No. 92080-0

SUPREME COURT OF THE STATE OF WASHINGTON

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent,

v.

AVNET, INC.,

Petitioner.

AMICUS CURIAE MEMORANDUM OF THE COUNCIL ON STATE TAXATION

Gregg D. Barton, WSBA No. 17022
PERKINS COIE LLP
1201 Third Avenue, Suite 4800
Seattle, WA 98101-3099
Telephone: 206.359.8000
Facsimile: 206.359.9000
Attorneys for *Amicus Curiae*
Council On State Taxation

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INTRODUCTION

This case concerns the Department of Revenue ("DOR") ignoring United States Supreme Court Dormant Commerce Clause precedent and its own rules when assessing the State's Business and Occupation ("B&O") tax on Avnet, Inc. ("Avnet") for two types of transactions Avnet made to customers in Washington, when Avnet did not have the requisite contacts with the State for the DOR to impose the B&O tax with respect to those transactions.

Under Dormant Commerce Clause jurisprudence, a state must adhere to the four-prong test set out by the United States Supreme Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). Furthermore, the DOR must also follow its own properly promulgated rules. *Amicus* does not dispute Avnet was properly assessed taxes for its transactions associated with its office in Redmond, Washington. However, Avnet's transactions that were solicited, fulfilled and shipped by out-of-state Avnet offices and facilities for out-of-state customers to Washington destinations, through "National Sales"[1] and "Third Party Drop-Shipped Sales"[2] are not includable as taxable sales for the B&O. These

[1] National Sales include transactions where the customer requests shipping to many locations, including at least one location in Washington (*e.g.* Company X, a Nevada company, placing an order with Avnet's office in Arizona for products to be shipped (at least in part) to one of Company X's offices in Seattle, Washington).

[2] Third Party Drop-Shipped Sales include transactions where the customer requests shipping to a third party in Washington (*e.g.* Company Y, a Nevada company, placing an order with Avnet's office in Arizona, directing Avnet to ship the products to Company Y's customer in Spokane, Washington).

transactions are protected by both the Dormant Commerce Clause and a DOR rule allowing a company to dissociate certain out-of-state transactions. *Id.*; *see* also WAC 458-20-193 ("Rule 193").[3]

When the DOR imposed the B&O tax on the National Sales and the Third Party Drop-Shipped Sales, the DOR overstepped its authority. This Court needs to review the Court of Appeals' decision upholding the DOR's assessment that impermissibly expands the scope of the B&O tax and determine whether Rule 193, as in effect at the time, was binding on the DOR. If Rule 193 is not binding, this Court needs to address whether the taxes on Avnet's disputed transactions comply with the "substantial nexus over the activity" prong of *Compete Auto.* *Id.* at 279.

IDENTITY AND INTEREST OF *AMICUS*

The Council on State Taxation ("COST") is a nonprofit trade association based in Washington, D.C. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce. Today COST has grown to an independent membership of nearly 600 major corporations engaged in interstate and international business. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multi-jurisdictional business entities. COST members employ a substantial number of Washingtonians,

[3] Unless otherwise provided, all references to Rule 193 are to the version of that rule in effect prior to the changes finalized on August 7, 2015.

own extensive property in Washington, and conduct substantial business in Washington.

COST's membership is very concerned with the Court of Appeals decision allowing the DOR to ignore one of its own rules and subject taxpayers' transactions to gross receipts taxation in violation of the protections afforded under the Dormant Commerce Clause. Because the DOR seeks to improperly apply the B&O tax against Avnet, Inc. and other multijurisdictional businesses, COST has a keen interest in providing this Court with reasons why it should review the lower court's controversial decision.

Consistent with RAP 13.4(b), this Court should accept review because this decision conflicts with a prior decision of this Court, *B.F. Goodrich Co. v. Washington*, 38 Wn.2d 663, 231 P.2d 325 (1951), and with the U.S. Supreme Court's decision in *Norton Co. v. Dep't of Revenue of Illinois*, 340 U.S. 534 (1951). Additionally, the issue presented is a matter of substantial public interest because of its impact on interstate commerce.

STATEMENT OF THE CASE

COST adopts the Statement of the Case set forth by Petitioner in its Petition for Review. Pet. for Rev. 2-6.

ARGUMENT

I. THE DEPARTMENT OF REVENUE IS BOUND BY ITS PUBLISHED RULES

Avnet's business activities fall squarely within the purview of Rule 193, but the Court of Appeals' ruling allowed the DOR to disavow its own rule without a prospective repeal or amendment of that rule.[4] If the DOR is allowed to simply ignore its own rules where it suits its own purposes, taxpayers will no longer be able to rely on such rules and taxpayers' confidence with Washington's state and local tax system will suffer irreparable harm.

The Court of Appeals relied upon *Ass'n of Wash. Bus. v. Dep't of Revenue*, 155 Wn.2d 430, 446-7, 120 P.3d 45, 54-55 (2006), to support its determination that the DOR may ignore its own rule because it was merely interpretive; however, the Court's reliance on this case was misplaced.

The Court of Appeals properly cited *Ass'n of Wash. Business* for the proposition that, if a taxpayer challenges an interpretive rule such as Rule 193, the court is not bound by the rule. *Avnet, Inc. v. Dep't of Washington*, No. 45108-5-11 (Apr. 28, 2015), *citing Ass'n of Wash. Business v. Dep't of Revenue*, 155 Wn.2d at 447. When the DOR issues interpretive rules, it is publishing its position on how it understands a tax statute. However, that guidance is not binding on taxpayers, who are free

[4] *See* Pet. for Rev. 17-20.

to challenge the DOR's position as promulgated in its rule. It is the court's duty to decide whether the DOR's interpretive rule or a taxpayer's position is correct.

Ass'n of Wash. Business did not address the DOR disavowing a position in its rule. As this Court noted: "[the] DOR will stick by its rules (whether interpretive, procedural, or legislative) unless and until they are stricken by a court. For interpretive rules in particular, DOR will maintain it interpreted the underlying statutes correctly, and any taxpayer who disagrees will have to persuade a court otherwise." *Ass'n of Wash.* at 447-48. Thus, while *Ass'n of Wash. Business* stands for the proposition that taxpayers and courts are not bound by interpretive rules in cases of taxpayer challenges, it did not relieve the DOR from following its own rules, or authorize the courts to allow the DOR to retroactively reverse its position on a published rule upon which a taxpayer has relied.

Other Washington courts have determined that "[a]dministrative agencies are bound by their own rules."[5] Further, Washington is not alone in this determination. In *U.S. v. Nixon*, 418 U.S. 638, 694-96 (1974), the U.S. Supreme Court, considering whether the Attorney General was bound by a rule defining the Special Prosecutor's authority, noted the following:

> [I]t is theoretically possible for the Attorney General to amend or revoke the regulation defining the Special Prosecutor's authority.

[5] *See Skamania County v. Woodall*, 104 Wn. App. 525, 539, 16 P.3d 701, 708 (2001), *citing Deffenbaugh v. DSHS*, 53 Wn. App. 868, 871, 770 P.2d 1084, 1085 (1989).

> But he has not done so. So long as this regulation remains in force the Executive Branch is bound by it . . . .

Id. at 696. Other courts have also held that agencies are bound by their rules until such rules are repealed.[6]

If the states' taxing agencies are no longer bound by their own rules and allowed to repudiate promulgated rules at their convenience, the state and local tax system of voluntary compliance will be seriously undermined. First, the public will no longer be able to rely on any agency pronouncements. Although taxpayers are not required to follow the DOR's interpretive rules contrary to their understanding of tax statutes, taxpayers need to be able to rely on rules that comport with their reading of the law. Rules, including interpretive rules, are intended to provide guidance on the accepted procedures and policies of the DOR, which taxpayers use to obtain certainty when filing their state tax returns as well as financial statements. *See Hansen Baking Company*, 48 Wn.2d at 743-744 ("If it were permissible for a taxing agency to challenge, years later, [its lawful] rules promulgated by its own enforcement agency, taxpayer would never be able to close their books with assurance.") It is critical for taxpayers to be able to rely on the interpretations of the DOR, the agency charged with administering the B&O tax laws, so that they can voluntarily

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[6] *See also Burke v. Houston NANA L.L.C.*, 222 P.2d 851, 868 (Alaska 2010); *Eastwood Nursing and Rehab. v. Dep't of Pub. Welfare*, 910 A.2d 134, 144 (Pa. Commw. Ct. 2006), c*iting Dep't of Envtl. Res. v. Rushton Mining Co.*, 591 A.2d 1168, 1173 (Pa. Commw. Ct. 1991) and *Home Builders Ass'n of Chester v. Dep't of Envtl. Prot.*, 828 A.2d 446, 450 (Pa. Commw. Ct. 2003).

comply with the law and avoid costly controversy and litigation.

Considering the significant consequences that the Court of Appeals decision could have, this Court should review this case to make clear the holding in *Ass'n of Wash. Business* does not allow the DOR to ignore its own promulgated rules, nor the Court of Appeals to relieve the DOR of its obligation to do the same.

II. THE U.S. CONSTITUTION'S DORMANT COMMERCE CLAUSE PROTECTS BUSINESSES' GROSS RECEIPTS DISSOCIATED FROM ANY INSTATE ACTIVITY FROM BEING SUBJECT TO TAXATION BY A STATE.

There is no dispute that the State of Washington had the requisite "substantial nexus" under the U.S. Supreme Court's first prong of its four-prong test in *Complete Auto* to impose its B&O tax on some of Avnet's gross receipts transactions. However, the U.S. Supreme Court was clear in *Complete Auto* that the test for whether a taxpayer had sufficient contacts with a state was not whether the taxpayer itself had substantial nexus, but whether the activity conducted by the taxpayer had substantial nexus with the state.[7]

The DOR in its response brief asserts the Court of Appeals correctly determined that a U.S. Supreme Court case, *Tyler Pipe Indus., Inc. v. Dep't of Revenue*, 483 U.S. 232 (1987), set the controlling precedent for the U.S. Supreme Court's nexus standard. *See* Ans. to Pet.

[7] "We note again that no claim is made that [1] *the activity is not sufficiently connected to the State* to justify a tax, or [2] that the tax is not fairly related to benefits provide the taxpayer, or [3] that the tax discriminates against interstate commerce, or [4] that the tax is not fairly apportioned." *Complete Auto* at 287 (emphasis added).

for Rev. 1-2. However, that case simply affirmed that a person assisting an out-of-state business in establishing and maintaining the marketplace can create substantial nexus for a taxpayer. *Tyler Pipe* at 250. *Scripto Inc. v. Carson*, 362 U.S. 207 (1960), an earlier case that stands for substantially the same proposition, did not suddenly eviscerate prior U.S. Supreme Court holdings requiring the state, especially for gross receipts taxes, to have substantial nexus over the activity taxed.[8]

Reliance on the U.S. Supreme Court's decision in *Standard Press Steel Co. v. Dep ' t of Revenue*, 419 U.S. 560 (1975), by the DOR and the Court of Appeals is also unfounded.[9] In that case, there was no attempt by the taxpayer to dissociate its salesperson's activity from the actual sales being made to a customer in Washington. A salesperson creates substantial nexus in the state when that person solicits sales. *See Northwest Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959). In contrast to *Standard Press Steel*, Avnet was able to identify those transactions that are connected with its in-state and out-of-state offices. This misconstruction and misapplication of *Standard Press Steel*, alone, warrants the need for this Court to review this case.

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[8] As noted by the U.S. Supreme Court in *Nat'l Geographic v. Cal. Bd. of Equalization*, 430 U.S. 551 (1977), the Court upheld the California Supreme Court's decision that California could impose its compensatory use tax (compensatory to the State's sales tax) based on there being "no risk of double taxation." *Id.* at 559.

[9] And, similarly, any reliance on *General Motors Corp. v. State*, 60 Wn.2d 862, 376 P.2d 843 (1962), and the U.S. Supreme Court's review of that case, *General Motors Corp. v. Washington*, 377 U.S. 436 (1964), is misplaced. General Motors failed to prove its out-of-state wholesaling activity was dissociated from General Motors' district managers and others assisting retail dealers in the State. As noted by the U.S. Supreme Court in *Tyler Pipe*, "*General Motors* is not a controlling precedent." *Id.* at 242.

Most importantly, the U.S. Supreme Court's decision in *Norton Co. v. Dep't of Revenue of Illinois*, 340 U.S. 534 (1951), is still controlling.[10] As pointed out by the Court in *Norton*, sales and use tax cases are distinguishable because the tax is principally imposed "on the local buyer or user." *Id.* at 537. That is definitely not the case with this State's B&O tax. As stated by the Court "[t]he only items that are so clearly interstate in character that the State could not reasonably attribute their proceeds to the local business are orders sent directly to [the out-of-state location] by the customer and shipped directly to the customer from [the out-of-state location]. Income from those we think was not [constitutionally] subject to [Illinois' gross receipts] tax." *Id.* at 539. "[A business] can avoid taxation on some Illinois sales only by showing that particular transactions are dissociated from the local business and interstate in nature." *Id.* at 537. Similar to *Norton*, Avnet was able to identify the out of state transactions that are dissociated from its transactions where its instate office facilitated the sale.

The U.S. Supreme Court clearly knows how to overrule prior laws which no longer support the principle in an underlying case. In the same year that *Norton* was decided, 1951, the U.S. Supreme Court also issued a decision in another Dormant Commerce Clause case, *Spector Motor Serv.,*

[10] Immediately after that decision, this Court issued its holding in *B.F. Goodrich Co. v. State of Washington*, 38 Wn.2d 663 (1951), reversing the DOR's unconstitutional attempts to apply the B&O tax to apply the B&O tax to facts that "strongly resembles the case at bar." *Id.* at 670.

Inc. v. O'Connor, 340 U.S. 602 (1951). The Court in *Spector* held that "there is … long-established precedent for keeping the federal privilege of carrying on exclusively interstate commerce free from state taxation. To do so gives lateral support to one of the cornerstones of our constitutional law—*McCulloch v. Maryland,* [17 U.S. 316 (1819)]." *Spector* at 610. In 1977, the U.S. Supreme Court overruled the *Spector* case in its landmark *Complete Auto* decision. *Complete Auto* at 288-89. If the Court had also determined that *Norton* outlived its usefulness, which it has not, it would have also stated in *Complete Auto* that *Norton* was no longer good authority to limit the states' ability to impose gross receipts taxes on businesses engaged in interstate commerce. This is an important constitutional issue warranting this court's review.

CONCLUSION

For these reasons stated above, COST urges the Court to review the decision of the Court of Appeals.

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PERKINS COIE LLP

By: _____

Gregg D. Barton
WSBA No. 17022
GBarton@perkinscoie.com
1201 Third Avenue, Suite 4800
Seattle, WA 98101-3099
Telephone: 206.359.8000
Facsimile: 206.359.9000

Attorneys for *Amicus Curiae*
Council On State Taxation