FILED
SEPTEMBER 22, 2026
In the Office of the Clerk of Court
WA State Court of Appeals, Division III

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION THREE

M'KNIB COMPANY, Appellant, v. STATE OF WASHINGTON, DEPARTMENT OF REVENUE, Respondent.	)	No. 41068-4-III UNPUBLISHED OPINION

STAAB, C.J. — Washington State imposes a Business and Occupation (B&O) tax on every person—including out-of-state businesses—that has a "substantial nexus" with Washington and engages in business activities in the state. The tax is a gross receipts tax levied on the privilege of doing business. In determining whether B&O tax is owing, the taxpayer must first determine if they have a substantial nexus to Washington. Once nexus is established, the business must determine its apportionable income attributable to Washington.

M'KNIB Company is a Colorado corporation and one of numerous affiliated entities involved in the franchising and subfranchising of Comfort Dental dentistry practices in various states including Washington.

After an audit, the Department of Revenue (DOR) assessed B&O tax against M'KNIB for business activities connected to Washington spanning several years. After paying the tax assessed, M'KNIB filed this rebate action in superior court, arguing that its business connections to Washington did not meet the substantial nexus threshold and thus it did not owe any B&O taxes and was entitled to a full refund of the taxes paid. The superior court ultimately denied M'KNIB's motion for summary judgment and granted DOR's motion, dismissing M'KNIB's complaint. M'KNIB appeals.

We conclude that genuine issues of material fact exist such that granting summary judgment was improper. We affirm the superior court's denial of M'KNIB's motion for summary judgment but reverse the order granting DOR's motion for summary judgment. We remand for a de novo trial in which M'KNIB will have the burden to prove not only that the tax assessed amount was incorrect but also the correct assessment, if any.

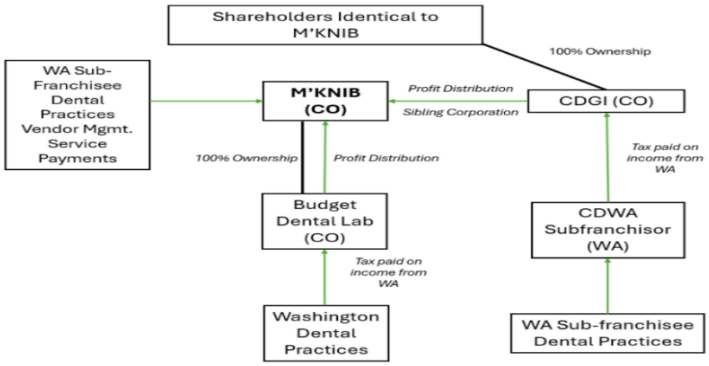
BACKGROUND

M'KNIB is owned by nine individuals with varying percentage interests. Its nine owners are its only employees.

One of M'KNIB's affiliates is Budget Dental Lab LLC, which is a single member limited liability company owned entirely by M'KNIB. Budget Dental's principal place of business is also in Colorado. Budget Dental manufactures dental prosthetics and sells them to Comfort Dental franchisees and subfranchisees.

Comfort Dental Group, Inc., (CDGI) is another affiliate of M'KNIB, also located in Colorado. While CDGI is owned by the same shareholders as M'KNIB, it is not a subsidiary of M'KNIB. CDGI's purpose is to license Comfort Dental intellectual property. For Comfort Dental practices in franchise states, CDGI licenses directly with those franchise practices. For Comfort Dental practices in subfranchisee states, like Washington, CDGI licenses with the subfranchisor, here CDWA, LLC, who then licenses with the subfranchised Comfort Dental practice. CDWA is a Washington limited liability company registered with DOR.

CDWA's licensing rights are governed by the "Master Franchise Agreement" (MFA) between itself and CDGI. The MFA states, in relevant part, that CDGI's "system" for establishing, operating, developing, and promoting dental offices includes "the use and license of the service mark 'Comfort Dental' and related service marks, trademarks and trade names owned by [CDGI] or one of its affiliates." Clerk's Papers (CP) at 597.



Br. of Appellant at 16.

AUDIT

DOR audited M'KNIB "for tax periods covering years 2012 through 2018." CP at 3. DOR contends that during the audit M'KNIB failed to provide requested documents, including "[t]rial balance reports, sales detail reports, and state apportionment reports." CP at 991-92, 49-50, 478. M'KNIB also did not provide "any contracts or other agreements" that were in place during the audit. CP at 50. M'KNIB did, however, provide its federal tax returns that "identified gross receipts earned" by M'KNIB. CP at 992. The auditor also considered information gathered during simultaneous audits of some of M'KNIB's affiliates, including Budget Dental and CDGI. Because the records were insufficient, the auditor estimated M'KNIB's receipts attributable to Washington.

The auditor determined that three categories of M'KNIB's income were attributable to Washington. The first category was income M'KNIB received from Budget Dental, which the auditor classified as payment for "management services." CP at 50. The second category was income from CDGI, which the auditor classified as vendor contracting services. The third category of income was categorized as "all remaining income" and included payments related to services M'KNIB provided directly to franchisees and subfranchisees. CP at 50.

From each of these three categories of income, the auditor estimated the income attributable to Washington. He then concluded that M'KNIB "had substantial nexus with Washington" and proceeded to estimate M'KNIB's Washington-taxable income. CP at

50. Based on the "estimated amounts of Washington-taxable income" and because the auditor "received no additional records from M'KNIB" the auditor "applied the Service and Other Activities B&O tax rate to that amount and issued an estimated tax assessment [of] $161,339.18." CP at 51.

ADMINISTRATIVE APPEAL

M'KNIB sought administrative review of the DOR's estimated tax assessment. As part of the review process, "M'KNIB provided some additional documents, including summary records," working trial balances for each year of the audit period, maintenance invoices "which did not specify to whom the invoices were issued," and summary records of total maintenance fees charged by each franchisee and subfranchisee location during the audit period. CP at 51.

The additional documents provided during the administrative review did not result in any adjustments to the auditor's estimated tax assessment. A tax review officer ultimately determined that M'KNIB's income was properly sourced to Washington based on available records. M'KNIB then paid the estimated tax assessment and sought a full refund in superior court.

LAWSUIT AND SUMMARY JUDGMENT

M'KNIB filed a "complaint for tax refund," pursuant to RCW 82.32.180, seeking a refund of the B&O tax it paid. CP at 1-9 (capitalization omitted). The complaint alleged that M'KNIB received revenue in the form of management fees from four

sources: CDGI, Budget Dental, Washington subfranchisees, and franchisees and subfranchisees located in other states. The complaint asserted that M'KNIB provided only "executive-level management services" to Budget Dental and CDGI and the Washington customers of Budget Dental and CDGI did not receive a "benefit from any management services rendered by M'KNIB" to these Colorado corporations. CP at 4.

With respect to revenue received directly from franchisees and subfranchisees, M'KNIB did not challenge the basis for the assessed tax but did challenge the amount assessed. M'KNIB argued that DOR's method of combining all income it received from franchisees and subfranchisees and then apportioning that income based on the number of subfranchisees in Washington, was inaccurate. According to M'KNIB, it earned significantly less revenue from subfranchisees than from direct franchisees because it offered and provided fewer services to subfranchisees. In addition, because the actual revenue received from Washington subfranchisees fell below the "economic nexus threshold," M'KNIB did not owe taxes on the revenue received from Washington subfranchisees. CP at 8.

Based on information received during discovery, the auditor revised its calculations on taxes owed and reduced M'KNIB's tax liability "from $161,339.18 to $109,019." CP at 52, 117. The auditor indicated this adjustment was based in part on the auditor reclassifying M'KNIB's income from CDGI as "[r]oyalties," which were taxed at a lower rate than vendor contracting services. The auditor also attributed all income from

Budget Dental and all remaining income from before June 12, 2014, outside of Washington "as a result of the DOR's interpretation of RCW 82.04.46[2](3)(b)(i)." CP at 52. However, as M'KNIB points out, the auditor made additional changes, including increasing attributable income in certain years, that the auditor did not explain in his declaration.

DOR and M'KNIB both moved for summary judgment. M'KNIB argued that summary judgment was proper because the undisputed evidence demonstrated that it did not meet the substantial nexus threshold with Washington. M'KNIB raised two arguments for why payments received from CDGI and Budget Dental should not be counted toward nexus. First, M'KNIB raised a new argument that funds transferred to M'KNIB from CDGI and Budget Dental were not for management fees but rather for profit sharing and thus exempt from B&O taxation. Second, M'KNIB argued that the income from these two affiliates was tied solely to Colorado customers and could not be attributed to Washington.

M'KNIB also set forth evidence to support its argument that the auditor's estimate of revenue from Washington subfranchisees was considerably higher than the actual revenue received from these subfranchisees.

DOR sought summary judgment dismissal of M'KNIB's complaint requesting that its tax assessment, subject to the partial refund calculated based on discovery documents, be affirmed. It argued M'KNIB could not carry its burden, under RCW 82.32.180, of

proving DOR's estimated tax burden was incorrect nor could it prove the correct amount of tax.

The superior court denied M'KNIB's motion for summary judgment and granted DOR's summary judgment. M'KNIB's complaint was therefore dismissed with prejudice.

M'KNIB appeals.

ANALYSIS

1. BACKGROUND ON WASHINGTON B&O TAX

Washington imposes a B&O tax on "every person that has a substantial nexus with this state . . . for the act or privilege of engaging in business activities," measured "against [the] value of products, gross proceeds of sales, or gross income of the business." RCW 82.04.220(1). The Washington Supreme Court has confirmed that "'the legislature intended to impose the [B&O] tax upon virtually all business activities carried on within the state,'" and the "tax is to be imposed as broadly as constitutionally allowed." *Avnet, Inc. v. Wash. Dep't of Revenue*, 187 Wn.2d 44, 50-51, 384 P.3d 571 (2016). The tax is broadly structured so that a taxpayer first determines whether it has nexus under RCW 82.04.067, then determines the applicable B&O classification, and finally applies either direct attribution or apportionment to measure the Washington tax base.

Under RCW 82.04.220 and RCW 82.04.067, Washington may impose B&O tax only on persons with "substantial nexus" with the state. The substantial nexus requirement recognizes the constitutional limitations under the dormant commerce clause and the due process clause of the Fourteenth Amendment to the United States Constituion on Washington's ability to tax out-of-state entities. *See Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 843, 246 P.3d 788 (2011).

DOR contends that M'KNIB had an economic nexus to Washington. The statutory definition of "substantial nexus" is set forth in RCW 82.04.067. Under the relevant definition for the periods audited in this case (2012 to 2018), substantial nexus was met when a nonresident business had a minimum amount of receipts arising from business transacted in Washington. Former RCW 82.04.067(1)(c)(iii) (2010). The receipt amount was adjusted regularly. Former RCW 82.04.067(5)(a). The threshold was $250,000 in 2010, rising to $267,000 in 2013, and rising again to $285,000 in 2018.

When a business earns income that can be taxed in both Washington and another state, apportionment is constitutionally required to avoid multiple tax burdens. *Wash. State Dep't of Revenue v. Ass'n of Wash. Stevedoring Co.*, 435 U.S. 734, 750, 98 S. Ct. 1388, 55 L. Ed. 2d 682 (1978). The legislature codified this requirement in RCW 82.04.460(1), which provides that "any person earning apportionable income taxable under this chapter and also taxable in another state must, for the purpose of computing tax liability under this chapter, apportion to this state, in accordance with RCW 82.04.462,

that portion of the person's apportionable income derived from business activities performed within this state." "Apportionable income" means "gross income of the business generated from . . . apportionable activities . . . less the applicable exemptions and deductions." RCW 82.04.460(4)(a). Critically, "apportionable activities" means "only those activities taxed under [a specific, closed list of B&O classifications]" enumerated in RCW 82.04.460(4)(a)(i)–(x).

While determining the economic nexus and apportionable income are two separate steps, under the circumstances in this case the calculations are similar. A taxpayer's "receipts from this state" is calculated using the same method that a taxpayer calculates "the numerator of the receipts factor under RCW 82.04.462" for purposes of attributing apportionable income to Washington. RCW 82.04.067(2)(a)(i). Both calculations require the taxpayer to determine the gross income attributable to Washington.

2. STANDARDS OF REVIEW

This case comes to us on appeal from the superior court's dismissal of M'KNIB's refund appeal filed under RCW 82.32.180. When a taxpayer files a refund appeal under this statute, the superior court shall conduct a trial de novo and the taxpayer, as the plaintiff, has the burden to prove two things: (1) "that the tax as paid [was] incorrect, either in whole or in part," and (2) "the correct amount of the tax." RCW 82.32.180. Both parties may "produce evidence that is competent, relevant, and material to determine the correct amount of the tax." *Id.*

Since this case was decided on summary judgment, our review is de novo. *Wash. Imaging Servs., LLC v. Wash. State Dep't of Revenue*, 171 Wn.2d 548, 555, 252 P.3d 885 (2011). Summary judgment is proper if there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. CR 56(c). In order to prevail on summary judgment, the taxpayer must definitively establish that the tax amount paid was incorrect and also establish the correct amount of taxes owed. *See Texaco Ref. & Mktg., Inc. v. Dep't of Revenue*, 131 Wn. App. 385, 398, 127 P.3d 771 (2006).

To defeat DOR's motion for summary judgment, M'KNIB must present evidence that creates a genuine issue of material fact. *See id.* Because RCW 82.32.180 places the ultimate burden on the taxpayer challenging the assessment, DOR's prima facie showing of entitlement to judgment requires the taxpayer to produce specific facts establishing a genuine issue for trial on both the incorrectness of the tax and the correct amount owed. *Id.*

As a preliminary matter, we reject DOR's argument that a different standard should apply when a tax assessment is based on estimated amounts. In its brief, DOR continually alleges that M'KNIB failed to produce sufficient records and this forced the auditor to estimate M'KNIB's income based on limited information. DOR suggests that in light of this failure, M'KNIB must meet a higher burden and prove not only that the tax assessed was incorrect but also prove that the method of estimating the tax was unreasonable and DOR exceeded its authority. Br. of Resp't at 19, 41. We disagree.

The estimation of taxes under RCW 82.32.100(1) does not affect M'KNIB's burden at trial or the standard of review on appeal. RCW 82.32.180 is clear: a taxpayer appealing an assessment has the burden of proving that DOR's calculations were incorrect regardless of how the calculations were reached. However, to successfully rebut a DOR estimated assessment, the taxpayer must do more than criticize DOR's methodology—the taxpayer must produce evidence that supports an alternative, more reliable methodology that produces a specific correct amount. *Id.* But there are no additional requirements to show that DOR's methods were unreasonable or that DOR exceeded its authority in estimating the taxes due.[1]

3. SUBSTANTIAL NEXUS

As noted above, the first step in determining if M'KNIB is liable for B&O taxes is to determine if M'KNIB has a substantial nexus to Washington. The audit concluded that three sources of M'KNIB's income were attributable to Washington: income from Budget Dental, CDGI, and maintenance fees received directly from Washington subfranchisees. M'KNIB contends that income received from Budget Dental and CDGI is deductible from its gross income and should not be used to calculate whether M'KNIB has a nexus to Washington. Alternatively, it argues that payments received from Budget

[1] A taxpayer who fails to keep and preserve books, records, and invoices as required is precluded from seeking a refund appeal under RCW 82.32.180. Here, DOR does not allege that M'KNIB is precluded from filing its appeal under this provision.

Dental and CDGI cannot be attributed to Washington because the payments were between Colorado businesses. While M'KNIB concedes that maintenance income it received from Washington subfranchisees is apportionable and attributable to Washington, it argues that the apportionable income from this category is insufficient to meet the substantial nexus threshold.

4. PROFIT DISTRIBUTIONS

The first issue we address is whether M'KNIB received Washington-attributable receipts beyond the Washington subfranchisee maintenance fees and whether such receipts establish substantial nexus. In its motion for summary judgment, M'KNIB argued that payments it received from Budget Dental and CDGI were for profit distributions, which M'KNIB asserted are deducted from gross income and thus not included in the nexus calculation.

DOR disagrees with the characterization of revenue as profit distributions and argues that even if it is characterized as profit distribution it is still counted as part of M'KNIB's gross income.[2]

Under the versions of RCW 82.04.067 in effect for the audited years, M'KNIB would be deemed to have a substantial nexus with Washington if its "receipts from this

[2] DOR maintains that the maintenance income plus the royalty income received from CDGI meets the substantial nexus threshold. In the alternative, DOR argues that even if the payments received from CDGI and Budget Dental were for profit distributions, they are still counted toward gross income.

state" met or exceeded a designated amount. *See* former RCW 82.04.067(1)(c)(iii) (2010). "Receipts counting toward the thresholds in subsection (1)(c)(iii) and (iv) of this section are those amounts included in the numerator of the receipts factor under RCW 82.04.462." Former RCW 82.04.067.

The "receipts factor" is a fraction: the numerator is the taxpayer's total gross income attributable to Washington from apportionable activities during the tax year; the denominator is the taxpayer's total gross income from apportionable activities everywhere in the world during the tax year. RCW 82.04.462(3)(a). "'Gross income of the business' means the value proceeding or accruing by reason of the transaction of the business engaged in, and includes . . . royalties, fees, . . . dividends, and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses." RCW 82.04.080(1). As DOR points out, under this definition, M'KNIB's gross income includes money received as dividends or other emoluments regardless of how the income is designated.

Nevertheless, M'KNIB argues that profit distributions are deducted from gross income, pointing to RCW 82.04.4281. This statute allows a parent entity to deduct from the "*measure of tax* . . . [a]mounts derived as dividends or distributions from the capital

account by a parent from its subsidiary entities." RCW 82.04.4281(1)(b) (emphasis added).

We first address DOR's contention that even if the payments received by M'KNIB are classified as profit distributions, the amounts are included in gross income. We agree that deducting profits from the measure of tax is different than deducting profits from gross income. The deduction provided in RCW 82.04.4281 assumes that the nexus threshold has already been met. Indeed, the deduction is allowed only when "computing tax under this chapter." RCW 82.04.4281(1). Additionally, the statute only allows a deduction from the "measure of tax." *Id.* Thus, M'KNIB's argument that profit distributions are deducted from gross income under RCW 82.04.4281 fails.

However, DOR's argument also fails. DOR does not explain why we should focus only on gross income when determining the numerator for purposes of calculating the nexus. *See* Br. of Resp't at 64. Under RCW 82.04.462(3)(a), the numerator includes gross income *attributable to Washington from apportionable activities*. DOR does not point to any statute or regulation that describes profit distributions received by a parent company as an apportionable activity that can be attributed to Washington.

Otherwise, we conclude that the nature of the income received is a disputed issue of fact. Within its own complaint, M'KNIB characterizes the funds it received from Budget Dental and CDGI as "management fees." However, during depositions, both the

chief operating officer of M'KNIB and its accountant testified that the payments from Budget Dental to M'KNIB represented profit distributions.

DOR argues that income from CDGI should be classified as royalties, not profit distribution. There is evidence to support this classification. CDGI's cash flow report identified an outflow named "M'KNIB Income" matching receipts in 2014, 2015, and 2018, and listed the "M'KNIB Income" as part of the cost of goods sold. M'KNIB's chief operating officer testified that the line item marked "franchise income" in M'KNIB's cash flow statement was for new franchise deposits, consulting fees, and royalties.

However, there is also competent evidence that the franchise income was received by CDGI not M'KNIB. M'KNIB's chief operating officer testified that the franchise fees are received by CDGI and then CDGI's profit is distributed to M'KNIB. He also testified that CDGI—not M'KNIB—holds the intellectual property and trademark of Comfort Dental. M'KNIB produced the MFA between CDGI and CDWA to support the testimony that M'KNIB did not own the intellectual property. In addition, the evidence presented by M'KNIB indicates that Washington subfranchisees pay a franchise fee to CDWA, an independently owned corporation, which then remits a portion of these fees to CDGI, the owner or holder of the franchise rights.

The nature of this income is a material fact. M'KNIB was assessed B&O taxes based on money it received from Budget Dental. At the very least, even if there is a

nexus, if M'KNIB can prove that the income received from Budget Dental was for profit distribution then it may be entitled to a deduction from its measure of tax under RCW 82.04.4281 because Budget Dental is a subsidiary.[3] In addition, if M'KNIB can prove that money received from CDGI and Budget Dental was for profit distribution, and it can prove that receipt of profits is not an apportionable activity attributable to Washington, it may be able to prove that it lacked a substantial nexus.

5. WASHINGTON CONNECTION

M'KNIB contends that even if money received from Budget Dental and CDGI are characterized as payment for services, the gross receipts are strictly between Colorado companies and cannot be attributed to Washington for purposes of establishing either a nexus or an apportionable income. DOR responds that the payments should be characterized as royalties, which may be apportioned to Washington even when the taxpayer and customer are Colorado companies.

We conclude that genuine issues of material fact preclude summary judgment on this issue. To the extent that M'KNIB argues that payments between two out-of-state corporations can never be apportioned to Washington, it is incorrect. *See* WAC 458-20-19403. However, whether and to what extent payments can be apportioned to Washington depends on the nature and classification of the payments; a factual issue that is disputed.

[3] CDGI is not a subsidiary of M'KNIB.

The apportionment rules for establishing nexus and calculating taxes are different depending on the classification of payment received or services provided, i.e., profit distribution, management fees, royalties, or services related to CDGI's business activities. Without knowing how the money received by M'KNIB is classified we cannot determine if the payments are for apportionable activities attributable to Washington.

For example, if CDGI pays M'KNIB for services related to CDGI's business activities, then the benefit is received where the customer's related business activities occur—either the customer's business location or the customer's market location. WAC 458-20-19402(303)(c). Whereas, if M'KNIB is collecting royalties from CDGI, then apportionment is most likely controlled by RCW 82.04.2907 and WAC 458-20-19403.[4]

As we noted above, there is a genuine issue of material fact as to whether the funds transferred from Budget Dental represented profit distributions, payment for services performed, or royalties.

[4] On appeal, both parties argue that apportionment of royalties is controlled by WAC 458-20-19402. But this regulation specifically excludes apportionment of royalties from its scope. *See* WAC 458-20-19402(103)(b). Instead, royalty attribution is controlled by WAC 458-20-19403, which neither party addresses on appeal. *See* WAC 458-20-19402(105)(b), (301); WAC 458-20-19403(101).

6. OTHER INCOME

M'KNIB's final argument on appeal is that the auditor's revised adjustments to the income classifications and allocations are incorrect. We agree that the basis for the revised adjustments remains unclear and raises a genuine issue of material fact.

During the pendency of this litigation, the auditor revised the spreadsheet used to calculate M'KNIB's tax liability. While the auditor provided a declaration explaining some of the changes, he did not explain all of the changes.

In its brief, DOR acknowledges that the nature of the income sources used in the revised adjustment remains unclear. Still, DOR maintains that the adjustments were made in good faith based on new information received and were rational and reasonable. We do not disagree with DOR; but this is not the standard on summary judgment. In order to prevail on summary judgment, DOR must demonstrate that there are no genuine issues of material fact. At the very least, the unexplained increases in attributable income in the auditor's revised summary of adjustments raise a genuine issue of material fact.

CONCLUSION

We affirm the superior court's denial of M'KNIB's motion for summary judgment. M'KNIB has failed to show as a matter of law that it does not have a substantial nexus to Washington. We reverse the superior court's grant of DOR's motion on summary judgment. At trial, if M'KNIB can meet its burden of proving that the auditor's calculation or classification of income was incorrect, then M'KNIB will also

have the burden of demonstrating the correct method of calculating substantial nexus and its tax liability.

A majority of the panel has determined this opinion will not be printed in the Washington Appellate Reports, but it will be filed for public record pursuant to RCW 2.06.040.

Staab, C.J.

WE CONCUR:

Hill, J.

Cooney, J.