Cite as Det. No. 13-0213, 33 WTD 64 (2014)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 13-0213
. . .	)	
	)	Registration No. . . .

RULE 193: B&O TAX – NEXUS CREATING ACTIVITY – INTERSTATE SALES OF GOODS TO WASHINGTON CUSTOMERS – An out-of-state manufacturer who sends engineers into Washington to provide technical support and assistance during installation has established sufficient nexus to impose the B&O tax on it sales into the state.

RULE 193: B&O TAX – SUBSTANTIAL NEXUS – MINIMUM CONTACTS – INDEPENDENT CONTRACTORS. An out-of-state manufacturer who employs an independent third party sales representative to provide technical support services and customer relations work has established substantial nexus with Washington.

RULE 193; RCW 82.04.4286: INTERSTATE SALES – OUT-OF-STATE ACCEPTANCE. A substantial and detailed inspection of goods prior to shipping may establish acceptance outside of Washington where there is no right to a final inspection upon delivery in Washington, the final inspection forms designate that inspection as acceptance of the goods, and there is evidence that the customer takes dominion and control of the goods outside Washington.

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.

Kreger, A.L.J. – An out-of-state company engaged in the business of designing and manufacturing custom heating systems protests the assessment of tax on sales of equipment to Washington customers, and contends that it lacks nexus with Washington. We conclude that the Taxpayer's activities within Washington establish nexus.[1]

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

ISSUES

1. Whether the limited presence of a third-party sales representative and company engineers to assist in the installation of heating systems establishes nexus with Washington under RCW 82.04.067 and WAC 458-20-193.

2. . . .

FINDINGS OF FACT

[Taxpayer] is an [out-of-state] corporation engaged in the business of designing and manufacturing custom heating systems for the petroleum refining industry. The heating systems are each unique and designed for a specific customer and a specific application.

In 2011, the Department of Revenue (Department) through the Tax Discovery Unit of the Compliance Division contacted the Taxpayer with an inquiry about its Washington business activities after the Taxpayer's products were observed in transit to Washington customers. Interaction with the Tax Discovery Unit disclosed that the Taxpayer had an independent sales representative who made visits to potential customers and also sent engineers into Washington on field service engagements in conjunction with the installation of equipment at Washington oil refineries.

The Taxpayer asserted that the sale of the equipment at issue occurred outside of Washington and also believed that the activities of its agents and employees were not sufficient to establish taxing nexus with Washington. The Department disagreed, and in May of 2011 the Taxpayer was involuntarily registered. In November of that same year an estimated assessment for January 1, 2007, through September 30, 2011, was issued to the Taxpayer.

After receiving the estimated assessment the Taxpayer provided additional information and sales detail, and based on this information an amended assessment was issued, in May of 2012. This assessment was for $ . . . comprised of $. . . in retailing business and occupation (B&O) tax, $. . . in service and other activities (service) B&O tax, interest of $. . ., a delinquent penalty of $. . ., an unregistered business penalty of $. . ., and an assessment penalty of $. . . . The Taxpayer timely appealed the assessment.

On appeal, the Taxpayer has provided additional detail of the sales, production, and installation process for the equipment at issue as well as representative documentation detailing the inspection and acceptance process of the equipment sold. This detail included contractual provisions and copies of inspection forms.

The Taxpayer is one of a limited number of companies who design and produce the type of heating systems at issue. The systems are completely custom, tailored to the specifications of the particular customer as well as to the government regulatory guidelines. The Taxpayer does repair and replacement work on systems it initially designed as well as other systems, in addition to designing new heating systems. However, the Taxpayer does not provide any routine

maintenance services. The Taxpayer adheres to the American Petroleum Institute (API) guidelines and is an approved API 560 supplier. The API sets standards for the systems, including inspection and acceptance of the complete product.

The Taxpayer engages in a competitive bidding process for its projects. The Taxpayer does the engineering and design for its projects in house. Once the design work is completed the customer will sign off and approve the design. This is the last point in time for the customer to walk away from the project. If the customer should elect to go with another provider, it can pay for the design work and elect not to proceed with the project. However, once the designs are approved and signed by the customer, the customer is committed to pay for the completed product that will be fabricated to the approved design specifications using components and materials from approved vendors.

Most of the Taxpayer's work occurs on a regular schedule as approximately every ten years there will be replacement and repair work, alternating with complete system replacement. The Taxpayer's customers have to interrupt the oil refining process to allow for the installation or repair of the equipment at issue, so every effort is made to limit the time the refinery is shut down. To that end, the customer exerts considerable control over the order and shipping timing so the components are delivered to the refinery to allow for efficient installation. The customer manages and conducts the installation process, but on occasion may desire to have one of the Taxpayer's engineers on site to address any questions with regard to the use and installation of the equipment that may arise. The Taxpayer's engineers do not actually oversee the installation work, but rather provide advice to the oil refinery engineers who are responsible for the installation.

During the audit period the Taxpayer's sent engineers into Washington for three field service engagements. Two of these visits were for four to six days, and the third engagement was for a 10-day period.

During the audit period, the Taxpayer also employed an independent third-party sales representative. This representative lived in California and worked for the Taxpayer as well as other companies specializing in heat transfer systems for the oil refining industry. The representative visited Washington approximately two times a year, but did not represent the Taxpayer on every visit. The representative is a licensed engineer, and his work for the Taxpayer included a combination of technical support services as well as customer relations work. The representative did not receive order inquires, submit quotes, or accept purchase orders for the Taxpayer. The Taxpayer is no longer working with this sale representative and believes his last visit on behalf of the Taxpayer occurred in 2010.

ANALYSIS

Washington imposes a business and occupation (B&O) tax "for the act or privilege of engaging in business" in this state. RCW 82.04.220.[2] The tax is measured by applying particular rates against the value of products, gross proceeds of sale, or gross income of the business as the case may be. RCW 82.04.220. RCW 82.04.250 imposes the B&O tax on entities making sales at retail.

WAC 458-20-193 (Rule 193) sets out administrative guidance regarding application of the B&O and retail sales taxes to interstate sales. Rule 193 reads, in pertinent part:

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

Nexus requirements flow from limits on a state's jurisdiction to tax found in the Due Process and Commerce Clause provisions of the United States Constitution. The limitations imposed by the two clauses are discussed in depth in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, (1977), in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), and in the Department's determinations.[3] *See, e.g.*, Det. No. 01-074, 20 WTD 531 (2001); Det. No. 96-144, 16 WTD 201 (1996). The nexus limitation requires that the activity taxed have "substantial nexus" with the taxing state. Consistent with this requirement, Rule 193 defines "nexus" as "the activity carried on by the seller in Washington which is significantly associated with the seller's ability to establish and maintain a market for its products in Washington." Rule 193(1)(f). This definition was cited with approval in *Tyler Pipe Industries, Inc. v. Dep't of Revenue*, 483 U.S. 232, 250-251 (1987). Therefore, Washington may not assert B&O tax on revenue from sales of goods which originate outside the state unless the purchaser receives the goods in this state and the seller has nexus. *See Lamtec Corp. v. Dep't of Revenue*, 151 Wn. App. 451, 467, 215 P.3d 968, 976 (2009), *aff'd*

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[2] RCW 82.04.030 defines "person" to include corporations, limited liability companies, associations, and any group individuals acting as a unit, whether nonprofit, or otherwise. "Engaging in business" in Washington means "commencing, conducting, or continuing in business." RCW 82.04.150. "Business" is defined as including all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or another person. RCW 82.04.140.

[3] RCW 82.04.067 codifies the substantial nexus standard, providing in part:

> (6) . . . For purposes of the taxes imposed under this chapter on any activity not included in the definition of apportionable activities in RCW 82.04.460, a person is deemed to have a substantial nexus with this state if the person has a physical presence in this state, which need only be demonstrably more than a slightest presence. . . . A person is also physically present in this state if the person, either directly or through an agent or other representative, engages in activities in this state that are significantly associated with the person's ability to establish or maintain a market for its products in this state.

by Lamtec Corp. v. Dep't of Revenue, 170 Wn. 2d 838, 246 P.3d 788 (2011), *cert. denied* 132 S. Ct. 95 (2011).

The determination of whether in-state activities create nexus looks to the entire collection of a taxpayer's different activities, the totality of which may create substantial nexus. *GMC v. City of Seattle*, 107 Wn. App. 42, 25 P.3d 1022 (2001); *see also General Motors Corp. v Washington*, 377 U.S. 436 (1964) (overruled on other grounds); *Tyler Pipe*, 483 U.S. at 250 (1987); Rule 193. Thus, establishing taxing nexus requires consideration of the entire bundle of a taxpayer's in-state activities.[4]

In this case, the Taxpayer is engaged in the business of selling tangible personal property (the heating systems) and related engineering services. During the audit period the Taxpayer had both a third-party representative as well as employee engineers in Washington. The Taxpayer asserts that its instate activities are not related to generating sales, because the specialized nature of its work results in it being one of a limited number of vendors who is invited to bid on various projects. The Taxpayer also asserts its Washington sales did not arise from the activities of the third-party representative or the employee engineers, but rather were driven by the requirement that the refineries solicit bids from approved contractors. The Taxpayer emphasizes that neither the third-party representative nor the engineers accepted orders for projects.

However, we note that the standard is not whether the instate activity directly solicits a sale, but rather whether this activity is significantly associated with establishing or maintaining a market within this state. WAC 458-20-193(2)(f); *Standard Pressed Steel Co. v. Dep't of Revenue*, 419 U.S. 560 (1975); *National Geographic Soc. v. California Bd. of Equalization*, 430 U.S. 551 (1977); Det. No. 04-0148, 24 WTD 371 (2004).[5] For example, the Department has held infrequent visits to Washington customers by nonresident employees constituted sufficient nexus to allow the taxation of sales, even though the employees were not salespersons. Det. No. 88-368, 6 WTD 417 (1988). Where employees provided advice to customers regarding the safe handling of a product, such activity was also found to be important in maintaining sales into the state. Det. No. 91-213, 11 WTD 239 (1991). *See also Standard Pressed Steel Co.*, 419 U.S. 560

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[4] For example, in Det. No. 96-144, 16 WTD 201 (1996), we concluded that, once the activities of a company go beyond purely mail order activities, and it has demonstrably more than the slightest presence in the state, substantial nexus is established. *Accord*, *Matter of Orvis Co. v. Tax Appeals Tribunal*, 86 N.Y.2d 165, 630 N.Y.S.2d 680, 686-87, 654 N.E.2d 954, 960-61 (N.Y. 1995), *cert. denied*, 516 U.S. 989, 116 S.Ct. 518 (1995) ("While a physical presence of the vendor is required, it need not be substantial. Rather, it must be demonstrably more than a 'slightest presence' . . . . And it may be manifested by the presence in the taxing State of the vendor's property or the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf.")

[5] As the U.S. Supreme Court emphasized in *National Geographic:*

> [T]the relevant constitutional test to establish the requisite nexus for requiring an out-of-state seller to collect and pay the use tax is not whether the duty to collect the use tax relates to the seller's activities carried on within the State, but simply whether the facts demonstrate "some definite link, some minimum connection, between the State and the person . . . it seeks to tax."

430 U.S. at 561 (internal quotations omitted).

(where nexus was established through the presence of a resident employee engineer who was not involved in sales, but only consulted with the customer regarding the customer's product needs.).

We conclude that both the activities of the third-party sales representative and that of the employee engineers are significantly associated with maintaining a market for the Taxpayer's products. In particular the presence of the employee engineers for the field service engagements directly and specifically supports the sales of equipment. While these engineers do not personally install the equipment, they are present to assist and advise on the installation and answer customer questions that may arise during the installation process. While there may not be a field service engagement for every sale, the fact that it is available and that customers on occasion avail themselves of this option is an important part of the sales process and sufficient to establish taxing nexus. The Taxpayer's petition is denied on the issue of nexus and we sustain the conclusion of the Tax Discovery Division that the Taxpayer has sufficient contacts with Washington to establish taxing nexus.

DECISION AND DISPOSITION

[The Taxpayer's petition is denied on the issue of nexus.] . . .

Dated this 15th day of July 2013.