Cite as Det. No. 21-0083, 42 WTD 066 (2023)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 21-0083
. . .	)	Registration No. . . .

[1] WAC 458-20-193; RCW 82.04.067: EXCISE TAXES – BUSINESS AND OCCUPATION TAX – SUBSTANTIAL NEXUS. Activities of a parent company with Washington brick and mortar stores that took and placed orders in addition to promoting the subsidiary's products were significantly associated with the subsidiary's ability to maintain a market in Washington, which allowed it to carry on business in Washington and created substantial nexus.

[2] WAC 458-20-203; RCW 82.04.030: EXCISE TAXES – SEPARATE PERSON. Upon merger into the parent organization, a subsidiary entity ceased to exist as a separate legal entity and became a division of the parent and was no longer a separate person or company subject to tax.

[3] WAC 458-20-102; RCW 82.04.470: WHOLESALE SALES – BURDEN OF PROOF. All sales of tangible personal property are treated as retail sales unless the seller takes from the buyer a properly executed reseller permit or timely provides suitable documentation allowed by WAC 458-20-102 to identify and substantiate specific sales as wholesale sales.

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.

Kreger, T.R.O. A company distributing [tangible personal property], disputes tax assessments covering a period when it was a subsidiary of a national [retailer] and a subsequent period after it merged into its parent entity. The company disputes the sufficiency of taxing nexus for pre-merger periods and disputes the taxation of internal transfers for post-merger periods. Additionally, the company asserts that a number of wholesale sales were improperly classified as retail sales. We find that the company established substantial nexus for pre-merger periods based on its relationship with and use of its parent company's Washington retail locations. We also find that the company has not provided sufficient records to characterize disputed transactions as wholesale sales, and we sustain these portions of the assessments. However, for post-merger periods we conclude that the company ceased to exist as a separate legal entity and became part of the parent entity and,

therefore, there was no longer a basis to tax accounting entries as if they were still taxable intercompany transfers. The Taxpayer's petitions are granted in part and denied in part.[1]

ISSUES

1. For pre-merger periods, under RCW 82.04.067 and WAC 458-20-193, is substantial nexus with Washington established for an out-of-state company, where its parent entity with nexus in Washington promotes, markets, and places sales orders at Washington retail locations for the Taxpayer's products?

2. Does the continued use of the federal tax identification number created before a legal merger provide a basis to treat a division of a company as a separate "person" or "company" as defined by RCW 82.04.030?

3. Has the taxpayer provided sufficient detail to substantiate that the nature of certain disputed sales were properly reported as wholesale sales rather than retail sales under RCW 82.04.470(1) and WAC 458-20-102?

FINDINGS OF FACT

. . . , LLC (Taxpayer) is a distributor of [tangible personal property], based . . . [outside of Washington State]. The Taxpayer was originally set up as a Delaware single member Limited Liability Company. In . . . [Parent Company], a national retailer . . . of [tangible personal property], purchased the Taxpayer. The Taxpayer operated as a subsidiary of . . . [Parent Company] until . . ., when the Taxpayer was merged into . . . [Parent Company] and has operated as a division of . . . [Parent Company] since that time.

The Department of Revenue selected the Taxpayer for a review of its Washington business activities. The Audit Division conducted a review of both pre- and post-merger activities that identified additional tax due and issued an assessment and corresponding audit report for those periods. For the pre-merger period, the Audit Division issued an assessment, Letter ID: . . . in the amount of $. . . , covering the period of January 1, 2010, through July 31, 2014.[2] For the post-merger period, the Audit Division issued an assessment, Letter ID: . . . , in the amount of $. . . , covering the period of August 1, 2014, through January 31, 2017.[3] The Taxpayer timely filed petitions for review contesting both assessments, which were consolidated on review and are both addressed here.

The Taxpayer makes primarily wholesale sales of [tangible personal property], but also makes some retail sales. The Taxpayer was structured to focus on business-to-business sales transactions and did not have a substantial focus on retail sales.

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

[2] The pre-merger assessment comprised a tax adjustment of $. . . , [($. . . in wholesaling B&O tax, $. . . in retailing B&O tax, and $. . . in retail sales tax)], interest of $. . . , and a penalty adjustment of $. . . .

[3] The post-merger assessment comprised a tax adjustment of $. . . , [($. . . in wholesaling B&O tax, $. . . in retailing B&O tax, and $. . . in retail sales tax)], interest of $. . . , and a penalty adjustment of $. . . .

For the pre-merger period, the Taxpayer asserts that its primary sales mechanism was through the . . . catalog, which was available in print and electronic versions. The Taxpayer did not have property, employees, or independent contractors located in Washington for the pre-merger period.

The Taxpayer acknowledges that the majority of its sales were primarily . . . [through Parent Company] with more limited sales to other purchasers placed directly with the Taxpayer through its website and through direct phone orders. Orders placed through the Taxpayer's website or direct catalog purchases ordered from the Taxpayer could not be returned to . . . [Parent Company] stores. The Taxpayer asserts that its . . . catalogs were not made available in the . . . [Parent Company] stores. The . . . catalogs were discontinued shortly after the merger.

For the . . . [Parent Company] sales, the customer would come into. . . [a Parent Company] retail store to place a special order. . . . [A Parent Company] sales associate would initiate a purchase from the Taxpayer on a store computer that would track the order as a special-order purchase by . . . [Parent Company] from the Taxpayer. The products ordered were primarily shipped via common carrier[,] and the Taxpayer did not charge the customer for shipping costs. Most orders were shipped from distribution centers located outside of Washington, although on occasion orders were shipped directly from a manufacturer or vendor.

The Audit Division provided exhibits of . . . Catalogs and . . . [Parent Company] special order catalogs that were focused on different product lines such as . . ., as well as . . . [Parent Company] marketing and promotional materials that also carried the Taxpayer's logo. The . . . [Parent Company] special order catalogs and marketing materials carried a smaller . . . logo in addition to the . . . [Parent Company] logo. The Audit Division also provided a copy of . . . [Parent Company] marketing materials that detailed information on the special services that . . . [Parent Company] offers to professional customers, including details about the Taxpayer's product lines.

The Taxpayer asserts that for pre-merger periods it had not established substantial nexus with Washington[,] and the . . . [Parent Company] special orders should be considered as a wholesale sale between the Taxpayer and . . . [Parent Company].

For the post-merger period, the Audit Division assessed tax on transfers between the Taxpayer and its parent because the accounting records and consolidated returns continued to use the Taxpayer's federal tax identification number (FEIN). The Audit Division requested a copy of IRS Form 966 for Corporate Dissolution or Liquidation, to support the change in status from a subsidiary to a division with the merger.

The Taxpayer provided a copy of the State of . . . Certificate of Merger dated August 4, 2014, and notes that under Washington Rule of Evidence 902, a certificate of merger from another state is considered a self-authenticating document. The Taxpayer transferred title to all of its tangible and real property, as well as its employees, to . . . [Parent Company]. *See* August 4, 2014, Certificate of Merger. Additionally, the Taxpayer notes that it could not provide a copy of Form 966 requested by the auditor because this form does not apply to a single member LLC, which was the Taxpayer's corporate form prior to the merger. For pre-merger federal tax filings, the Taxpayer was considered a disregarded entity and was not a separate filer, but rather filed through the . . . [Parent Company's] consolidated federal tax returns. The Taxpayer explains that continuing to use the old

FEIN number to track the Taxpayer's activities and transaction in . . . [Parent Company] records post-merger was primarily attributable to labels and identification used when the files were initially set up in . . . [Parent Company's] accounting software and emphasized that these tracking and recordkeeping practices do not indicate that the Taxpayer continued to exist as a separate entity after the merger. The failure to remove or change this information was done as a matter of convenience and to maintain consistency in internal accounting records.

Finally, the Taxpayer asserts that some of the sales identified as retail rather than wholesale in the audit were properly reported as wholesale sales. The Taxpayer indicated that supporting detail for specific transactions it was disputing was stored in an archive and that it was in the process of obtaining this supporting detail, and would provide additional information identifying specific transactions with records to support their classification as wholesale sales. To date additional detail to support the wholesale nature of these specific transactions has not been received.

ANALYSIS

The B&O tax is imposed on every person for the act or privilege of engaging in business activities in Washington.[4] RCW 82.04.220. RCW 82.04.030 defines "person" to include corporations, limited liability companies, associations, and any group [of] individuals acting as a unit, whether nonprofit, or otherwise. "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 B&O 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. Washington imposes a B&O tax on various tax classifications, including making retail sales under RCW 82.04.250 and wholesale sales under RCW 82.04.270.

Washington law imposes retail sales tax on every retail sale in this state. RCW 82.08.020. The definition of "retail sale" excludes "[p]urchases for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person." RCW 82.04.050(1)(a)(i). A "wholesale sale" is [generally] defined as "any sale, which is not a sale at retail." RCW 82.04.060(1).

1. Substantial Nexus:

RCW 82.04.067 establishes the statutory "substantial nexus" thresholds that apply to persons engaging in business. A person is physically present in this state if the person has property or employees in this state. [RCW 82.04.067(3)(a).] The statute further explains that:

[4] The Legislature "intended to impose the business and occupation tax upon virtually all business activities carried on within the state." *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn.2d 139, 149, 3 P.3d 741 (2000) (quoting *Time Oil Co. v. State*, 79 Wn.2d 143, 146, 483 P.2d 628 (1971)). Unlike the federal income tax, the B&O tax is not a tax on profit, net gain, capital gain, or sales "but a tax on the total money or money's worth received in the course of doing business." *Budget Rent-A-Car of Wash.-Oregon v. Dep't of Revenue*, 81 Wn.2d 171, 173, 500 P.2d 764 (1972). The B&O tax provisions "leave practically no business and commerce free of the business and occupation tax." *Id.* at 175.

> A person is also physically present in this state for the purposes of subsection (1)(c)(ii) of this section 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.

RCW 82.04.067(3)(b).[5]

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. The rule explains that in order for Washington to impose these taxes, a seller must have nexus with Washington and the sale must occur in Washington. Rule 193.

Rule 193 discusses nexus, in pertinent part, as follows:

> **Nexus**. . . . A person who sells tangible personal property is deemed to have nexus with Washington if the person has a physical presence in this state, which need only be demonstrably more than the slightest presence.
> . . .
> (a) **Physical presence.** A person is physically present in this state if:
> . . .
> (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;

Rule 193(102) (emphasis in original).

Washington does not assert B&O tax on sales of goods that originate outside this state unless the purchaser receives the goods in Washington and the seller has nexus with Washington. *See, e.g., Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 246 P.3d 788 (2011), *cert. denied*, 565 U.S. 816 (2011). As detailed above[,] actions of a representative or agent can establish nexus. RCW 82.04.067(3)(a); Rule 193(102)(a)(iii).

The nexus limitation requires the activity taxed have "substantial nexus" with the taxing state. "[S]uch a nexus is established when the taxpayer [or collector] 'avails itself of the substantial privilege of carrying on business' in that jurisdiction." *South Dakota v. Wayfair*, 585 U.S. ___, 138 S. Ct. 2080, 2099 (2018) (quoting *Polar Tankers, Inc.* v. *City of Valdez*, 557 U. S. 1, 11 (2009)).
. . .

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,

[5] In 2016, the Legislature made several changes and updates to RCW 82.04.067, including creation of subparagraphs in RCW 82.04.067(6) to provide for more logical organization, but despite this reorganization, the language of the original statute in paragraph (6) was retained and remains substantially as shown.

is sufficient to establish nexus. WAC 458-20-193(7). *See Standard Pressed Steel Co. v. Dep't of Revenue*, 419 U.S. 560, 95 S. Ct. 706 (1975); *Nat'l Geographic Soc. v. California Bd. of Equalization*, 430 U.S. 551, 97 S. Ct. 1386 (1977). *See also* Det. No. 04-0148, 6 WTD 417 (1988).[6] Any activity performed in this state on behalf of the seller that is significantly associated with the seller's ability to establish or maintain a market in this state for its sales establishes nexus over the seller. Rule 193. *See Lamtec*, 170 Wn.2d at 851.

The activities of an affiliated company with nexus that support the market for an out-of-state affiliate can establish taxing nexus for the out-of-state affiliate. In *Borders Online, LLC v. State Board of Equalization*, 129 Cal. App. 4th 1179, 29 Cal. Rptr. 3d 176 (2005), the court held that the activities of related brick-and-mortar stores, which operated through a separate but affiliated entity, established nexus for Borders Online, which did not have direct activities in California. The California court concluded the advertising and solicitation activities by the affiliated company, the separately owned brick-and-mortar stores, which accepted returns and exchanges of merchandise purchased online and promoted the website, acted as the online entity's representative and established nexus. *Id.* at 190. The court concluded that:

> The cross-selling synergy was also maintained by the use of similar logos, by the link to Borders' website from Online's website, and by the sharing of some market and financial data between the two entities. Online generated more than $1.5 million in sales in California in 18 months. These facts amply support the conclusion that Online had a representative with a physical presence in the State and the representative's activities were "'significantly associated with [Online's] ability to establish and maintain a market in [the] state for the sales.'"

Id. at 190-91 (internal citations omitted); *accord New Mexico Taxation and Revenue Dep't v. Barnesandnoble.com LLC*, 303 P.3d 824 (N.M. 2013). . . . [Here,] the question is whether the activities of the Taxpayer's parent, . . . [Parent Company], in marketing the Taxpayer's products and accepting and placing orders for the Taxpayer, were sufficient to establish substantial nexus with Washington.

The Taxpayer emphasizes that its . . . catalogs were not distributed through the . . . [Parent Company] retail stores. However, this does not negate the fact that the Taxpayer's logo and brand name were present on a variety of . . . [Parent Company] special order catalogs, as well as other marketing and promotional materials. The Taxpayer asserts that for a customer making a special-order purchase at . . . [a Parent Company] retail store there was no difference from making a special order from an unaffiliated vendor. While a customer may not have been aware of the ownership relationship between the Taxpayer and . . . [Parent Company], the key fact is that . . . [Parent

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[6] 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).

Company] directly promoted the Taxpayer's products and allowed customers to directly place orders for the Taxpayer's products at . . . [Parent Company] Washington retail locations.[7]

The Taxpayer also notes that unlike the *Borders Online* case addressed above, it maintained a separate, distinct business name and that direct purchases made through its website or catalogs could not be returned to . . . [Parent Company] stores. Taxpayer asserts that its activities in Washington should not be considered substantial. We disagree. While there is not the same brand name overlap as in the *Borders Online* case, we find that the cross-promotion activities are substantially similar to the cross-selling synergy addressed in *Borders Online.* Furthermore, in addition to the promotional activities, here, the parent company actually directly took and placed orders for its affiliate at its retail locations, which is a direct sales activity that was not present in *Borders Online*. Here . . . [Parent Company] went beyond simply promoting and marketing the Taxpayer to its customers, and enabled the Taxpayer's customers to place orders at . . . [Parent Company's] retail locations. We find that these activities were significantly associated with the Taxpayer's ability to maintain a market in Washington, which allowed it to carry on business in Washington and created substantial nexus. The Taxpayer's petition is denied on this issue.

2. Impact of Merger:

The general rule is that transactions between affiliated companies are subject to B&O tax. *See* Det. No. 96-046, 16 WTD 74 (1996); ETA 3134.2009. The separate treatment of separately incorporated entities is fundamental to Washington's tax system. Det. No. 02-0154R, 24 WTD 134 (2005) (citing WAC 458-20-203 (Rule 203)).[8] This is true regardless of the corporations' affiliations. *Id*. Absent abuse of those separate forms, the Department will recognize each entity individually for purposes of the taxes it administers. Det. No. 98-004, 17 WTD 231 (1998).

In this case the Audit Division relies on the continued use of the Taxpayer's FEIN post-merger in records and materials that track the Taxpayer's activities for the parent company's consolidated tax returns. The Audit Division, however, does not provide any support or authority for the assertion that mere continued use of a FEIN indicates status as a separate entity.
Pre-merger, while organized as a separate, affiliated entity, the transactions between the Taxpayer and . . . [Parent Company] were taxable. However, upon the merger in . . ., the Taxpayer ceased to exist as a separate entity and became a division of the parent entity. In Det. No. 02-163, 22 WTD 262 (2003), we held that a corporate division cannot separately incur its own retail sales tax

[7 Parent Company's activities establish that it was acting as an agent or representative of Taxpayer. During the period at issue Parent Company's activities included: carrying Taxpayer's logo on Parent Company's special-order catalogs, detailing Taxpayer's product lines on Parent Company . . . marketing materials, providing support to customers interested in making a special order of Taxpayer's product, and accepting orders for the Taxpayer's products.]

[8] Rule 203 provides:

> Each separately organized corporation is a "person" within the meaning of the law, notwithstanding its affiliation with or relation to any other corporation through stock ownership by a parent corporation by the same group of individuals.
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> Each corporation shall file a separate return and include therein the tax liability accruing to such corporation. This applies to each corporation in an affiliated group, as the law makes no provision for filing of consolidated returns by affiliated corporations or for the elimination of intercompany transactions from the measure of tax.
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> Each unincorporated association organized under the Massachusetts Trust Act of 1959 (chapter 23.90 RCW) is likewise taxable in the same way as are separate corporations.

obligation[,] and we find that conclusion applicable to this case. After the merger the Taxpayer and . . . [Parent Company] were no longer each a separate "person" or "company" as defined by RCW 82.04.030, but rather became a single entity[,] and so there was no longer a separate transaction subject to tax. The Taxpayer's petition is granted on this issue[,] and we remand for adjustment of the assessment to remove the assessment of tax on post-merger transfers.

3. Wholesale Sales:

Unless a seller has taken from a buyer a reseller permit, the burden of proving that a sale is a wholesale sale rather than a retail sale is upon the person who made it. RCW 82.04.470(1). If a seller does not receive a reseller permit at the time of the sale, have a reseller permit on file at the time of the sale, or obtain a reseller permit from the buyer within a reasonable time after the sale, the seller shall remain liable for the retail sales tax. RCW 82.04.470(1). All sales are treated as retail sales unless the seller takes from the buyer a properly executed reseller permit or other documentation described below. WAC 458-20-102(5) (Rule 102(5)). A taxpayer may prove the exempt nature of a transaction (using an exemption certificate or other means) within 90 days of the sale, 120 days of the Department's request, or a longer period as provided by Department rule. RCW 82.08.050(7).

The Taxpayer asserted that some wholesale sales were improperly recategorized as retail sales and stated that it would be providing additional records to identify the specific sales at issue and substantiate that these were properly reported as wholesale transactions. However, to date no such records or detail have been produced. Absent such information, we affirm that the transactions were properly subject to tax as retail sales in the assessment and deny the Taxpayer's petition on this issue.

If the Taxpayer can provide additional records that would be sufficient to characterize a particular sale as a wholesale sale under the provisions of Rule 102, it may pay the tax and file a petition for refund. Application for refund or credit cannot be made for taxes paid more than four years prior to the beginning of the calendar year in which the refund application is made, or examination of records is completed. RCW 82.32.060(1). Additional information on requirements and procedures for claiming a refund can also be found in WAC 458-20-229.

DECISION AND DISPOSITION

Taxpayer's petition is denied in part and granted in part. We deny the petition with respect to creation of substantial nexus and substantiation of disputed wholesale sales. We grant the petition with respect to imposition of tax on internal transactions for post-merger periods.

Dated this 20th day of April 2021.