Cite as Det. No. 14-0383, 34 WTD 265 (2015)

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. 14-0383
. . .	)	Registration No. . . .

[1] RULE 193: B&O TAX – INTERSTATE SALES – INBOUND SALES – PLACE OF SALE – DELIVERY IN WASHINGTON – RECEIPT IN THIS STATE. The place where legal title to goods passes is not determinative of whether delivery has occurred in Washington under Rule 193. Income from sales of goods that are shipped from an out-of-state location into Washington, FOB origin, is subject to B&O taxation in Washington.

[2] RULE 193: B&O TAX – OUT-OF-STATE MANUFACTURER – NEXUS. An out-of-state manufacturer's visits to Washington helped establish or maintain sales in Washington and that contact creates substantial nexus with this state.

[3] RULE 254; RCW 82.32.070: RECORDS – RETAIL SALES TAX - RECORDKEEPING. Taxpayer must maintain and provide adequate records to demonstrate that he is entitled to an adjustment of a tax assessment.

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.

Munger, A.L.J. – The Taxpayer, an [out-of-state] manufacturer and wholesaler of prefabricated buildings, protests the assessment of wholesaling B&O tax on sales made to Washington State customers.[1]

ISSUES

1. Whether under WAC 458-20-193 delivery of the Taxpayer's products occurred in Washington State.

2. Whether under WAC 458-20-193 the Taxpayer's business visits into Washington create taxable nexus with Washington State for B&O tax purposes.

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

3. Whether the Department should adjust an estimated assessment when the Taxpayer fails to produce any sales records? RCW 82.32.070; WAC 458-20-254.

FINDINGS OF FACT

The [Taxpayer is] an [out-of-state] manufacturer, [that] wholesales prefabricated commercial buildings, classrooms, park restrooms, and mobile construction offices to retail dealers.[2] The Taxpayer delivered the buildings by using third-party common carriers, and delivery is usually to the designated site where the building is installed. Occasionally, the dealer will pick up the building with its own trucks.

The Washington State Department of Revenue (Department) audited the Taxpayer for the period of January 1, 2009 through December 31, 2012. For this audit, the auditor requested sales records, similar to what was used in a previous audit of the Taxpayer, including job files to verify the final destination of the modular building, and information on who hauled the buildings. On October 10, 2013, the Taxpayer provided information to the auditor that included a list of independent brokers, along with documents we describe in further detail below. The Taxpayer provided no sales documentation. The information the Taxpayer provided was insufficient to complete the audit based on actual sales; so consequently, the Department issued an estimated audit assessment on November 8, 2013. The assessment included $. . . in wholesaling B&O tax and with interest and penalties totaled $. . . when issued. The assessment remains unpaid, and the Taxpayer timely appealed.

The same Taxpayer on appeal here had been audited for the periods of January 1, 2000 through December 31, 2001, and January 1, 2002 through September 30, 2006. The October 24, 2007 audit reports for these prior audit periods described its nexus finding as follows:

> On March 23, 2007, a completed Washington Business Activities Questionnaire was received from . . . , Attorney. It stated that [Taxpayer] visits Washington State on "average less than three days/year" for "average less than four hours/day/visit" to perform "very infrequent warranty work" and "very infrequent building installation assistance." The questionnaire also describes the Washington activity to include maintenance and repair services and installation. This activity creates nexus in the state of Washington, as explained in WAC 458-20-193. According to 18 WTD 211, one or two visits a year is significant to confer nexus.

The two prior audit assessments were resolved with Closing Agreement Number 5535 dated August 21, 2009 and September 10, 2009. In that agreement, . . . the Taxpayer's President, agreed to obtain a letter ruling from the Department if he decided to structure future sales to his Washington customers as occurring outside the State of Washington. The Taxpayer did not do this. That settlement included payment of almost all of the assessed wholesaling B&O tax.

Subsequent to this agreement, from the fourth quarter of 2009 through the third quarter of 2014, the Taxpayer filed excise tax returns claiming no income in Washington State, except for two quarters, in which it reported nominal amounts of wholesaling income (Q-1 2011) and retailing in the Olympia area (Q-2 2012).

[2] The Taxpayer also makes some retail sales of its buildings.

In 2012, the Audit Division noticed that the Taxpayer's reported income was not consistent with amounts assessed in the previous audit. This led to the current audit described above.

The documents provided to Audit we mentioned above were dated January 1, 2009 through September 28, 2012. All of these documents are on the same form and on [Taxpayer] letterhead as follows:

> **Acceptance of Product being shipped from [out-of-state]**
> **manufacturing plant into State of Washington**
>
> The signature below verifies that the building identified as:
> Job Name _____
> Job number _____
> Is hereby accepted FOB the plant located at . . .
>
> Accepted by: _____
> For:
> Date:

One hundred ninety six of these forms were provided by the Taxpayer, with dates from January 1, 2009 through September 28, 2012. On the "For" line the name of what presumptively was the buyer was typed in, and on the "Date" line a date was typed in. A hand written signature was on the "Accepted by" line, without any indication what position that person held with the Washington State buyer. Although the term "FOB" is used, there was no identification as to what company was used as the carrier. No other sales information was provided.

On appeal we gave the Taxpayer's representatives additional time to provide Audit with the information to correct the estimated assessment. On August 28, 2014 the Taxpayer's representatives provided a memo to the auditor asserting that the Taxpayer does not owe any tax, and attaching opinions from [two out-of-state] Attorney General's offices. Also attached was a draft lawsuit that it threatens to file in Federal District Court [out-of-state] if the tax is sustained.[3] It also asserts that delivery issues are to be resolved by reference to the UCC rather than to WAC 458-20-193. The Taxpayer provided no further sales information. The Taxpayer asserts that nothing had changed in its business activities since the last audit period.

ANALYSIS

Washington imposes a business and occupation ("B&O") tax on engaging in business activities in this state. RCW 82.04.220(1) provides:

> There is levied and collected from every person that has a substantial nexus with this state a tax for the act or privilege of engaging in business activities. The tax is measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be.

[3] For the Taxpayer's information we point out that such suits are barred by the Tax Injunction Act, 28 U.S.C. § 1341. *See also California v. Grace Brethren Church*, 457 U.S. 393, 102 S.Ct. 2498, 73 L.Ed.2d 93 (1982).

The B&O tax is "extensive and is intended to impose . . . tax upon virtually all business activities carried on in the State." *Analytical Methods, Inc. v. Dep't of Revenue*, 84 Wn. App. 236, 241, 928 P.2d 1123 (1996) (quoting *Palmer v. Dep't of Revenue*, 82 Wn. App. 367, 371, 917 P.2d 1120 (1996)). "Business" is defined broadly to include "all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly." RCW 82.04.140. Notwithstanding the broad definition of "business" in RCW 82.04.140 that essentially includes all business activities that benefit a taxpayer, a state cannot tax transactions that do not have sufficient connection or "nexus" with the state. *See Complete Auto Transit v. Brady*, 430 U.S. 274 (1977); *Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue*, 483 U.S. 232 (1987); *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992); Det. No. 05-0376, 26 WTD 40 (2007).

WAC 458-20-193 ("Rule 193") sets forth Washington's rule governing the taxation of the sale of goods shipped into this state. Rule 193(7) provides:

> 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.

(Emphasis added.) Thus, Washington only imposes B&O tax on Taxpayer's sales if the buyers receive the goods in Washington and Taxpayer has nexus in Washington. *Id.*

1. Delivery in Washington

Rule 193(7) provides:

> (a) Delivery of the goods to a . . . for-hire carrier located outside this state merely utilized to arrange for and/or transport the goods into this state is not receipt of the goods [outside this state] by the purchaser or its agent unless the . . . for-hire carrier has express written authority to accept or reject the goods for the purchaser with the right of inspection.

(Emphasis added.) In short, delivery is not deemed to occur outside of Washington if a seller merely hires a carrier to transport goods into this state, *unless* that carrier has the express written authority to accept or reject the goods with the right of inspection. Here, Taxpayer ships merchandise to Washington retailers by for-hire carriers. Taxpayer has not asserted, nor is there any evidence, that the carriers have express written authority from its Washington customers to accept or reject the goods outside of Washington. *See* Excise Tax Advisory 3091.2009 (ETA 3091).[4] We therefore conclude that under Rule 193, the products sold by Taxpayer to its

[4] ETA 3091 was issued by the Department on February 2, 2009 to provide guidance on what constitutes receipt of goods through an agent. This ETA was originally issued April 30, 1993 as ETA 561, and was converted to the ETA 3000 series in 2009. ETA 3091 states, in relevant part:

> For receipt to occur at the out-of-state location, the for-hire carrier must take those actions that would generally be taken by a prudent buyer to assure that the goods conform to the purchase order or contract. This generally requires at a minimum that the goods be physically examined by the receiving agent. The agent must also have

Washington customers were delivered and accepted in Washington during the Tax Period. *See also* Det. No. 06-0028, 26 WTD 97 (2007).

The Taxpayer argues that because title to its prefabricated passes to the customers in Oregon (FOB origin), there is no delivery in Washington. However, where legal title to goods passes is not determinative of whether delivery has occurred in Washington under Rule 193. It is well settled law that [income from sales of] goods that are shipped from an out-of-state location, FOB origin, [is] subject to the B&O tax under RCW 82.04.220. *Lamtec Corp. v. Dep't of Revenue*, 151 Wn. App. 451, 460, 215 P.3d 968 (2009). In *B.F. Goodrich v. State*, 38 Wn.2d 663 (1951), the Washington State Supreme Court sustained the imposition of B&O tax on products shipped directly to Washington purchasers, FOB out-of-state locations. *Id* at 664-66. The court rejected B.F. Goodrich's argument that transfer of title and delivery to the purchasers took place out-of-state because the goods were shipped FOB the out-of-state location. In *Field Enterprises, Inc. v. State*, 47 Wn.2d 852, 289 P.2d 1010 (1955), the Washington Supreme Court once again sustained the imposition of B&O tax on shipments made to Washington customers, FOB origin. *Id*. at 854-55. The court rejected the taxpayer's argument that delivery occurred out-of-state, concluding that its recent decision in *B.F. Goodrich* was controlling. *Id*. at 855-56.

Rule 193 clarifies that where legal title passes or the risk of loss passes is not controlling for purposes of determining whether there is receipt in Washington for B&O tax purposes. Rather, it is where the goods are received by the buyer that controls. *See also* WAC 458-20-103; Det. No. 98-146, 18 WTD 175 (1999). Two examples in Rule 193 provide, in relevant part:

> 11) **Examples - Inbound sales.** The following examples show how the provisions of this section relating to interstate sales of tangible personal property will apply when the goods originate outside Washington (inbound sales). The examples presume the seller has retained the proper proof documents.
>
> a) Company A is located in California. It sells machine parts at retail and wholesale. Company B is located in Washington and it purchases machine parts for its own use from Company A. Company A uses its own vehicles to deliver the machine parts to its customers in Washington for receipt in this state. The sale is subject to the retail sales and B&O tax if the seller has nexus, or use tax if nexus is not present.
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> b) Company A, above, ships the parts by a for-hire carrier to Company B in Washington. The goods are not accepted by Company B until the goods arrive in Washington. The sale is subject to the retail sales or use tax and is also subject to the B&O tax if the seller has nexus in Washington. It is immaterial whether the shipment is freight prepaid or freight collect.
>
> * * *
>
> e) Company B, above, instructs Company A to deliver the machine parts to a freight consolidator selected by Company B. The freight consolidator does not have authority to receive the goods as agent for Company B. Receipt will not occur until the parts are received by Company B in Washington. Company A is required

access to the purchase order or contract in order to determine if the goods conform. The mere giving to the for-hire carrier of a written authority to accept the goods at an out-of-state location, without some further act of acceptance, will not be considered as receipt by the purchaser or the purchaser's agent at that location. In short, the carrier must not only have written authority to accept or reject goods for the buyer, it must actually do so and provide documentation of that fact to the seller.

> to collect retail sales or use tax and is liable for B&O tax if Company A has nexus for this sale. The mere delivery to a consolidator or for-hire carrier who is not acting as the buyer's receiving agent is not receipt by the buyer.

(Emphasis added); *see also* Det. No. 99-216E, 18 WTD 264 (1999) (commercial law rules for delivery are not controlling for Washington B&O tax purposes; products sent FOB out-of-state were received in Washington and therefore subject to B&O tax); Det. No. 99-298, 20 WTD 197 (2001) (transfer of title does not govern where receipt occurs for Washington tax purposes; quality assurance inspection by the seller does not constitute final acceptance by the buyer).

The examples contained in Rule 193(11)(b) and (e) demonstrate that delivery of goods to for-hire carriers outside the state does not constitute out-of-state receipt by the buyer. Because Taxpayer's products were delivered to for-hire carriers [out-of-state], receipt does not occur until the goods arrive in Washington. Nothing has been provided that would show that the carriers ever had the inspection/rejection agent authority required by ETA 3091. The documentation provided does not even identify the carriers, and certainly does not prove that the Washington State buyers had granted the carriers any authority as their agent. Had the Taxpayer described this scenario to the Department in 2009 as required by the closing agreement, the Taxpayer would have been informed that delivery was still occurring in Washington State for B&O tax purposes. The Taxpayer's petition is denied as to this issue.

2. Nexus

Nexus is defined as "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." Rule 193(1)(f); *see also* RCW 82.04.067(6) (for periods beginning June 1, 2010); *Tyler Pipe Industries, Inc. v. Washington Dep't of Revenue*, 483 U.S. 232, 107 S. Ct. 2810 (1987).[5] Rule 193(7) provides examples of sufficient nexus in Washington for the B&O tax to apply. The following example is applicable here:

> 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."

Rule 193(7)(c)(v) (emphasis added.)

The activities of the seller's employees or representatives need not involve the solicitation of sales, per se. *Space Age Fuels, Inc. v. Washington*, 315 P.3d 604, 609 (2013). Any activity

[5] RCW 82.04.067(6), in effect for most of the current audit period, in pertinent part states:
…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.

performed in this state on behalf of the seller that is significantly associated with the seller's ability to establish and maintain a market in this state for the sales establishes nexus over the seller. Rule 193(7); *Standard Pressed Steel Co. v. Dep't of Revenue*, 419 U.S. 560 (1975); *National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551 (1977). In the present case, Audit had found nexus in the previous audit based on the Taxpayer's multiple visits to Washington State customers. On appeal, the Taxpayer has indicated nothing has changed and we have no evidence that nexus creating activities have ceased.. . . . [Further, while denying that it was making other sales delivered in Washington, Taxpayer reported a sale in Olympia, Washington and collected and remitted sales tax on that sale.] This clearly indicates that its Washington State business activities are ongoing into the current audit period. These activities constitute "significant services in relation to the establishment or maintenance of sales into Washington" under the example in Rule 193(7)(c)(v) and were significantly associated with Taxpayer's ability to establish or maintain its Washington market under Rule 193(1)(f).

Our conclusion is also supported by Department precedent. In Det. No. 00-003, 19 WTD 685 (2000), we held that certain in-state activities that did not involve the solicitation of sales were significantly associated with the seller's ability to establish and maintain a market in this state. Those activities included in-state dealer training, supporting promotional efforts at in-state trade shows, introducing and promoting new products in Washington, and establishing a network of independent contractors in Washington for repair work. In other cases, we have also held that occasional visits by nonresident employees who do not solicit sales can establish substantial nexus with this state. For example, occasional visits by nonresident employees to provide advice on the safe handling of products created substantial nexus. Det. No. 88-368, 6 WTD 417 (1988). In Det. No. 91-213, 11 WTD 239 (1991), substantial nexus existed where nonresident employees made occasional visits to this state to show product samples and to explain the Company's policies. Such product-related activities were held to be significantly associated with the ability to establish and maintain a market in this state for the products being sold in Washington. In light of the case law and Department precedent discussed above, we conclude that the activities of the Taxpayer in this state are sufficient to establish nexus.

Records

RCW 82.32.070 and WAC 458-20-254 require every person liable for payment of excise taxes to prepare and preserve all books of record in an organized manner. Specifically RCW 82.32.070 requires that:

> Every person liable for any fee or tax imposed by chapters 82.04 through 82.27 RCW shall keep and preserve, for a period of five years, suitable records as may be necessary to determine the amount of any tax for which he may be liable, which records shall include copies of all federal income tax and state tax returns and reports made by him. All his books, records and invoices shall be open for examination at any time by the department of revenue. . .

(Emphasis added.) *See also* WAC 458-20-254(3) and Det. No. 00-043, 20 WTD 39 (2001). Similarly, WAC 458-20-254(2)(a), the administrative rule regarding records, provides: "It is the duty of each taxpayer to prepare and preserve all books of record in a systematic manner conforming to accepted accounting methods and procedures." In the present appeal, the Taxpayer has refused to produce any sales records for its Washington customers as required by RCW 82.32.070 and WAC 458-20-254.

RCW 82.32.100 allows the Department to estimate taxes with the best materials it has when the taxpayer does not provide the necessary records. Given these circumstances, we conclude the Department's estimate of taxes in the present case based on the Taxpayer's prior audit was reasonable in light of the complete lack of any substantiating sales records.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 4th day of December, 2014.