

Cite as Det. No. 14-0157, 33 WTD 539 (2014)

BEFORE THE APPEALS 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)
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 No. 14-0157
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 Registration No. . . .
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[1] WAC 458-20-193: RECEIPT IN WASHINGTON. Out-of-state buyer did not have receipt of goods in Washington because it exercised dominion and control over goods outside of 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.

Sohng, A.L.J. – Out-of-state nutritional supplement manufacturer and wholesaler protests business and occupation (“B&O”) tax imposed on the grounds that [the buyer does not receive the goods] in Washington. The petition is granted.¹

ISSUE

Is there receipt in Washington under WAC 458-20-193(2)(d) [for purposes of establishing a sale in Washington] when an out-of-state manufacturer sells goods to a Washington buyer, but physically delivers such goods to an out-of-state third party that packages the goods for the buyer into retail saleable units?

FINDINGS OF FACT

[Taxpayer] is a . . . limited liability company based [out of state]. Taxpayer has no employees, facilities, or property in Washington. The Department of Revenue’s (the “Department’s) Compliance Division examined Taxpayer’s books and records for the period January 1, 2005, through September 30, 2012. During the examination, Taxpayer submitted a Washington Business Activities Questionnaire (“WBAQ”) to the Compliance Division, which indicated that

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

it earned over \$18 million in revenue from Washington sales and that a sales representative visited Washington once a year to “present new products and discuss forecasts on existing products.” The WBAQ also stated that Taxpayer delivered products into Washington by common carrier. The Compliance Division also stated that in a field visit to a local [nutritional supplement retail] store inquiring about [the product], the “Sales Clerk advised that representatives [of Taxpayer] come into the state to conduct semi-annual training on most products sold at [the store].”² On December 12, 2012, the Compliance Division issued the following assessments against Taxpayer:

Tax Period	Jan. 1, 2005 – Dec. 31, 2007	Jan. 1, 2008 – Sept. 30, 2012	Total
Assessment No.	
Tax³	\$...	\$...	\$...
Penalties
Interest
Total	\$...	\$...	\$...

Taxpayer is a contract manufacturer and wholesaler of vitamins, nutritional supplements, and energy drinks. Taxpayer operates its sole manufacturing plant [out of state]. Taxpayer states that as a contract manufacturer, it does not have any proprietary rights to the goods it manufactures; rather, Taxpayer claims that the parties that engaged Taxpayer for its manufacturing services have all ownership rights over the products. The product at issue in this appeal is an energy drink . . . (the “Beverage”).⁴

. . . (“Buyer”) is located in . . . Washington, and owns the proprietary rights to the Beverage. Buyer sells the Beverage to retailers in Washington, . . . (the “Retailers”).⁵ The Retailers pay Buyer directly for these purchases. Buyer does not itself manufacture the Beverage that the Retailers have purchased; it hires Taxpayer to manufacture it in bulk quantities at its plant [out of state]. Taxpayer states that there is no written manufacturing contract between itself and Buyer and that their relationship is governed only by purchase orders between Taxpayer and Buyer. A typical purchase order between Buyer and Taxpayer provides as follows:

² Response to Taxpayer’s Appeal Petition at 1 (May 23, 2013).

³ The tax assessed consists of wholesaling business and occupation (“B&O”) tax and litter tax.

⁴ Taxpayer’s appeal petition initially contested the portion of the assessment attributable to sales of a weight loss aid . . . Taxpayer also contested nexus in its appeal petition. However, Taxpayer has conceded the tax due on sales of [the weight loss aid]; therefore we will not consider it and assume that Taxpayer agrees that it has nexus in Washington. In general, nexus for one sale is nexus for all sales. See Det. No. 87-69, 2 WTD 347 (1987); Det. No. 94-209, 15 WTD 96 (1996).

⁵ Taxpayer was unable to provide purchase orders or contracts between Buyer and the Retailers.

S O L [Buyer] D ...	S H I [Buyer] P ...
T O Customer number: 100703	T O

CUSTOMER ORDER NO.	SALESPERSON	SHIP DATE	BULK PRICE	ORDER DATE
910-2	1000	6/25/2010		5/20/2010

QUANTITY	ITEM NO.	DESCRIPTION	PRICE
7920	[. . .]	[Beverage] Combo Economy Box 30's Kit	... per 1 ea
		Ship via [Buyer] Acct # 602452 (Special bulk packaging instructions: all bulk powder orders to be packed in 100 kg drums.)	
		Total Amount	...

The purchase orders instruct Taxpayer to manufacture the Beverage in bulk quantities in 100 kilogram drums. The purchase orders do not contain any other information. After manufacturing is complete, Taxpayer delivers the bulk product (contained in large drums) to . . . (“Packager”), an unrelated fulfillment center located [out of state]. There is no evidence that Packager has facilities in Washington. Before Taxpayer delivers the product to Packager, a representative from Buyer sends an email to Taxpayer that authorizes Taxpayer to release the Beverage to Packager and instructs Taxpayer as to how much of the Beverage to deliver to Packager. For example, on April 22, 2010, . . . , Buyer’s Operations Manager, wrote to . . . , Taxpayer’s Senior Vice President of Business Development, the following email:

This is to authorize the release of [the Beverage].

To: Packager
Po: 647
No: 9270 combo boxes (MVM releases)
No: 600 orange boxes
No: 600 grape boxes
No: 120 pink boxes

After Taxpayer delivers the Beverage to Packager, Packager removes it from the large drums and repackages it into smaller, saleable units. Buyer pays Packager a “finishing” fee for these repackaging and assembly services. Taxpayer states that it does not have a written contract with Packager and that its role in the transaction and responsibility to Buyer ends upon delivery of the bulk Beverage to Packager [out of state]. Taxpayer has no further involvement with any aspect of the Beverage after delivery to Packager. Taxpayer’s understanding is that Packager receives further packaging instructions directly from Buyer. Taxpayer states that it does not have access

to any written contracts between Buyer and Packager. Buyer arranges and pays for the shipping of the finished goods from Packager [out of state] to the Retailers in Washington via common carrier, as evidenced by straight bills of lading.

Based on Taxpayer's responses on the WBAQ, the Compliance Division concluded that there was receipt in Washington and that Taxpayer had nexus in Washington. Taxpayer, on the other hand, claims that there is no delivery or receipt in Washington.

ANALYSIS

Washington imposes a B&O tax "for the act or privilege of engaging in business" in this state. RCW 82.04.220. 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).

With respect to the time and place of sale generally, WAC 458-20-103 ("Rule 103") provides, "a sale takes place in this state when the goods sold are delivered to the buyer in this state, irrespective of whether title to the goods passes to the buyer at a point within or without this state." WAC 458-20-193 ("Rule 193") further explains when the Department may tax the sale of goods into this state. Rule 193 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.

Rule 193(7) (emphasis added). Thus, Washington may only impose B&O tax on sales of the Beverage if Buyer receives the goods in Washington and Taxpayer has nexus in Washington. *Id.*

Rule 193 defines the term "delivery," "receipt," and "agent" as follows:

(c) "Delivery" means the act of transferring possession of tangible personal property. It includes among others the transfer of goods from consignor to freight forwarder or for-hire carrier, from freight forwarder to for-hire carrier, one for-hire carrier to another, or for-hire carrier to consignee.

(d) "Receipt" or "received" means the purchaser or its agent first either taking physical possession of the goods or having dominion and control over them.

(e) "Agent" means a person authorized to receive goods with the power to inspect and accept or reject them.

Rule 193(2)(c)-(e). The issue here is whether there is "receipt" in Washington under Rule 193(2)(d). The definition of "receipt" in Rule 193(2)(d) involves either the physical possession of property or dominion and control over it. [Thus], the Rule covers both actual possession and constructive possession. "Actual possession means that the goods are in the personal custody of the person charged with [the crime of] possession; whereas, constructive possession means that the goods are not in actual, physical possession, but that the person charged with [the crime of] possession has dominion and control over the goods." *State v. Callahan*, 77 Wn.2d 27, 29, 459 P.2d 400 (1969) (citing *State v. Walcott*, 72 Wn.2d 959, 435 P.2d 994 (1967)). Although the cases cited above involve the application of law to the crime of possession, they are nonetheless instructive with respect to how constructive possession works in this context.

Black's Law Dictionary contains the following definitions, which are relevant here:

Constructive possession. A person has constructive possession of property if he has power to control and intent to control such item. Exists where one does not have physical custody or possession, but is in a position to exercise dominion or control over a thing.

Control, n. Power or authority to manage, direct, superintend, restrict, regulate, govern, administer, or oversee. The ability to exercise a restraining or directing influence over something.

Dominion. Perfect control in right of ownership. . . . In the civil law, with reference to the title to property which is transferred by a sale of it, dominion is said to be either "proximate" or "remote," the former being the kind of title vesting in the purchaser when he has acquired both the ownership and the possession of the article, the latter describing the nature of his title when he has legitimately acquired ownership of the property but there has been no delivery.

BLACK'S LAW DICTIONARY 217, 229, 338 (6th ed. 1991).

In addition, Washington law defines "constructive possession" in other contexts. With respect to sales by an agent or bailee, it is defined as "possession of the power to pass title to tangible personal property." WAC 458-20-159. And for purposes of the hazardous substance tax, "constructive possession" means that "the person with control does not have physical possession." RCW 82.21.020(3). "Control" refers to "the power to sell or use" the taxable product or "to authorize the sale or use by another." *Id.*

Buyer clearly did not take physical possession of the Beverage [out of state]. So we must examine whether Buyer had constructive possession by exercising dominion and control over the

Beverage [out of state]. The emails that Buyer sent to Taxpayer, by its own terms, “authorize[d] the release of [the Beverage] to Packager.” Buyer also provided direct instructions to Taxpayer regarding the type and quantities of the Beverage that Taxpayer was required to deliver to Packager. Moreover, Taxpayer actually delivered the product in bulk to Packager [out of state] and it did not exercise any further control over the product.⁶ Packager then repackaged the product into smaller quantities at Buyer’s direction. These facts support Buyer’s power and authority to manage, direct, and oversee the Beverage, which is equivalent to the exercise of “a directing influence over something.” The factors present here are consistent with the definitions of “constructive possession,” “control,” and “dominion” cited above. We conclude that Buyer had the requisite dominion and control over the Beverage as required by Rule 193(2)(d).

Our conclusion is supported by Department precedent in which we held that a buyer is not required to take possession of property for a sale to occur for purposes of Rules 103 and 193. In Det. No. 99-216E, 18 WTD 264 (1999), we stated, “The definition of receipt uses the concept of ‘dominion and control’ to cover situations where possession has not transferred from the seller to the buyer, but in substance, a sale has been made.” *See also* Det. No. 88-155, 5 WTD 179 (1988); Det. No. 91-174, 11 WTD 353 (1992) (both holding that constructive delivery occurred in Washington where a seller continued to store the sold goods in Washington at an out-of-state buyer’s request, pending the buyer’s future disposition of the goods).

Because there is no evidence of receipt of the Beverage in this state, Washington may not assert B&O tax under Rule 193(7). The petition is granted.

DECISION AND DISPOSITION

We grant Taxpayer’s petition with respect to sales of the Beverage, but otherwise sustain the assessments.

Dated this 13th day of May, 2014.

⁶ [The Department has long held that there is delivery to an agent of the buyer only when the agent has the power to inspect and accept or reject the goods. *See, e.g.*, Det. No. 99-216E, 18 WTD 264, 273 (1999); Det. No. 06-0028, 26 WTD 97, 103 (2007) *see also* ETA 3091.2009; Rule 193(2)(e), (7). In this case, the Department finds that Packager, as the agent of Buyer, was authorized to receive the goods with the power to accept or reject by Buyer, because the goods were repackaged for sale by Packager. For this reason, we hold there was acceptance of the goods outside the state. The holding in this matter is to be distinguished from cases where an agent has the power to redirect the delivery of goods from out-of-state, but does not have the power to actually accept the goods outside the state.]