

Cite as Det. No. 17-0075, 36 WTD 592 (2017)

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

In the Matter of the Petition for Correction of) D E T E R M I N A T I O N
Assessment of)
) No. 17-0075
)
...) Registration No. . . .
)

[1] RCW 82.04.067(6); WAC 458-20-193(102)(a) – SUBSTANTIAL NEXUS FOR RETAIL SALES – INDEPENDENT WHOLESALE SALES REPRESENTATIVE. The in-state activities of an independent wholesale sale representative creates sufficient nexus with the state to impose retail sales tax and B&O tax on a taxpayer's internet retail sales where the representative creates a market for taxpayer's products.

[2] RCW 82.32.090; RCW 82.32.105(3); WAC 458-20-228(9) AND (10) – CIRCUMSTANCES BEYOND THE CONTROL OF THE TAXPAYER – LACK OF KNOWLEDGE OF TAX LIABILITY. The lack of awareness that instate activities create nexus does not constitute a circumstance beyond the control of the taxpayer that caused its delinquency.

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.

Stojak, T.R.O. – A company, that retails and wholesales custom glassware, tableware, lighting and home décor, petitions for correction of an assessment of retail sales tax, retailing Business and Occupation (“B&O”) tax, wholesaling B&O tax, and penalties and interest contending that it lacked substantial nexus with Washington during the relevant years. The company also requests a waiver of interest and penalties. In regards to the tax, interest, unregistered business penalty, and delinquent penalty, we deny the petition. In regards to the assessment penalty, we deny the petition in part and grant it in part.¹

ISSUES

1. Pursuant to RCW 82.04.067(6) and WAC 458-20-193, did the in-state activities of an independent wholesale sales representative create sufficient nexus with the state to impose retail sales tax and B&O tax on its retail sales?

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

2. Under RCW 82.32.105(3) and WAC 458-20-228(9) and (10), has Taxpayer demonstrated any circumstance entitling it to a waiver or cancellation of interest and penalties?

FINDINGS OF FACT

... (“Taxpayer”) handcrafts glassware, tableware, and lighting and home décor products, for retail or wholesale sale, across the United States. Taxpayer designs and handcrafts its products at its [out-of-state] workshop. It maintains a few retail shops on the East Coast. Otherwise, it transacts all of its retail sales through the internet. Taxpayer also wholesales its handcrafted products to retailers throughout the United States. Taxpayer uses independent sales representatives to solicit wholesale sales. For the relevant years, Taxpayer paid an independent sales representative to call on Washington retailers and solicit sales of its products. Taxpayer did not report and pay any excise tax to Washington until the second quarter of 2016.

The Department of Revenue (“Department”) Compliance Division (“Compliance”) conducted an examination into Taxpayer’s business activities within the state for the period of April 30, 2012, through March 31, 2016 (“audit period”). Pursuant to this examination, Compliance concluded that Taxpayer’s business activities within the state created sufficient nexus with the state to subject it to the retail sales tax and B&O tax. Based on this conclusion, Compliance issued an assessment on July 7, 2016, for \$ The assessment included retail sales tax of \$. . . , retailing B&O tax of \$. . . on Taxpayer’s internet retail sales, wholesaling B&O tax of \$. . . on its wholesale sales, interest of \$. . . , a delinquent penalty of \$. . . , a five-percent assessment penalty of \$. . . , and a five-percent unregistered business penalty of \$ The due date for payment of the assessment was August 8, 2016.

On July 28, 2016, Taxpayer contacted the Compliance employee that issued the assessment via telephone. Pursuant to this phone call, the Compliance employee advised Taxpayer that it could request abatement of the assessed penalties by sending him a letter that he would forward on to the Department’s Taxpayer Account Administration (“TAA”) Division.² Accordingly, on August 5, 2016, Taxpayer submitted a letter to the Compliance employee, via email, requesting abatement of the penalties included in the July 7, 2016, assessment. The Compliance employee was out-of-state on this day and did not receive the email until his return on August 12, 2016. Prior to his return, on August 9, 2016, the Department assessed Taxpayer an additional ten-percent assessment penalty on its outstanding tax balance. Upon return to the office on August 12, 2016, the Compliance employee forwarded Taxpayer’s letter requesting an abatement of penalties on to TAA.

On August 15, 2016, TAA sent Taxpayer a letter denying its request for an abatement of the assessed penalties. On August 23, 2016, Taxpayer submitted a review petition (“petition”) with the Administrative Hearings and Review Division seeking a review of the assessment. Taxpayer’s petition explains that it was unaware that its use of an independent sales representative to solicit wholesale customers in the state of Washington created sufficient nexus to subject it to tax. It states that “[t]he independent wholesale representative represents the company’s entire northwest area for wholesale sales only” and that “[r]epresentatives do not communicate when they physically visit customer locations or whether sales are done remotely via electronic means.” It

² The Compliance employee entered a note in the Department’s internal computer system to this extent.

further states that “[t]he company has no presence in the state as it relates to retail sales[,]” which are primarily conducted through the internet. In that regard, it protests that “[a] small activity with limited tax liability (\$. . . for 4 years) has created a large liability for other parts of [its] business that have no formal activity in the state.”

Taxpayer’s petition also protests the assessment of penalties and interest in general in its case, which it deems “aggressive.” In particular, Taxpayer protests the assessment of the additional ten-percent assessment penalty on August 9, 2016, noting that it submitted a letter seeking abatement of the penalties prior to the due date of the assessment, but that it was not received until after the due date as a result of the Compliance employee’s absence.

Taxpayer also argues that substantial nexus does not exist in its case. Taxpayer argues that the activity of the in-state sales representative to solicit wholesale sales of its products was minimal during the relevant timeframe. In support of this assertion, Taxpayer highlights the fact that it paid the sales representative for the Northwest region less than . . . dollars for its efforts during the relevant timeframe. In addition, Taxpayer asserts that web sales comprise the majority of its sales, and that the independent sales representative’s activity in Washington did nothing to further its internet retail market. Finally, during the hearing, Taxpayer reiterated its objection to the assessment of penalties and interest in its case, particularly the penalties that accrued after it submitted its letter to Compliance requesting an abatement of the penalties assessed as instructed.

ANALYSIS

Nexus

Washington imposes a B&O tax on “every person that has a substantial nexus with this state . . . for the act or privilege of engaging in business activities” in this state. RCW 82.04.220. The tax is measured by applying particular rates against the value of the products, gross proceeds of sale, or gross income of the business as the case may be. RCW 82.04.220. RCW 82.04.270 imposes the wholesaling B&O tax on entities making sales at wholesale, and RCW 82.04.250 imposes the retailing B&O tax on entities making sales at retail. In addition, persons making sales at retail must collect and remit retail sales tax. RCW 82.08.020, RCW 82.08.050.

WAC 458-20-193 (“Rule 193”) sets forth administrative guidance regarding the application of the B&O tax and retail sales tax to interstate sales; in order to impose these taxes, Rule 193 requires that a seller have nexus with Washington and the sale occur in Washington.³ Rule 193 deems a person to have “nexus” with Washington if the person has a physical presence in Washington, which need only be demonstrably more than the slightest presence. “A person is physically present in this state if . . . [t]he person, either directly or through an agent or other representative, engages

³ [WAC 458-20-193 was amended effective 8/7/15. This amendment did not change the physical presence standard for substantial nexus that was articulated in the previous version of WAC 458-20-193.]

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[.]” Rule 193(102)(a).⁴⁵

Here, Taxpayer does not contest that its customers received its products in Washington. However, Taxpayer asserts that the activity of the independent sales representative it hired to solicit wholesale sales of its products in Washington was insufficient to create substantial nexus during the relevant timeframe. Taxpayer also challenges the imposition of tax in this case based on what it perceives as a lack of a connection between the activities of the independent sales representative and its in-state internet retail sales.

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, 279 (1977); *Quill Corp. v. North Dakota*, 504 U.S. 298 (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). [For Commerce Clause purposes, the] nexus limitation requires the activity taxed have “substantial nexus” with the taxing state.⁶ Nexus can be established by a taxpayer maintaining employees, offices, or other property in this state, regardless of whether the in-state activities of the taxpayer directly relate to the taxed activity. *National Geographic Soc. v. Bd. of Equalization*, 430 U.S. 560, 95 S. Ct. 1386 (1977). Nexus may also 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 (1987).

The determination of whether in-state activities create nexus looks to the entire collection of a taxpayer's different activities, the totality of which creates substantial nexus. *GMC v. City of Seattle*, 107 Wn. App. 42, 25 P.3d 1022 (2001); see also *General Motors Corp. v Washington*, 377

⁴ Rule 193 mirrors the statutory substantial nexus standard pertaining to non-apportionable business activities for purposes of the B&O tax. RCW 82.04.067 as in effect during the audit period stated:

(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.

⁵ Laws 2015, 3rd sp.s. ch. 5 § 204 amended RCW 82.04.067, effective September 1, 2015. Pursuant to this amendment, the economic nexus standard in RCW 82.04.067(1) governs the determination of whether substantial nexus exists for taxpayers engaging in wholesale activity. However, pursuant to RCW 82.04.220(2), a “person who has substantial nexus with the state in any tax year under the provisions of RCW 82.04.067 will be deemed to have a substantial nexus with the state for the following year.” This provision is referred to as “trailing nexus.” As discussed in this determination, Taxpayer established substantial nexus with Washington pursuant to the activity of its independent wholesale sales representative. This nexus trailed to the remainder of 2015 and 2016 despite Washington's adoption of the economic nexus standard.

⁶ The 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 at 307. In questioning the state's assertion of nexus in this case, Taxpayer does not differentiate between the nexus limitations pertaining to the Due Process Clause as opposed to the Commerce Clause. Taxpayer does not raise any argument or provide any fact that would suggest it quarrels with the conclusion that it “purposefully availed itself of the benefits” of the Washington economic market. Accordingly, we concentrate on the more relevant, stringent limitation imposed by the Commerce Clause.

U.S. 436 (1964), *overruled on other grounds*, *Tyler Pipe*, 483 U.S. at 250 (1987) (holding that it is the bundle of corporate activity that determines whether a taxpayer has nexus with a state); WAC 458-20-193. Thus, establishing taxing nexus requires consideration of the entire bundle of a taxpayer's in-state activities.

As stated, the standard for determining whether nexus exists is not whether the in-state activity directly solicits a sale, but rather whether this activity is "significantly associated with establishing or maintaining a market within this state." Rule 193(102)(d). *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. 15-0151, 35 WTD 182 (2016). In *Standard Pressed Steel*, taxable 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. 419 U.S. at 560. Similarly, 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).

The Washington Supreme Court recently found that Commerce Clause requirements were satisfied by "the presence of activities within the state." *Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 850-51, 246 P.3d 788 (2011).⁷ In *Lamtec*, a New Jersey corporation ("Lamtec") that manufactures insulation and vapor barriers challenged Washington's assertion of substantial nexus in its case. Lamtec had no offices or agents permanently in Washington State. Lamtec sold its products to wholesale customers in the state who placed orders over the telephone. About two to three times a year, three Lamtec sales employees visited major customers in Washington. During the visits, the employees did not solicit sales directly, but they answered customer questions and provided information about Lamtec products. The court held that these facts were sufficient to withstand Lamtec's Commerce Clause challenge. In doing so, the court noted that "[t]he contacts by Lamtec's sales representative were designed to maintain its relationship with its customers and to maintain its market within Washington state. Nor were the activities slight or incidental to some other purpose or activity." *Id.* at 851.

The court's holding in *Lamtec* is consistent with the position taken by the Department in published determinations. See, e.g., Det. No. 15-0151, 35 WTD 182 (2016) (out-of-state manufacturer and retailer of party supplies, and fire awareness and education products had substantial nexus with Washington based on regular visits to Washington by independent sales representative to sell products to commercial accounts) and Det. No. 15-0099, 34 WTD 505 (2015) (out-of-state seller of garden supplies had substantial nexus with Washington based on infrequent visits by nonresident employee to maintain customer goodwill).

In this case, Taxpayer argues that the visits by the independent wholesale sales representative were insufficient to create nexus with the state. Taxpayer bases this argument on the fact that the sales representative's efforts in Washington were minimal as evidenced by the low amount of

⁷ *Lamtec* involved a challenge to the imposition of the B&O tax. The retail sales tax was not at issue.

compensation paid to the representative.⁸ We reject this argument. The independent sales representative, hired by Taxpayer directly, solicited sales of Taxpayer's products in Washington. This activity contributed to Taxpayer's ability to maintain a market for its unique products in this state. This activity is sufficient to create nexus based on the standard established by *Lamtec* and recognized in applicable Department determinations. Accordingly, we conclude that the activity of the independent sales representative was sufficient to establish taxing nexus in Washington.

Taxpayer also argues that substantial nexus does not exist in its case due to the lack of connection between the in-state activity of its independent wholesales representative and its internet retail sales in the state. Although not articulated as such, Taxpayer essentially asks us to "dissociate" its wholesale sales from its retail sales.

In general, nexus for one sale is nexus for all sales . . . Det. No. 04-0208, 24 WTD 217 (2005), *citing*, Det. No. 94-209, 15 WTD 96 (1996). The Division I Court of Appeals recently addressed the concept of dissociation in *Irwin Naturals v. State of Washington*, 195 Wn. App. 788, 382 P.3d 689 (2016). In *Irwin*, an out-of-state corporation, in the business of developing, marketing, and selling retail and wholesale nutritional products, contended that the Commerce Clause prohibited Washington from imposing retail sales tax and B&O tax on its retail sales because the target of its in-state activities was the wholesale market. The Court rejected the taxpayer's attempt to dissociate its retail sales from its wholesale sales for purposes of a nexus determination. The Court held that "[f]or purposes of a sales tax, a substantial nexus exists if the corporation has a presence in the taxing state" and for purposes "of a B&O tax, a substantial nexus exists if the corporation's in-state activity aids in establishing or maintaining a market within the taxing state." *Id.* at 795.⁹ The Court concluded that *Irwin*'s in-state wholesale activity satisfied these requirements for purposes of imposing tax on its retail sales.

We note that the taxpayer bears the burden of showing a lack of connection between its nexus creating activities and the sales it seeks to dissociate. *Avnet, Inc. v. State of Washington, Department of Revenue*, 187 Wash.2d 44, 61, 384 P.3d 571, 580 (2016) (*citing Norton Co. v. Department of Revenue of State of Illinois*, 340 U.S. 534, 537 (1951)). Here, a sales representative, hired by Taxpayer, traveled to Washington to solicit sales of Taxpayer's products. This activity created nexus with the state of Washington. While these visits were to wholesale customers, this fact alone is insufficient to show a lack of connection between the visits and Taxpayer's internet sales in Washington. Accordingly, we are unable to conclude that the activity of Taxpayer's independent wholesale sales representative was not significantly associated with its ability to establish and maintain a market for its products in this state. As such, we decline Taxpayer's petition in respect to the assessment of tax.

⁸ As stated, Taxpayer notes that the sales representatives it employed in Washington did not communicate whether sales were solicited pursuant to physical visits or electronically. However, Taxpayer does not dispute that at least some of the sales during the examination period were solicited pursuant to physical visits. Under the standards discussed in this determination, even infrequent visits are sufficient to establish nexus with Washington.

⁹ In *Irwin*, the Court devoted significant analysis to differentiating between substantial nexus jurisprudence in the area of a sales or use tax as opposed to a B&O tax. In regards to the former, the Court noted the preference established by *Quill* for a bright-line "physical presence" test which has survived despite "the trend of eschewing formalistic, inflexible rules[.]" *Irwin*, 382 P.3d at 795 (*citing Quill*, 504 U.S. at 314). In this case, Taxpayer established a physical presence in the state through its independent wholesales representative.

Penalties

The Department operates under a progressive delinquent penalty scheme. Pursuant to RCW 82.32.090(1), if “payment of any tax due on a return to be filed by a taxpayer . . . is not received on or before the last day of the second month following the due date, there *is assessed* a total penalty of twenty-nine percent of the amount of the tax under this subsection.” (emphasis added).

RCW 82.32.090(2) states “[i]f the department . . . determines that any tax has been substantially underpaid, there is assessed a penalty of five percent of the amount of the tax determined by the department to be due. If payment of any tax determined by the department to be due is not received by the department by the due date specified in the notice, or any extension thereof, there is assessed a total penalty of fifteen percent of the amount of the tax under this subsection” A tax is “substantially underpaid” when a taxpayer has paid less than 80% of the tax due and the amount of the underpayment is at least \$1,000. RCW 82.32.090(2).

Under RCW 82.32.090(4), “[i]f the department finds that a person has engaged in any business or performed any act upon which a tax is imposed under this title and that person has not obtained from the department a registration certificate as required by RCW 82.32.080, the department must impose a penalty of five percent of the amount of tax due from that person for the period that the person was not registered as required by RCW 82.32.030.”

The department’s authority to waive or cancel penalties is restricted to the authority granted by the Legislature. Otherwise, the assessment of penalties is mandatory when the conditions for imposing them are met. RCW 82.32.090; Det. No. 01-193, 21 WTD 264 (2002); Det. No. 99-279, 20 WTD 149 (2001). The Legislature has granted the department limited authority to waive or cancel penalties pursuant to RCW 82.32.105. Pursuant to this statute, the department is required to waive penalties when it finds that the underlying act giving cause to the assessment of the penalty, i.e., delinquent payment, was due to circumstances beyond the control of the taxpayer. RCW 82.32.105.¹⁰

WAC 458-20-228(9) (“Rule 228”) defines “circumstances beyond the control of the taxpayer.” It states:

The circumstances beyond the control of the taxpayer must actually cause the late payment. Circumstances beyond the control of the taxpayer are generally those which are immediate, unexpected, or in the nature of an emergency. Such circumstances result in the taxpayer not having reasonable time or opportunity to obtain an extension of the due date or otherwise timely file and pay.

Rule 228(9) goes on to provide a non-exclusive list of circumstances that generally will and will not be considered circumstances beyond the control of the taxpayer. As relevant here, a misunderstanding or lack of knowledge of a tax liability is generally not considered a circumstance beyond the control of the taxpayer, and will not qualify for a waiver of the penalty. Rule 228(9)(a)(iii)(B). Det. No. 01-096, 22 WTD 126 (2003) (“‘Lack of knowledge’ is not a

¹⁰ In the case of a delinquent penalty, the Department may also waive this penalty if the taxpayer has a good filing and payment history. RCW 82.32.105(2).

‘circumstance beyond the control of the taxpayer’ because the law, regulations, and Department publications explaining all tax laws are publicly available . . .”).

In this case, Taxpayer failed to report and pay tax for the relevant period. Taxpayer also failed to obtain a registration certificate as required by RCW 82.32.030. Taxpayer submits that its failure to do so resulted from a lack of awareness that its instate activities created nexus. As provided by Rule 228(9)(iii)(B), this lack of awareness is not considered a circumstance beyond Taxpayer’s control. Accordingly, we deny Taxpayer’s petition as it relates to the assessment of the delinquent penalty and the registration penalty.

In regards to the assessment penalty, Taxpayer substantially underpaid the amount of tax determined by the Department to be due. As discussed, Taxpayer’s underpayment was not the result of a circumstance beyond its control. Accordingly, the five-percent penalty provided in RCW 82.32.090(2) applied. However, in regards to the additional ten-percent assessment penalty, we conclude that Taxpayer did not fail to pay the amount due “by the due date specified in the notice, or any extension thereof[.]” The assessment in this case included a due date of August 8, 2016. Prior to this due date, Taxpayer protested the assessment of penalties and interest in its case. . . . Taxpayer submitted a letter to the Department prior to this due date requesting a waiver of the assessed penalties. . . .¹¹ Taxpayer received a letter denying its request for a waiver of the penalties on August 15, 2016. This letter provided Taxpayer thirty days to request an administrative review of the denial. Taxpayer timely submitted its review petition within the thirty days allotted, thereby further extending the due date for payment. Therefore, we deny Taxpayer’s petition as it pertains to the five-percent penalty included in the original assessment, but grant it as it pertains to the additional ten-percent penalty assessed after Taxpayer timely submitted its request for a waiver.

Interest

When the Department determines that a tax or penalty has not been paid in full, it will assess the additional amount found to be due and add interest on the tax. RCW 82.32.050(1). The imposition of interest is not discretionary. The legislature has mandated the imposition of interest where a taxpayer has failed to timely pay the requisite tax. [Det. 99-042, 19 WTD 784 (2000)]. The Department has the authority to waive interest in two limited circumstances: 1) where the failure to timely pay tax was the direct result of written instructions given to the taxpayer by the department; or 2) where the extension of a due date for payment of an assessment of deficiency was not at the request of the taxpayer and was for the sole convenience of the department. RCW 82.32.105(3); WAC 458-20-228(10). These limited circumstances were not present in Taxpayer’s case. As such, there is no basis to waive the assessed interest.

¹¹ Pursuant to RCW 82.32.160, “[a]ny person having been issued a notice of additional taxes, delinquent taxes, interest, or penalties assessed by the department, may within thirty days after the issuance of the original notice of the amount thereof or within the period covered by an extension of the due date thereof granted by the department petition the department in writing for a correction of the amount of the assessment[.] . . . If no such petition is filed within the thirty-day period the assessment covered by the notice shall be final.” Accordingly, a timely filed petition for correction of an assessment with the Department extends the due date for payment of the assessment. . . .

DECISION AND DISPOSITION

Taxpayer's petition is denied in part and granted in part. We deny the petition with respect to the tax, interest, delinquent penalty, unregistered business penalty, and five-percent assessment penalty. We grant the petition with respect to the ten-percent assessment penalty assessed on August 9, 2016.

Dated this 22nd day of March 2017.