property within the state; (2) does not regularly maintain a stock of tangible personal property in the state for sale; (3) is not incorporated under the laws of the state; and (4) makes sales in this state exclusively to or through a direct seller's representative.

A "direct seller's representative" is defined as a person who buys consumer products on a "buy-sell" basis for resale in the home or other than a retail establishment. The remuneration a person may receive from such services must be directly related to sales rather than the number of hours worked. The sales services must be performed pursuant to a written contract and such contract would provide that the person will not be treated as an employee.

Analysis (continued)

The original Governor's request bill (SB 3244/HB 160) was supported by PCAA and several community action groups. Cities and counties support the inclusion of local government entities in Section 3. The Department of Revenue supports the amendment proposed in Section 4.

Attachment

JOHN SPELLMAN
Governor



KAREN RAHM
Director

STATE OF WASHINGTON

PLANNING & COMMUNITY AFFAIRS AGENCY

Ninth & Columbia Building, MS/GH51 • Olympia, Washington 98504 • (206) 753-2200

BACKGROUND of an act exempting defined recipients of state and federal grants from the Business and Occupation tax

The legislature in 1980 exempted certain non-profit health or social welfare organizations from paying B & O tax on a list of services. Grants for weatherization of low income homes, to assist in the payment of fuel costs, and the community services block grant which is designed to have an impact on poverty within communities of the state are not now exempted from B & O Tax. This bill would exempt those activities.

The proposed bill would also exempt from B & O tax grants received by municipal corporations or political subdivisions of the state.

The federal grants do not allow program funds to be used for any purpose except those permitted by the grant. Payment of taxes would fall under administration and could not be paid from program funds. The local share of administrative overhead is 5% for most of the grants (in one case there is no funding for administration) The 1% B & O tax would be due on the entire program but would have to be apid from the administrative funds. That means that 20% of the administrative allowance for these grants would have to be used to pay state taxes.

CHRIS SPELLMAN
Governor



KAREN RAHM
Director

STATE OF WASHINGTON

PLANNING & COMMUNITY AFFAIRS AGENCY

Ninth & Columbia Building, MS/GH51 • Olympia, Washington 98504 • (206) 753-2200

SUMMARY of an act relating to Business and Occupation Taxes

This bill adds community action councils to the list of organizations not subject to the B & O tax. The bill also adds weatherization assistance or minor home repair for low-income households, assistance in the payment of energy costs to or on behalf of eligible households, and community services which have a measurable and potentially major impact on causes of poverty in the state's communities to the list of services which are not subject to the B & O tax when performed by a defined social or health service organization.

Additionally, B & O taxes would not be applied to federal or state grants received by municipal corporations or political subdivisions of the state.

N SPELLMAN
Governor



KAREN RAHM
Director

STATE OF WASHINGTON

PLANNING & COMMUNITY AFFAIRS AGENCY

Ninth & Columbia Building, MS/GH51 • Olympia, Washington 98504 • (206) 753-2200

Section by Section Analysis
An Act relating to the Business and Occupation Tax

- Section 1. (1) Adds community action council to the definition of organizations eligible to be exempted from paying B & O tax under 82.04.4297.
- (2) Adds to the list of activities which are exempted from B & O tax when performed by organizations defined in subsection 1 of this Section:
- j) weatherization assistance or minor home repair for low-income homeowners or renters;
 - k) assistance to low-income homeowners and renters to offset the cost of home heating energy, through direct benefits to eligible households or to fuel vendors on behalf of eligible households; and,
 - l) community services to low-income individuals, families and groups, which are designed to have a measurable and potentially major impact on causes of poverty in communities of the state.

New.

- Section 2. Exempts from the imposition of B & O tax grants received from the state or the United States by municipal corporations or political subdivisions.

OFH - ENROLLED BILL ANALYSIS

Number SSB 3244 Short Title Excise Taxes

Date Enrolled 5/23 Analyst Dave Weig

Date Due Governor 5/26 5 pm Division Forecasting

Due to Fred 1 pm 5/26

* * * * *

Bill Description

See description prepared by Program Development Division

Analysis (Issue background, analysis of program and fiscal impacts, pro and con arguments, principal proponents and opponents, other comments)

This bill combines portions of three bills into one (SB3244, HE72, HB566). The Department of Revenue is preparing an analysis and recommendation. No specific analysis or recommended action is proffered here since the basic issues concern tax administration and the Department of Revenue is preparing a response.

Recommended Action

Sign ()

Veto Bill ()

Do-Not Sign - Let Pass ()

Veto Section(s) _____

NOTE: IF A BILL OR SECTION VETO IS RECOMMENDED, PLEASE COMPLETE OTHER SIDE.

3/83/016

SUBSTITUTE SENATE BILL NO. 3244 BY

Committee on Ways and Means (Originally sponsored by Senators Thompson, Isaac, Raver, Blusack, Fuller, Gramling, Bender (by HANCOCK) Governor Spellman request))

Modifying provisions on excise taxes.

SENATE RECORD

Filed by Committee and ordered printed 4-13-83 On motion Substituted for Original Bill, placed on calendar

4-13-83 Read second time and

Advances to third reading under suspension of rules.

Enrolled Received from the

Signed, President of the S Signed, Speaker of the I Signed by the Gov

SENATE RECORD

APR 2 1983 Returned to S and placed in Committee on Tax

Reported back Committee with the recommendation MAJORITY do pass MINORITY do not pass That Substitute Senate Bill be substituted therefor and that Subs Bill Do Pass Passed to second reading.

APR 2 8 1983 Read third time

APR 2 1983 43 Nays Title Agree Sent to 1

5-12-83 Read third time and

Messrs. G. H. ...

Yes 95 Nays 0 Title Agreed to Referred to Senate

Chief Clerk

MAY 2 1983

This Senate concurred in the House Amendments and PASSED AS AMENDED Yea 58 Nays 8

Secretary

4-13-83 Read third time and

Passed Yea 46 Nays 1 Title Agreed to Sent to House

Secretary of the Senate

HOUSE RECORD

4-13-83 Received from Senate Read first time and referred to Committee

5-5-83 Reported back by Committee with the recommendation MAJORITY do pass MINORITY do not pass That Substitute Senate Bill be substituted therefor and that Substitute Bill Do Pass Passed to second reading.

5-17-83 Read second time and

Advances to third reading



Washington State Association of Counties

AREA CODE 206
TELEPHONE 491-7100

6730 MARTIN WAY N.E.
OLYMPIA, WASHINGTON 98506

May 27, 1983

The Honorable John Spellman
Governor of the State of Washington
Legislative Building
Olympia, Washington 98504

OFFICE OF THE GOVERNOR
CORRESPONDENCE DISTRIBUTION

ORIGINAL: MS5
ACTION: GOV
XCS: _____

DATE: 6-1-83

W/1834

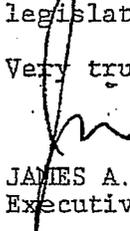
Dear Governor Spellman:

~~Substitute Senate Bill 3244~~ which revises the current applicability of the Business and Occupation tax to local governments is now before you awaiting your approval. The measure would exempt local governments from B & O taxation applied to grants received from the federal government.

As you are aware, many of these federal grants provide important funding sources to counties in carrying out human and social service programs. Taxing these grants diminishes the source of dollars important to meet desired program outcomes, and is counter-productive to their public purpose of federal aid.

The Washington State Association of Counties supported this legislation and requests your approval.

Very truly yours,


JAMES A. METCALF
Executive Director

JAM:smh

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of counsel
ELVIN F. CARNEY
WILLIAM C. HALLIN

*and
6/1/83*

May 27, 1983

Governor John Spellman
Legislative Building
Olympia, Washington 98504

Re: SSB 3244 -- "Direct Seller Representatives"

Dear Governor Spellman:

This letter is to urge your support for the provisions of SSB 3244 which deal with the imposition of the B & O tax on certain out of state businesses. We represent the Direct Selling Association, a national trade association of companies which have over 60,000 direct seller representatives in Washington State.

The measure which is on your desk is the compromise result of a recommendation from the Joint Administrative Rules Review Committee, chaired by Senator Eleanor Lee. Prior to this legislative session, Senator Lee's committee held four lengthy hearings on attempts of the Department of Revenue to tax out of state businesses whose products are sold through the efforts of independent contractors and distributors, even through the out of state business has no real property, inventory, employees or representatives who are not independent contractors in this state. Washington statutes do not presently define what is meant to do business in this state. The result has been a policy of "taxation by ambush" and setting tax policy through the courts instead of the legislature.

Subsequent drafts of the original bill were developed to accommodate the Department of Revenue to reduce the fiscal note from \$30 million in the original bill (SB 3482) to approximately \$1.1 million in SB 3244. We believe the revenue impact has been consistently overstated, although it was not a significant issue in passage of SSB 3244, with

Governor John Spellman
May 27, 1983
Page Two

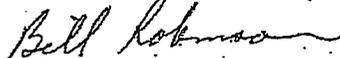
respect to the amendment to SSB 3244 which passed the Senate 36 - 8 and the House 95 - 0.

SSB 3244 adds some equity and certainty to a very unfair and confusing area of the law by providing that the whole-sale B & O tax does not apply if a person does not own or lease realproperty or maintain inventory in Washington, and makes sales exclusively through a "direct sellers representative", which is narrowly defined and parallels federal law.

Steve Excell is intimately familiar with the issue and the dynamics which led to the compromise bill. I have also discussed the measure with Marilyn Showalter and Joe Taller.

Your affirmative action on SSB 3244 will be very much appreciated. If you have any reservations or questions, we will be pleased to answer them. Thank you for your consideration.

Very truly yours,



William T. Robinson

cc: Jared Blum, Vice Pres./General Counsel, Direct Selling Assoc.
Senator Eleanor Lee

NSPELTMAN
Governor



KAREN RAHM
Director

STATE OF WASHINGTON

PLANNING & COMMUNITY AFFAIRS AGENCY

Ninth & Columbia Building, MS/GH51 • Olympia, Washington 98504 • (206) 753-2200

May 25, 1983

TO: Marilyn Showalter
Legal Counsel to the Governor

FROM: Karen Rahm *KR*

SUBJECT: SSB 3244 (Excise Taxes)

Recommendation: Sign (Executive Request Legislation)

Comments:

The first three sections of this bill were introduced as executive request legislation. The bill amends several provisions of RCW 82.04, a chapter dealing with the business and occupation tax. Section 1 of the bill clarifies the exemption of public funds received by nonprofit health and social welfare organizations. One addition to the existing legislation specifically includes community action councils among health and social welfare organizations. Other additions specifically exempt programs that provide assistance for weatherization and home repair for low income residences, home heating payment assistance, and community services designed to impact causes of poverty.

Section 2 exempts federal grants to the state and local jurisdictions from business and occupation tax levies. Section 3 exempts local jurisdiction revenues generally from the collection of business and occupation taxes. It also specifies that the Legislature may impose a business and occupation tax on any specific local jurisdiction activity.

The House Committee on Ways and Means amended the bill to add Section 4, which amends provisions of RCW 82.04 dealing with meat packers and direct sales personnel. We have no recommendations on that section.

Sections 1 through 3 of SSB 3244 are valuable additions to RCW 82.04 for local jurisdictions and nonprofit health and social welfare programs. These amendments will enable the affected programs to get maximum benefit from the public funds that are involved.

The Association of Washington Cities, the Washington State Association of Counties and the Washington State Community Action Agency Directors' Association have also supported Sections 1 through 3 of this legislation. We recommend that the Governor approve those Sections of SSB 3244.

KR:nj

DIRECT SELLING ASSOCIATION

1730 M Street, N.W., Suite 610, Washington, DC 20036

202/293-5760 • 202/466-5760

TWX 7108239283 Cable: USDSA

*out d
6/1/83 #*

May 27, 1983

The Honorable John Spellman
Legislative Building
Olympia, WA 98504

Dear Governor Spellman:

I am writing on behalf of the Direct Selling Association (DSA) to urge your support of Substitute Senate Bill No. 3244, as amended, which will once and for all clarify what it means to be "doing business" in Washington.

By way of background, DSA is the national trade association which represents 140 leading companies that manufacture consumer products sold primarily in the home by more than four million self-employed individuals across the country, with more than 60,000 direct sellers in Washington. A great majority of our member companies are small business concerns, with the typical company having annual sales in the three to five million dollar range. There are substantially fewer large companies, with only a dozen or so having sales above 100 million, including Mary Kay Cosmetics, Inc. and Shaklee Corporation.

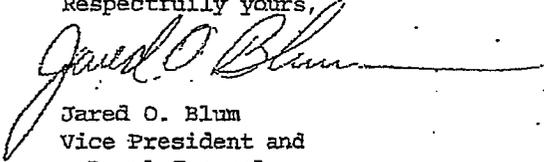
Other than a hand-full of member companies which have employees in the state and who would therefore by definition be "doing business" in the state, almost every other DSA member company has no employees, offices, warehouses, inventory or property in Washington. Nonetheless, the Department of Revenue has heretofore assessed a wholesale business and occupation tax against these out-of-state direct selling companies essentially because consumer products manufactured by these companies are sold in Washington by self-employed individuals who already individually pay a retail and service business and occupation tax.

In keeping with the resolution of the Joint House and Senate Agency Rules Review Committee, Substitute Senate Bill No. 3244 defines the parameters of what it means to "do business" in such a way as to conform the state law with that of its sister states and in a manner which accords with applicable Supreme Court decisions. Under the terms of the bill the 60,000 or so direct sellers in Washington will properly be subject to a retail business and occupation tax but the out of state manufacturers will for the first time have clear guidelines as to what activities will result in a wholesale business and occupation tax liability.

The Honorable John Spellman
May 27, 1983
Page 2

Given the fact that Substitute Senate Bill No. 3244 represents a workable compromise of a long standing legislative issue, I request your support of this worthy measure.

Respectfully yours,



Jared O. Blum
Vice President and
Legal Counsel

wjm

JOHN SPELLMAN
Governor



DONALD R. BURROWS
Director

STATE OF WASHINGTON
DEPARTMENT OF REVENUE
Olympia, Washington 98504 MS-AX-02

OFFICE OF THE GOVERNOR
CORRESPONDENCE DISTRIBUTION

ORIGINAL: Stine
ACTION: Gov
XCS: _____
DATE: 6-9-83

DATE: June 6, 1983
TO: The Honorable John Spellman
Governor
FROM: Donald R. Burrows, Director
Department of Revenue
RE: Recommendation for Veto - Substitute Senate Bill 3244

Summary & Recommendation

This bill establishes several new exemptions from state business and occupation tax and modifies an existing preferential rate. With the exception of the new B&O exemption provided to "direct sellers" in Section 5 of the Act, I recommend that you approve this bill.

A detailed explanation of each of the provisions of the bill is contained below. The first exemption, a B&O exemption for nonprofit health or social welfare organizations, was an Executive Request measure. The second exemption, an exemption from the B&O tax for governmental grants received by local governments, is essentially an extension of the same type of exemption granted to social welfare organizations. The third exemption, an exemption from the B&O tax for local governments with respect to all income received except for enterprise or utility-type revenues, clears up an uncertain area of tax law. The fourth exemption, which abolishes the preferential B&O rate for retail meat processors, was a Departmental Request bill and was also included in SHB 72.

All of the above listed exemptions are clearly justifiable as a matter of tax policy. They present no insurmountable administrative problems. For these reasons, I would recommend approval.

The remaining exemption, an exemption from the B&O tax for out-of-state manufacturers who sell into Washington through "direct selling" schemes has little, if any, justification as a matter of tax policy. The bill provides an exemption from wholesaling and retailing B&O for out-of-state manufacturers who make sales in Washington exclusively through the "direct selling scheme". In order to be exempt,

(continued)

The Honorable John Spellman
June 6, 1983
Page 2

the taxpayer cannot have employees located in the state, own or lease property in the state, or maintain a stock of goods in this state. The bill would apply to certain "direct sellers" who fit this category, e.g., Mary Kay Cosmetics and Shaklee. It would not, however, apply to others who have employees in this state or a stock of goods, e.g., Avon Products and Amway.

The bill was heavily lobbied in conjunction with a bill sponsored by the Seattle Trade Center merchants, which would have exempted all out-of-state manufacturers who do not have employees, property or a stock of goods in this state. Because of the fiscal impact of exempting all out-of-state manufacturers, the legislature apparently decided to provide relief only to the "direct seller" category.

The major justification advanced on behalf of the bill was that it would clarify the state's taxing jurisdiction over these out-of-state manufacturers, thus bringing stability and predictability to the conduct of their business in Washington. This justification exists. There are uncertainties in the area of whether this state has the jurisdiction, consistent with the Due Process clause, to impose the B&O tax on out-of-state manufacturers who do not have employees or property in this state. In recent years, the U.S. Supreme Court has greatly expanded the jurisdictional reach of state taxing power. Where it will end no one knows at this time. This uncertainty is compounded by the fact that "direct selling" is a relatively new form of doing business. There is not a lot of case law in the area.

Other than the uncertainty argument, there are no justifications. Washington provides a market for these manufacturers at considerable governmental expense. The Tax Advisory Council, which addressed the issue, stated in its report at page 52:

"The Council believes that the total exemption urged by the out-of-state sellers would be inequitable: the sellers take advantage of the market available here, and they ought to contribute to the services which support those markets."

The Tax Advisory Council recommended that the B&O rate on these taxpayers be reduced by 50% in recognition of the fact that less use is made of state services than instate businesses.

The tax exemption will not encourage new business activity in this state. The lack of a tax exemption will not drive existing business out-of-state. Indeed, if any business leaves the state, it will be businesses who will move their employees and stocks of goods to Portland in order to take advantage of the tax exemption.

(continued)

The Honorable John Spellman
June 6, 1983
Page 3

The fiscal impact of the exemption is expected to result in a net loss of \$1.2 million in B&O tax revenues for the 83-85 biennium.

For the foregoing reasons, I recommend that you veto Section 5 of the bill.

Finally, I strongly recommend that you veto Subsection (3) of Section 5, if possible to do so as a legal matter. This subsection is intended to protect out-of-state direct sellers currently undergoing audit for past periods from the argument that the legislature intended to tax them prior to the enactment of their exemption. In other words, it is possible that a court would construe this as an attempt to give retroactive effect to the exemption. This would exacerbate the fiscal impact because businesses which have been paying the tax could seek refunds back to January 1, 1979. The amount has been estimated to be approximately \$2 million. Prior to the enactment of this exemption, there was no legislative exemption other than an exemption for business activities which the state could not tax as a matter of federal constitutional law.

The following is a more detailed analysis of each of the provisions in the bill.

Nonprofit Social Welfare Organizations

Section 1 of the bill expands the B&O tax exemption originally established in 1979 for nonprofit health or social welfare organizations. The existing law provides a deduction for governmental grants received by such organizations which are used in conducting special programs, including certain health care services, programs to combat juvenile delinquency; provision of care for orphans, employment programs, and legal aid for the indigent. This bill expands the deduction to include grants used to provide weatherization assistance and minor home repairs for low-income homeowners or renters; assistance to low-income households for home heating costs; and general programs to alleviate poverty. Further, the bill provides that community action councils be included in the types of nonprofit groups which may claim such deductions.

In many cases, the nonprofit organizations that receive the grants contract with other groups or business to actually perform the social or health service. The contractors remain subject to B&O tax on the income they receive. However, there has been the potential for B&O tax liability on the part of the nonprofit organization itself on the amount of the grant. This bill removes that possibility in the instances listed above. Since little or no B&O tax has actually been paid by such nonprofit groups, the impact of Section 1 is minimal in terms of actually budgeted revenues. This provision was an Executive Request measure.

(continued)

The Honorable John Spellman
June 6, 1983
Page 4

Grants Received by Local Government

Section 2 of the bill provides a blanket exemption from B&O tax for any municipal corporation or political subdivision of the state on income received from the state or federal government in the form of grants. There are no restrictions on the use of such grants funds. There has been the potential for B&O tax liability on the part of local government for such grants, but little or no tax has actually been reported in the past. Accordingly, the impact is considered minimal.

General Exemption for Local Government

The third section of SSB 3244 provides an even broader B&O tax exemption for local government by completely exempting any county, city, town, school district, or fire district from state B&O tax, except for utility or enterprise activities as defined by the state auditor. The exemption pertains to any source of income received by these jurisdictions, regardless of the method of financing. The legislature specifically reserves the right to tax on a prospective basis certain activities or income sources of local government in the future.

Most state excise tax that has been previously paid by local jurisdictions reflects utility income subject to public utility tax (e.g., power, water and garbage service). Such income is not affected by this bill. But this exemption will preclude taxation of income received by one local jurisdiction which represent charges for services rendered to other units. The estimated impact of the B&O tax exemption for general local government activities is a state general fund loss of \$240,000 for the 1983-85 biennium.

Meat Wholesalers

The fourth section of the bill restricts the utilization of a preferential B&O tax rate concerning meat processors. Currently, slaughterers and processors of perishable meat products are taxed at 0.33 percent instead of the 0.44 percent general B&O tax rate (both excluding surtaxes). This amendment provides that only firms which sell the meat at wholesale may obtain the preferential tax rate. Accordingly, retail grocery stores and restaurants which process their own meat will be subject to the B&O retailing category on their sales of such products to consumers. The effect of this limitation is projected to yield additional state revenues of \$609,100 for the 1983-85 biennium. (NOTE: This provision was also included in SHB 72.)

(continued)

The Honorable John Spellman
June 6, 1983
Page 5

Exemption for Direct Sellers

Section 5 of SSB 3244 establishes a new exemption from B&O tax for firms located in other states which make retail or wholesale sales in Washington exclusively through the use of direct seller's representatives. To be exempt from B&O tax the firm must not own or lease real property or maintain a stock of goods for sale in Washington and must not be incorporated in this state. Direct seller's representatives are defined as persons who make sales of consumer products in this state on behalf of the firm on a buy-sell basis or a deposit-commission basis and not on the basis of actual employment by the firm (e.g., compensation on the basis of number of hours worked). Further, such sales must not be solicited from a permanent retail establishment.

This exemption will apply to businesses represented by door-to-door salesmen and agents who demonstrate products in the home. The representatives will remain subject to B&O tax on their commissions or other compensation they receive. Also they will remain liable for collection of retail sales tax on any sales of taxable tangible personal property sold in this state. The estimated effect of the exemption is a reduction in state B&O tax of \$1.19 million for the ensuing biennium.

DRB:pg

cc: Steve Excell

FINAL LEGISLATIVE BILL REPORT

SSE 3244

BY Senate Committee on Ways and Means (Originally sponsored by Senators Thompson, Jones, Bauer, Bluechel, Fuller, Granlund and Bender) (By Governor Spellman Request)

Modifying provisions on excise taxes.

SENATE COMMITTEE on Ways and Means

HOUSE COMMITTEE on Ways and Means

SYNOPSIS AS PASSED LEGISLATURE E1

BACKGROUND:

Unless specifically exempted by law, health or social welfare organizations, community action councils and municipal corporations or political subdivisions of the state are subject to the B&O tax on grants or income they receive from any source.

A B&O tax of 0.33 percent is paid by meat processors and meat wholesalers. Under the current definition of meat processing, certain retailers of meat products who perform "processing" activities can qualify for this reduced B&O tax rate (as opposed to 0.44 percent).

Businesses located outside the state which make sales in this state through a direct seller's representative may or may not (depending on court decisions) be subject to this state's B&O tax.

SUMMARY:

Health or social welfare organizations, including community action councils, performing specified services are exempt from the B&O tax. These services include weatherization assistance or minor home repair for low income homeowners or renters; energy assistance for low income homeowners or renters; and community services to low income families or groups.

Grants received by municipal corporations or political subdivisions of the state from the state or federal government are exempt from the B&O tax.

Local jurisdictions are exempt from the B&O tax except for utility or enterprise activities.

The special B&O tax rate of 0.33 percent specifically applies solely to meat processors and meat wholesalers and not meat retailers. Meat retailers will pay a tax of 0.44 percent.

Business activities "within this state" is redefined so that a person would be subject to retailing or wholesaling B&O tax only if that person (firm) (a) owns or leases real property within Washington State, (b) regularly maintains a stock of tangible personal property in this state for sale in the ordinary course of business, (c) is not a corporation in this state, and (d) makes sales exclusively through a direct seller's representative.

Revenue: An exemption for community service activities from the B&O tax is provided. An exemption for local units of government on governmental activities from the B&O tax is provided. The B&O tax on meat retailers is clarified (at 0.44 percent). An exemption for direct sellers from the B&O tax is provided.

VOTES ON FINAL PASSAGE:

Regular Session
Senate 46 7

First Special Session
Senate 43 7
House 95 0 (House amended)
Senate 38 8 (Senate concurred)

Dept. of Revenue

Add a new section to Chapter 82.04 RCW to read:

3244

could include
with
3909

(1) This chapter shall not apply to any person in respect to gross income derived from the business of making sales at wholesale or retail if such person:

- (a) Does not own or lease real property within this state; and
- (b) Does not regularly maintain a stock of tangible personal property in this state for sale in the ordinary course of business; and
- (c) Is not a corporation incorporated under the laws of this state; and
- (d) Makes sales exclusively to or through a direct seller's representative in this state.

(2) For purposes of this section, the term "direct^r seller's representative" means a person who buys consumer products on a buy-sell basis or a deposit-commission basis for resale, by the buyer or any other person, in the home or otherwise than in a permanent retail establishment, or who sells, or solicits the sale of, consumer products in the home or otherwise than in a permanent retail establishment; and

- (a) Substantially all of the remuneration paid to such person, whether or not paid in cash, for the performance of services described in this subsection is directly related to sales or other output, including the performance of services, rather than the number of hours worked; and
- (b) The services performed by the person are performed pursuant to a written contract between such person and the person for whom the services are performed and such contract provides that the person will not be treated as an employee with respect to such purposes for federal tax purposes.

TO: SE
FROM: RAS



FYI

State of Washington

JOHNSPELLMAN, Governor

April 15, 1983

OFFICE OF THE GOVERNOR

The Honorable Dan Grimm
Washington State Representative
415 House Office Building
Olympia, Washington 98504

Dear Representative Grimm:

Substitute Senate Bill 3244 has passed Third Reading in the Senate and has been referred to the House Ways and Means Committee. Passage of this bill will clarify an important public policy issue, that of local municipalities and political subdivisions being liable for Business and Occupation tax on grants received from the state or Federal government. It will also amend existing statute to ensure that weatherization, low-income home energy assistance, and community services block grant funds received by specified nonprofit organizations and expended on behalf of low-income and elderly persons are not subject to the B&O tax.

Additionally, it will exempt those non-proprietary activities carried out by local jurisdictions, i.e. fees charged for fingerprinting, from the B&O tax.

With the exception of non-proprietary fees, none of these activities are being taxed at this time, although notice has been given to several cities, and to some of the nonprofit organizations, that the activities are indeed subject to B&O tax under current law.

Your assistance in passage of this bill would be appreciated.

Sincerely,

Rollie Schmitten
Deputy Chief of Staff,
Legislative Affairs

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West's
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in Five Languages

Definitions of the Legal and Commercial
Terms and Phrases of American, English, and
Civil Law Jurisdictions

English to
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K-Z

West Publishing Company
St. Paul, Minnesota

THROUGH

- **Through** By means of, in consequence of, by reason of; in, within; over; from end to end, or from one side to the other. By the intermediary of; in the name or as agent of; by the agency of; because of. *Great Atlantic & Pacific Tea Co. v. City of Richmond*, 183 Va. 931, 33 S.E.2d 795, 802. "Through" is function word capable of several meanings depending on its use; it may indicate passage from one side to another, means of communication, or movement from point to point within a broad expanse or area. *State v. Smith*, Mo., 431 S.W.2d 74, 78.
 - G. durch, bis einschließlich; innerhalb, namens, in Vertretung.
 - S. por medio de; del principio al fin; a través; de un lugar a otro.
 - F. au moyen de; par l'entremise de; par suite de; dans; à travers.
 - I. per mezzo di; tramite; a causa di; in; attraverso.
- **Through bill of lading** One by which a railroad contracts to transport over its own line for a certain distance carloads of merchandise or stock, there to deliver the same to its connecting lines to be transported to the place of destination at a fixed rate per carload for the whole distance. Embodies undertaking to be performed in part by persons acting as agents for issuer. U.C.C. § 7-302.

That species of bill of lading which is used when more than one carrier is required for shipping.

 - G. durchgehendes Konnossement *n*, Durchkonnossement, Transitlekonnossement, Durchfuhrkonnossement.
 - S. conocimiento *m* de embarque utilizado cuando el transporte es efectuado por más de un agente.
 - F. connaissement *m* utilisé lorsque plus d'un transporteur effectue le transport.
 - I. polizza *f* di carico usata quando più di un vettore effettua il trasporto.
- **Through lot** A lot that abuts upon a street at each end.
 - G. durchgehendes Baugrundstück *n*.
 - S. lote *m* que va de calle a calle.
 - F. lot *m* qui va de rue à rue.
 - I. particella *f* che va da una strada all'altra.
- **Throw out** To ignore (e.g. a bill of indictment) or dismiss a cause of action.
 - G. verwerfen, als unzulässig zurückweisen.
 - S. desechar o declarar sin lugar una causa.
 - F. ignorer ou rejeter une cause d'action.
 - I. ignorare o rigettare una causa di azione.
- **Thrusting** Within the meaning of a criminal statute, is not necessarily an attack with a pointed weapon; it means pushing or driving with force, whether the point of the weapon be sharp or not.
 - G. stechen, (auf jmdn mit spitzem Gegenstand) zustoßen, auf jmdn einstechen.
 - S. ataque *m* con un arma punzante.
 - F. attaque *f* avec une arme pointée.
 - I. attacco *m* con un'arma appuntita.
- **Tick** A colloquial expression for credit or trust; credit given for goods purchased.
 - G. Anschreibenlassen *n*, Häkchen *n*, Kredit *m*.
 - S. crédito *m*; fiado *m*.
 - F. crédit *m*.
 - I. credito *m*.
- **Ticket** In contracts, a slip of paper containing a certificate that the person to whom it is issued, or the holder, is entitled to some right or privilege therein mentioned or described; such, for example, are railroad tickets, theater tickets, pawn tickets, lottery tickets, etc.

Citation or summons issued to violator of motor vehicle law.

In election law, a list of candidates for particular offices to be submitted to the voters at an election; a ballot. See also **Citation**.

 - G. Fahrkarte *f*, Zettel *m*, Karte *f*, Billet *n*, Strafzettel *m*, Berechtigungsschein *m*; gebührenpflichtige Verwarnung *f*; Wahlliste *f*.
 - S. billete *m*; multa *f*; lista *f* de candidatos a una elección; escrutinio *m*.
 - F. billet *m*; amende *f*; liste *f* des candidats à une élection; scrutin *m*.
 - I. biglietto *m*; multa *f*; lista *f* di candidati a una elezione; scrutinio *m*.
- **Ticket of leave** In English law, a license or permit given to a convict, as a reward for good conduct, particularly in the penal settlements, which allows him to go at large, and labor for himself, before the expiration of his sentence, subject to certain specific conditions and revocable upon subsequent misconduct. English equivalent of parole.

[BRITISH]

 - G. Urlaubsschein *m*, vorläufiger Entlassungsschein *m* aus der Haftanstalt.
 - S. libertad *f* condicional.
 - F. liberté *f* conditionnelle.
 - I. libertà *f* vigilata.
- **Ticket-of-leave man** A convict who has obtained a ticket of leave.

[BRITISH]

 - G. bedingt Entlassener *m*.
 - S. beneficiario *m* de la libertad condicional.
 - F. bénéficiaire *m* de la liberté conditionnelle.
 - I. beneficiario *m* della libertà vigilata.
- **Tidesmen** In English law, are certain officers of the custom-house, appointed to watch or attend upon ships until the customs are paid; and they are so called