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Cite as Det. No. 21-0211, Annual WTD Page (Year)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for	)	<u>D E T E R M I N A T I O N</u>
Refund/Correction of Assessment of	)	
	)	No. 21-0211
	)	
...	)	Registration No. ...
	)	

RCW 82.04.067; WAC 458-20-193: NEXUS – PHYSICAL PRESENCE – WARRANTY SERVICES. An out-of-state distributor established substantial nexus by sending representatives each year to visit Washington retailers that sold the distributor’s products and offering warranty repair services through those retailers.

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.

Peña, T.R.O. – An out-of-state corporation engaging in online retail sales to customers in Washington and wholesale sales to retailers in Washington disputes the assessment of B&O tax and retail sales tax based on lack of nexus. We deny the taxpayer’s petition.<sup>1</sup>

ISSUES

Under the Commerce Clause, U.S. Const. art. I, § 8, cl. 3, the Due Process Clause, U.S. Const. amend. XIV, § 1, RCW 82.04.067, and WAC 458-20-193 (Rule 193), does an out-of-state business making retail sales of . . . goods to purchasers in Washington and wholesale sales of . . . goods to retailers and distributors in Washington have substantial nexus for business and occupation tax and retail sales tax purposes?

FINDINGS OF FACT

. . . (Taxpayer) is an out-of-state company headquartered in . . . , that distributes . . . goods such as . . . under various brands. . . .

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

The Department's Compliance Division (Compliance) began its investigation of Taxpayer on June 11, 2018, to determine if Taxpayer had a Washington registration requirement. During the period of January 1, 2012, through November 30, 2018 (Audit Period), Taxpayer wholesaled . . . goods to retailers for resale, including retailers in Washington (Retailers), and made online retail sales of . . . goods directly to consumers, including those located in Washington. Taxpayer did not own any retail locations, known as boutiques, in Washington during the Audit Period.

Ultimately, Compliance concluded Taxpayer met the wholesaling and retailing economic nexus thresholds in Washington along with establishing physical nexus. Taxpayer does not dispute the establishment of economic nexus but does dispute the establishment of physical nexus. Compliance determined Taxpayer had established physical nexus through visits to Washington and the Retailers' performance and acceptance of repairs on Taxpayer's behalf.

According to at least one of the Retailers, Taxpayer's "representatives come to the office and check on stores for all of the [Taxpayer] brands at least one meeting a year" in Washington. Compliance Response Exhibit C, Retailer email to the Department dated March 6, 2019. Taxpayer did not address sending representatives to the Retailers' locations in its petition or at the hearing.

According to the [Brand A] website, a consumer may contact its nearest boutique or authorized retailer for repair or maintenance of a [Brand A] item. When asked at the hearing, Taxpayer's representative could not explain what an authorized retailer is. [Brand A] also provides an online tool to locate boutiques and "authorized dealers." [Brand B] lists a [local] Retailer as an authorized repair location for [Taxpayer's goods] on its website. According to at least one of the Retailers in response to a Department summons, if it is asked to repair an item of Taxpayer's, despite where it was originally sold, it will repair the item itself or send it to Taxpayer for warranty repair if the item is under warranty. Compliance Response Exhibit C, Retailer email to the Department, dated March 4, 2019.

Taxpayer does not dispute that a consumer may drop off an item at a Retailer for the Retailer to either repair it or send it to Taxpayer for repair. However, Taxpayer maintains that the service is provided at the discretion of the Retailer.

On October 23, 2020, the Department issued notice of balance due . . . for \$ . . . , which included retailing and wholesaling B&O tax, retail sales tax, penalties, and interest.

Taxpayer timely petitioned for review, arguing it did not have physical nexus with Washington during the Audit Period. Taxpayer argues the Retailers' voluntary act of shipping goods purchased by the retail customer to the Taxpayer for repair does not make the Retailers its agents under common law agency principles, citing to the unpublished Washington Court of Appeals opinion *State v. Warehouse Demo Services, Inc.*, 2 Wn. App. 2d 1065, 2018 WL 1399256 (2018, Unpublished). Taxpayer argues that without the ability to provide direction and exercise some level of control, a party is acting as their own principal and not on behalf of another. Thus, because it was not directing the Retailers to take warranty returns, the Retailers were not its agents. Taxpayer maintains, therefore, it did not have physical nexus with Washington during the Audit Period. Taxpayer does not dispute establishing economic nexus during the Audit Period.

## ANALYSIS

I. Due Process Clause and Commerce Clause

A person must have nexus with Washington in order to be subject to B&O tax on its gross income or subject to retail sales tax on retail sales. It follows that Washington may not assert B&O tax or retail sales tax on revenue from sales of goods that 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*, 170 Wn.2d 838, 246 P.3d 788 (2011), *cert. denied*, 132 S. Ct. 95, 181 L. Ed. 2d 24 (2011).

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. U.S. Const. amend. XIV, § 1; U.S. Const. art. I, § 8, cl. 3. The limitations imposed by the two clauses are discussed in depth in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977); *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992); and in the Department's determinations. See, e.g., Det. No. 01-074, 20 WTD 531 (2001); Det. No. 96-144, 16 WTD 201 (1996). Under established dormant Commerce Clause case law, nexus can be established in many different ways. For example, nexus can be established by third parties acting on behalf of the taxpayer where such activities are significantly associated with the seller's ability to establish and maintain a market. *Tyler Pipe Industries, Inc. v. Dep't of Revenue*, 483 U.S. 232, 250, 107 S. Ct. 2810, 2822, 97 L. Ed. 2d 199 (1987). [A formal agency relationship is not required, and imposing such a requirement would be inconsistent with the practical nexus analysis of modern U.S. Supreme Court precedent, which focuses on the nature of the in-state activity and the extent to which that activity assists the taxpayer in exploiting the taxing state's market.]

Nexus sufficient to meet dormant Commerce Clause constraints may also be established through "substantial virtual connections to the State." *South Dakota v. Wayfair, Inc.*, \_\_\_ U.S. \_\_\_, 138 S. Ct. 2080, 2095, 201 L. Ed. 2d 403 (2018). The simple and overarching inquiry under the dormant Commerce Clause is whether the taxpayer has "avail[ed] itself of the substantial privilege of carrying on business" in the taxing jurisdiction. *Id.* at 2099 (quoting *Polar Tankers, Inc. v. City of Valdez*, 557 U.S. 1, 11, 129 S. Ct. 2277, 2284, 174 L. Ed. 2d 1 (2009)).<sup>2</sup>

Here, Taxpayer has availed itself of the privilege of conducting business in Washington. Taxpayer has engaged in sufficient activities that are significantly associated with establishing or maintaining a market for their . . . goods in Washington. Through the Retailers, it provided repair services that are referenced in its marketing materials. Furthermore, Taxpayer sent its own representatives to the Retailers' locations in Washington, Taxpayer's wholesale customers, yearly. Therefore, Taxpayer established nexus with Washington and it was within the Department's authority to assert B&O tax and retail sales tax on revenue from Taxpayer's sales of goods into the state.

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<sup>2</sup> The nexus limitation imposed by the Due Process Clause is satisfied if "a foreign corporation purposefully avails itself of the benefits of an economic market in the forum state." *Quill Corp.*, 504 U.S. at 307. In questioning the state's assertion of nexus in this case, the Taxpayer's arguments do not specifically address potential differences between the nexus limitations pertaining to the Due Process Clause as opposed to the Commerce Clause. In light of the recent decision by the United States Supreme Court in *Wayfair*, 138 S. Ct. 2080, there may be no material difference between these nexus requirements. However, that is not an issue directly before us in this administrative appeal.

II. RCW 82.04.067

Consistent with this nexus limitation of the Due Process and Commerce Clauses, a person is deemed to have a substantial nexus with this state if the person has a physical presence in this state during the tax year, which need only be demonstrably more than a slightest presence. RCW 82.04.067(1)(c)(ii); Rule 193(102). Nexus may be established through the activities of the seller's own employees, or the activities of independent contractor representatives. RCW 82.04.067(3); Rule 193(102); *Scripto, Inc. v. Carson*, 362 U.S. 207, 211-12, 80 S. Ct. 619, 4 L. Ed. 2d 660 (1960); *Tyler Pipe*, 483 U.S. at 250. The activities of the seller's employees or representatives need not involve the solicitation of sales. Det. No. 14-0383, 34 WTD 265 (2015); Det. No. 00-003, 19 WTD 685 (2000). Any activity 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, and whether the activities generate sales is not determinative. *Space Age Fuels, Inc. v. Washington*, 315 P.3d 604, 178 Wn. App. 756, 766 (2013); *Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 850-51, 246 P.3d 788, 795 (2011); *Standard Pressed Steel Co. v. Dep't of Revenue*, 419 U.S. 560, 561-62, 95 S. Ct. 706, 42 L. Ed. 2d 719 (1975).

Rule 193, the Department's administrative rule on interstate sales of tangible personal property explains that in general, Washington imposes its B&O tax and retail sales taxes on sales of tangible personal property if the seller has nexus with Washington and the sale occurs in Washington.

Rule 193(102)(a) defines whether a person is physically present as follows:

- (i) The person has property in this state;
- (ii) The person has one or more employees in this state;
- (iii) 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 Washington; or
- (iv) The person is a remote seller as defined in RCW 82.08.052 and is unable to rebut the substantial nexus presumption for remote sellers set out in RCW 82.04.067(6)(c)(ii).

Rule 193(102)(d) provides a nonexhaustive list of types of activities that are significantly associated with establishing or maintaining a market for a person's products in Washington:

- (i) Soliciting sales of goods in Washington;
- (ii) Installing, assembling, or repairing goods in Washington;
- (iii) Constructing, installing, repairing, or maintaining real property or tangible personal property in Washington;
- (iv) Delivering products into Washington other than by mail or common carrier;
- (v) Having an exhibit at a trade show to maintain or establish a market for one's products in the state, except as described in subsection (101)(b) of this rule;
- (vi) An online seller having a brick-and-mortar store in this state accepting returns on its behalf;
- (vii) Performing activities designed to establish or maintain customer relationships including, but not limited to:

- A. Meeting with customers in Washington to gather or provide product or marketing information, evaluate customer needs, or generate goodwill; or
- B. Being available to provide services associated with the product sold (such as warranty repairs, installation assistance or guidance, and training on the use of the product), if the availability of such services is referenced by the seller in its marketing materials, communications, or other information accessible to customers.

Taxpayer has engaged in sufficient activities that were significantly associated with establishing or maintaining a market for their . . . goods in Washington both through the Retailers by providing a warranty repair service that is referenced in its marketing materials, and on its own by visiting the Retailers in Washington yearly. Rule 193(102)(d)(vii)(A), (B).

A. Warranty Repairs

Here, the Retailers handle repairs for Taxpayer, including sending warranty repair returns from customers directly to Taxpayer. The availability of the Retailers to provide repair service in Washington is advertised on Taxpayer's websites. The Retailers are thereby engaging in an activity in Washington on Taxpayer's behalf that is significantly associated with the Taxpayer's ability to establish or maintain a market for its products in Washington. Rule 193(102)(d)(vii)(B).

The Department has previously held that acceptance of returns of goods sold by an online seller helps the seller to establish and maintain a market in the state where those returns are accepted. *See* 30 WTD 82, 87-88 (citing *Borders Online, LLC v. State Bd. Of Equalization*, 129 Cal. App. 4th 1179, 29 Cal. Rptr. 3d 176 (Cal. App. 1st Dist 2005)); 29 WTD 10 (2008). The reasoning is that consumers feel more comfortable buying online when they can easily return the product at a local store. *Id.* As *Borders Online, LLC* states, "By accepting Online's merchandise for return, Borders acted on behalf of Online as its agent or representative in California. . . ." 129 Cal App. 4th at 1191; *compare* Det. No. 15-0321, 36 WTD 330 (2017) (A taxpayer did not have nexus in the absence of a cross return policy, and the Department could not consider evidence of a product purchased online returned to a store that occurred outside of the assessment period).

Taxpayer argues it did not have sufficient control over the Retailers to create an agency relationship. However, neither RCW 82.04.067 nor Rule 193(102) require an agency relationship. Furthermore, it is the activity of an agent or representative accepting returns on behalf of the seller that helps to establish and maintain the seller's market in the state. *See* 30 WTD 82, 87 (The creation of an agency or representative relationship can be implied based on conduct, circumstances, or ratification.). Accordingly, the amount of control Taxpayer wields over the Retailers is immaterial. Here, Taxpayer's advertisement of the availability of repair and warranty return services at Retailers' locations on its website implies a representative relationship with the Retailers. The repair and warranty return activities the Retailers perform for Taxpayer are significantly associated with Taxpayer's ability to establish and maintain a market in Washington.

B. Meetings with Retailers

Taxpayer does not dispute that it met with Retailers on a yearly basis to “check on the stores for all of the [Taxpayer] brands.” Compliance Response Exhibit C, Retailer email to the Department dated March 6, 2019. We conclude this meeting was likely to, at the very least, generate goodwill with the Retailer customers, and was therefore an activity to maintain wholesale customer relationships and significantly associated with maintaining Taxpayer’s market for its products in Washington. Rule 193(102)(d)(vii)(B).

Taxpayer, through its own actions and through the Retailers, has engaged in sufficient activities that are significantly associated with establishing or maintaining a market for their . . . goods in Washington to establish substantial nexus with this state. Rule 193(102)(d). Taxpayer’s presence in Washington is demonstrably more than the slightest presence. RCW 82.04.067(1)(c)(ii). Therefore, Taxpayer was required to register, collect and remit retail sales tax, and report and remit B&O tax for the Audit Period.<sup>3</sup>

#### DECISION AND DISPOSITION

Taxpayer’s petition is denied.

Dated this 22<sup>nd</sup> day of December 2021.

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<sup>3</sup> Taxpayer does not dispute establishing economic nexus during the Audit Period. Thus, we do not address it here.