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BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Correction of )	<u>D E T E R M I N A T I O N</u>
Assessment of )	
)	No. 11-0225
)	
.... )	Registration No. . . .
)	Document No. . . .
)	Audit No. . . . .
)	Docket No. . . .

Rule 193: B&O TAX – RETAIL SALES TAX – SUBSTANTIAL NEXUS—  
SOLICITATION OF SALES. An out-of-state seller’s two visits to a buyer in Washington were not associated in any way with its ability to establish and maintain a market for its product in Washington. Rather, those visits were for the purpose of making wholesale sales of product to the buyer, delivered outside the state, for sale at retail at the buyer’s locations outside the state. Because product sales to the buyer never enter the marketplace in Washington and because Taxpayer does not sell any of its products in the buyer’s stores in Washington and does not engage in any other marketing activities in Washington, Taxpayer does not have substantial nexus with Washington under Rule 193.

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

Klohe, A.L.J. - An out-of-state [seller of food products] protests an assessment of business and occupation (B&O) tax and retail sales tax, arguing that two visits to an international wholesale buyer during the last five years to promote sales of its product shipped from [outside Washington] through [Buyer’s location in another state] to [overseas locations] do not establish nexus in Washington. We agree. Accordingly, Taxpayer’s petition is granted.

ISSUE

Under WAC 458-20-193 (Rule 193), does taxpayer have substantial nexus in this state when its sales manager visited a wholesale customer in Washington for the purpose of selling its

merchandise overseas when the product is shipped through [Buyer's location in another state] and never enters the Washington marketplace?<sup>1</sup>

### FINDINGS OF FACT

[Taxpayer] is an [out-of-state] corporation that . . . makes wholesale sales of [food products] in stores across the United States and abroad. [It also makes] retail sales to individuals through a . . . customer service phone number and its website...

The Department's Audit Division (Audit Division) conducted a compliance audit of Taxpayer's books and records for the period of January 1, 2006, through December 31, 2009. On July 22, 2010, the Audit Division issued a \$ . . . assessment, which included retail sales tax in the amount of \$ . . ., retailing B&O tax in the amount of \$ . . ., wholesaling B&O tax in the amount of \$ . . ., a small business tax credit of -\$ . . ., a five percent (5%) penalty for substantial underpayment of the tax due in the amount of \$ . . ., and interest in the amount of \$ . . .

On September 22, 2010, the Audit Division issued a Post Assessment Adjustment (PAA), which corrected the original audit assessment. According to the Auditor's Detail of Differences and Instructions to Taxpayer as part of the PAA, the adjustment resulted from additional invoices and shipping documents provided by Taxpayer to document product sales that were shipped out of Washington via a freight forwarder in Washington state. The PAA reduced the assessment to \$ . . ., which included retail sales tax in the amount of \$ . . ., retailing B&O tax in the amount of \$ . . ., wholesaling B&O tax in the amount of \$ . . ., a small business tax credit of -\$ . . ., a 5% penalty in the amount of \$ . . . for substantial underpayment of the tax due, and interest in the amount of \$ . . .

Following issuance of the PAA, Taxpayer submitted an email request to the Audit Division requesting cancellation of the audit assessment as well as a refund of all taxes paid during the audit period based on its belief that it does not have substantial nexus with Washington under *Quill Corp. v. North Dakota*, 504 U.S. 298, 305, 112 S. Ct. 1904, 119 L.Ed. 2d 91 (1992). The Audit Division denied Taxpayer's request for a refund and cancellation of the audit assessment, stating that "[i]t is our expectation that at least some of [the] solicited sales will make it into the Washington State market." Therefore, the Audit Division determined that the presumption of nexus was successfully established.

In response to Taxpayer's request for a refund and cancellation, the Audit Division requested that Taxpayer provide documentation to show that:

- [Retailer] does not stock any of [Taxpayer's] products in its Washington State stores
- [Taxpayer's] visits into Washington State do not contribute significantly to sales to its numerous private customers

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

- [Taxpayer's] visits into Washington State do not involve marketing activities with other . . . Washington customers

Additionally, the Audit Division asked how Washington customers, including large retail chains learned of Taxpayer's . . . brand.

Taxpayer sent the following email response to the Audit Division:

The expectation that at least some of the solicited sales will make it into Washington State market is incorrect. The [Retailer's] stores in WA state are handled [through] the [Retailer's] NW division. [Taxpayer] is not associated in any way with this division. [Taxpayer] is only associated with [three of the Retailer's other divisions,] none of which distribute to the Washington market. All of the [Retailer's] divisions . . . have separate buyers, separate policies and we have no association with [Retailer's] NW [division].

The infrequent visits by our one salesperson [are] for [Retailer's] sales delivered to [Retailer's location in another state] for further distribution [overseas]. There [are] no marketing efforts or any other sales efforts. The whole purpose of the visit is to discuss International sales with the [Retailer's] International [division] buyer in [Washington]. They could just as easily meet elsewhere.

. . . [Taxpayer] establishes contact with large retail customers primarily through trade shows [outside Washington].

The salesperson in this case is Taxpayer's National Sales Director who visited Washington twice during the audit period to meet with an Assistant Buyer at [Retailer's] International [division]. Taxpayer explained that the address for [the International division] is near, but not identical to the address for [Retailer's] Northwest [division]. Taxpayer asserts that its National Sales Manager does not meet, or attempt to meet, or has ever met, with the [Retailer's] Northwest Buyer. Taxpayer asserts that they are not involved with [Retailers] Northwest [division] in any way. The [food product] that Taxpayer sells to [Retailer's] International [division] is shipped directly to the [Retailer's location outside Washington]. Taxpayer states that most of its sales into Washington are to individuals. Taxpayer's assumption is that individual customers find it through an internet search because it has not conducted any marketing efforts in Washington.

Taxpayer argues that infrequent visits by its sales representative to [Retailer's] International [division] do not create nexus because this activity is not significantly associated with its ability to establish or maintain a market for its products in Washington.

#### ANALYSIS

Washington imposes wholesaling and retailing B&O tax on the interstate sale of goods into Washington pursuant to RCW 82.04.220, .250, .270, and WAC 458-20-193 (Rule 193). The B&O tax is a gross receipts tax. RCW 82.04.070, .080, .090, 220. The legislative purpose

behind the B&O tax scheme is to tax virtually all business activity in the state. *Impecoven v. Dep't of Revenue*, 120 Wn.2d 357, 363, 841 P.2d 752 (1992). However, the tax may not be constitutionally imposed on interstate commerce unless a taxpayer has substantial nexus with the taxing state. *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904, 119 L. Ed.2d 91 (1992).

Rule 193(1)(f) defines “nexus” as follows:

"Nexus" means the activity carried on by the seller in Washington which is significantly associated with the seller's ability to establish or maintain a market for its products in Washington.

“Nexus” refers to having sufficient connection with the state for the state to have the power to tax sales into the state, and is a limitation on state taxing power the courts have found in the Due Process Clause and Commerce Clause of the United States Constitution. *See Quill*, 504 U.S. at 326; Det. No. 01-074, 20 WTD 531 (2001). Nexus may be established either by a seller’s own activities in the state or by activities of third parties who act on behalf of the seller in the state. *Tyler Pipe Indus., Inc. v. Dep't of Revenue*, 483 US 232, 107 S. Ct. 2810 (1987).

For example, the Washington Supreme Court recently upheld the Department’s finding of nexus for an out-of-state product manufacturer that sent sales representatives to Washington two or three times a year. *Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 850-51, 246 P.3d 788 (2011). Even though the sales employees in *Lamtec* did not solicit sales directly, but answered questions and provided information about Lamtec products, the Court held that the visits were significantly associated with its ability to establish and maintain its market in the state. *Id.* The Court’s holding in *Lamtec* is consistent with the Department’s long standing position regarding nexus, which is now codified in RCW 82.04.067(6)(2010). . . .

Unlike the Washington visits by sales employees in *Lamtec*, which the Court found to be significantly associated with Lamtec’s ability to sell its product in our state, in this case – Taxpayer’s two visits to the [Retailer’s] International [division] buyer in Washington are not associated in any way with its ability to establish and maintain a market for its product in Washington. Rather, those visits were for the purpose of making wholesale sales of [food products] to [Retailer] for sale at retail at [Retailer’s] locations [overseas]. Taxpayer transports the product purchased by [Retailer] from [Taxpayer’s out of state headquarters] to the [Retailer’s location outside of Washington] for direct shipment overseas . . . .

The fact that Taxpayer visited the [Retailer’s] International [division] buyer in Washington is not sufficient to create nexus in our state when the product is not sold in [Retailer’s] stores in Washington and the wholesale and retail sales that Taxpayer makes in Washington result from internet searches or retailer’s visits to national trade shows [outside of Washington]. We conclude that because product sales to [Retailer’s] International [division] never enter the marketplace in Washington and because Taxpayer does not sell any of its [food products] in

[Retailer's] stores in Washington and does not engage in any other marketing activities in Washington, Taxpayer does not have substantial nexus with Washington under Rule 193.

DECISION AND DISPOSITION

Taxpayer's petition is granted.

Dated this 15<sup>th</sup> day of July, 2011.