Cite as Det. No. 15-0190, 35 WTD 192 (2016)

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. 15-0190
. . .	)	Registration No. . . .

RULE 193; RCW 82.04.067: B&O TAX – NEXUS – INDEPENDENT CONTRACTOR – SALES ACTIVITIES: Independent distributors, who demonstrated products and solicited orders in Washington for an out-of-state corporation, established and maintained a market sufficient to establish nexus for the corporation with 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.

M. Pree, A.L.J. – An out-of-state corporation appeals business and occupation (B&O) taxes assessed on sales of its products delivered into Washington. The corporation contends that, because it had no property or employees in Washington, it was not obligated to pay Washington B&O taxes. Because independent businesses demonstrated the corporation's products and solicited orders here on the corporation's behalf, the corporation had sufficient activity in Washington (nexus), and is liable for B&O tax on its receipts and income. Petition denied.[1]

ISSUE

Under [constitutional nexus principles and] WAC 458-20-193 (Rule 193), is an out-of-state corporation with no Washington property or employees subject to B&O taxes, if independent businesses demonstrate its products and solicit orders here on its behalf?

FINDINGS OF FACT

[Taxpayer] is an out-of-state corporation. The taxpayer sells beauty and wellness products worldwide. Independent business owners (distributors)[2] demonstrate the taxpayer's products and solicit orders in Washington from customers and individuals who will personally use the products. The distributors may profit if they sell products they purchase from the taxpayer directly to their customers, or they can earn commissions when their customers purchase the

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
[2] The taxpayer also refers to them as independent sales representatives (ISRs). We will use the term "distributors" used in the 2008 Tax Collection Agreement (TCA) made with the Department.

products from the taxpayer. Customers who place orders with the taxpayer must visit the distributors' websites maintained by the taxpayer to order the products. The customers pay the taxpayer, which uses common carriers to ship the products directly to the customers in Washington. The taxpayer pays the distributors a commission for online sales to the distributors' customers. The taxpayer charges the distributors fees to host their websites.

The taxpayer charged and collected retail sales tax from the distributors' customers, which the taxpayer remitted to the Department of Revenue (Department) in accordance with a 2008 Tax Collection Agreement (TCA) the taxpayer made with the Department. While the TCA addressed the taxpayer's sales tax responsibilities with the distributors, under the TCA, the taxpayer did not agree to report or pay B&O tax on behalf of the distributors. The TCA specifically stated that the taxpayer was not responsible for the distributors' B&O taxes.[3] According to the TCA, the distributors were responsible for their own B&O taxes. The taxpayer agreed to report and remit B&O tax on its receipts from the distributors [for distributor purchases of product from the taxpayer].[4]

While the taxpayer reported and remitted retail sales tax per the TCA, for the period from January 1, 2010 through October 31, 2014 (audit period), the taxpayer did not report or pay B&O tax on its receipts. The Department's Taxpayer Account Administration Division (TAA) examined the taxpayer's business activities in Washington. TAA concluded that the taxpayer owed B&O tax during the audit period. In Document Number . . . , TAA assessed $ . . . in B&O tax under the retailing classification,[5] $ . . . in B&O tax under the wholesaling classification on sales made to the distributors,[6] and $ . . . in B&O tax under the service and other activities classification[7] for the period from January 1, 2010 through March 31, 2014. With $ . . . in litter tax and $ . . . in interest, the total due was $ . . . .[8] Seven individual assessments for each subsequent month through October 31, 2014 were also issued in the amounts of $ . . . , $ . . . , $ . . . , $ . . . , $ . . . , $ . . . , and $ . . . respectively. The taxpayer appealed all the assessments covering the audit period.

The taxpayer states that its activities in Washington were not significant and, therefore, did not create nexus, obligating the taxpayer to pay B&O taxes on its Washington receipts. According to the taxpayer, it did not have property or employees in Washington. The taxpayer states that its employees did not solicit sales here. Common carriers delivered its products to Washington customers.

TAA contends that the distributors gave the taxpayer nexus with Washington. The distributors were physically present here and performed activities, which maintained the Washington market for the taxpayer's products. They encouraged their customers to order products from the taxpayer on their websites for which the taxpayer paid the distributors a commission.

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[3] §II(B)(1) of the taxpayer's August 14, 2008 TCA with the Department.
[4] *Id.*
[5] This was for sales made directly from the taxpayer to the distributors' customers with the distributors receiving a commission from the taxpayer.
[6] The taxpayer sold these products to the distributors, who resold them to their customers.
[7] The service B&O tax was assessed on fees that the taxpayer charged the distributors to host their websites.
[8] This was an amended assessment.

Individuals interested in becoming distributors of the taxpayer's products completed an [application and agreement form] drafted by the taxpayer. The taxpayer furnished each applicant an individual web-site, free for the first . . . days and then $ . . . /month. The applicants could also buy kits including the taxpayer's products for parties hosted by the applicants to demonstrate use of the products for prospective customers. Common carriers delivered the kits to the applicants when they became distributors.

The distributors agreed to sell the taxpayer's products as independent contractors, not employees. They agreed to use the words in the taxpayer's literature to describe the taxpayer's products and not make misleading statements about the company's products. The agreement does not set hours, limit sales territory, or identify customers. The taxpayer or the distributor may terminate the agreement at any time. The taxpayer states that the duration of its relationship with 99% of the distributors is less than two years.

The distributors could also earn money by purchasing the products from the taxpayer and reselling them to their customers, keeping the markup. "Loyal Customers" were a distributor's customers that signed a three month (or longer) "auto-ship agreement" with the distributors. The taxpayer filled the Loyal Customers' product orders, and billed the Loyal Customers for the product at a price lower than the retail price charged by the distributors. The taxpayer paid the distributors an incremental commission measured by its sales to Loyal Customers. If a Loyal Customer became a distributor, the Loyal Customer's distributor earned additional "downline" commissions or bonuses under the taxpayer's compensation plan.

While the taxpayer disputes that it has nexus with Washington, and therefore should not pay B&O taxes on any of its receipts, it has not contested the B&O tax classification of the income. TAA taxed the sales to the distributors for resale to their customers under the wholesaling classification. TAA taxed the taxpayer's sales to Loyal Customers under the retailing classification. Finally, the taxpayer's charges for maintaining the distributors' websites were taxed under the service and other activities classification.

ANALYSIS

The B&O tax is imposed on every person for the act or privilege of engaging in business activities in Washington. RCW 82.04.220. RCW 82.04.030 defines "person" to include corporations. "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. 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.

The taxpayer states that it has no property or employees in Washington, and argues that without physical presence (nexus), it is not subject to Washington taxes. The nexus requirement flows from limits on a state's jurisdiction to tax found in the Due Process and Commerce Clause provisions of the United States Constitution. Generally, a state cannot tax transactions and activities that do not have sufficient connection or "nexus" to the taxing state, and cannot impose taxes that would create undue impediments to the operation of the national economy. Det. No.

01-188, 21 WTD 289, 292 (2002); Det. No. 08-0128, 28 WTD 9, 13 (2009). These limitations have been recognized and articulated in numerous court decisions. *See, e.g., Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)(Nexus is a prerequisite before a state may impose a tax on a nonresident); *Tyler Pipe Industries, Inc. v. Washington Dep't. of Revenue*, 483 U.S. 232, 250 (1987)(Generally, any state in which a taxpayer directly and actively engages in business and from such activity derives part of its gross receipts, has nexus to tax the revenue from the activity.).

As explained in RCW 82.04.067(6):

> . . . 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. For purposes of this subsection, a person is physically present in this state if the person has property or employees in this state. 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.

In Washington, any activity performed by an employee, agent, or other representative on behalf of a seller that is significantly associated with establishing or maintaining a market within this state, is sufficient to establish nexus. Rule193(7)(2010); *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, 6 WTD 417 (1988).[9] 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). In *Standard Pressed Steel*, 419 U.S. 560, 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. A single contact or transaction is enough to establish nexus. *See* Det. No. 88-249, 6 WTD 109 (1988).

Rule 193(7)(c)(2010)[10] gives examples of activities that create sufficient nexus in Washington for the B&O tax to apply. These include:

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[9] As the US 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.)

[10] Rule 193 was amended July 7, 2015, effective August 7, 2015. The new rule does not change the outcome for this taxpayer. Rule 193(102)(d) of the new rule also explains that a taxpayer has nexus with Washington State when it uses an agent or other representative to engage in activities in Washington that establish a market for the taxpayer's products in this state.

> (iii) The order for the goods is solicited in this state by an agent or other representative of the seller.
> . . .
> (v) The out-of-state seller, either directly or by an agent or other representative, performs significant services in relation to establishment or maintenance of sales into the state, even though the seller may not have formal sales offices in Washington or the agent or representative may not be formally characterized as a "salesperson."

It is well settled that the nexus requirement is satisfied by the in-state solicitation of orders by either an independent contractor or an employee. *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960); *Tyler Pipe*, 483 U.S. 232 (1987). In *Tyler Pipe*, the court affirmed the imposition of B&O tax when the taxpayer's independent contractor solicited orders and visited with customers in Washington State, although the company maintained no office, owned no property, and had no employees within the state. 483 U.S. at 250.

We recognize that the distributors were not the employees of the taxpayer, but this fact is ultimately not [material to the outcome]. The distributors solicited sales for the taxpayer as the taxpayer's representatives in Washington. The taxpayer repeatedly states that it had no employees in Washington, but does not dispute that the distributors demonstrated the taxpayer's products here, and solicited orders from their customers on behalf of the taxpayer for which the taxpayer paid them commissions. The distributors conducted activities in Washington as the taxpayer's representatives, which enabled the taxpayer to establish and maintain a market for its products here. The taxpayer's contention that because the distributors were not employees of the taxpayer, and therefore, did not give the taxpayer nexus, has been addressed by the United States Supreme Court:

> As a matter of law, the Washington Supreme Court concluded that this showing of a sufficient nexus could not be defeated by the argument that the taxpayer's representative was properly characterized as an independent contractor instead of as an agent. We agree with this analysis. In *Scripto, Inc. v. Carson*, 362 U. S. 207 (1960), Scripto, a Georgia corporation, had no office or regular employees in Florida, but it employed wholesalers or jobbers to solicit sales of its products in Florida. We held that Florida may require these solicitors to collect a use tax from Florida customers. Although "salesmen" were not employees of Scripto, we determined that "such a fine distinction is without constitutional significance." *Id*., at 211.

Tyler Pipe Indus., Inc. v. Wash. State Dep't. of Revenue, 483 U.S. 232, 250 (1987).

The distributors' Washington activities, including, but not limited to, demonstrating the taxpayer's products and soliciting orders of the taxpayer's products, established and maintained a market within Washington sufficient to establish nexus.[11] We conclude that the taxpayer owed B&O taxes on its Washington receipts and income.

[11] [We note that beginning September 1, 2015, out-of-state businesses making wholesale sales taxed under RCW 82.04.270 (the general wholesaling classification) or RCW 82.04.257(1) (certain digital products and services) may be subject to B&O tax on their wholesale sales in this state even if they don't have any direct or indirect physical

DECISION AND DISPOSITION

We deny the taxpayer's petition.

Dated this 20th day of July, 2015.

presence in this state. Such businesses may establish a substantial nexus for B&O tax purposes through a sufficient economic presence in this state. See RCW 82.04.067.]