

WHAT OREGON BUSINESSES SHOULD KNOW ABOUT WASHINGTON TAXES

By

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Let's say that you are a lawyer representing an Oregon business that is not registered or qualified to do business in Washington. One morning your client calls and tells you that several months ago the Washington Department of Revenue (the DOR) asked the company to complete a questionnaire concerning its business activities in Washington. Having nothing to hide, the company complied, reporting to the DOR that it made sales to Washington residents who shopped at its Oregon stores. In some instances, the Washington customers had picked up their merchandise at the client's Portland store, but in others your client had arranged for an independent delivery service to deliver the merchandise to the customer's home across the river in Vancouver.

Based on its responses to the questionnaire, the DOR has now notified your client that its activities in Washington created "nexus" with the state for purposes of requiring the company to (a) register with the DOR, (b) pay Washington's Business and Occupation (B&O) tax and (c) collect retail sales tax on any sales made to Washington consumers. Your client is now awaiting a tax bill from the DOR that will include an assessment for unpaid B&O tax and uncollected retail sales taxes, plus penalties and interest.

In a recent high profile case with just those facts, the Washington DOR levied \$1.7 million in taxes, interest and penalties against an Oregon retailer that had no stores, employees or other physical presence in Washington State.

Once the DOR makes such an assessment, your client's options are limited. There is an administrative appeal process available, but on the above facts your client will not get the DOR or the Board of Tax Appeals to budge. There is an argument to be made that under the United States Constitution the DOR is overreaching, especially by equating nexus with physical presence and imposing liability on the Oregon retailer for failing to collect sales tax. But, as a practical matter, your client will have to pay the full assessment and then make that argument in a lawsuit filed in a Washington Superior Court seeking a refund. A cursory review of Washington court decisions will lead many to the conclusion that your client's constitutional arguments will fall on the deaf ears of most Washington judges. So, you have to ask, can your client afford to pay the tax assessment and the legal fees necessary to take this tax dispute through the Washington court system and all the way to the United States Supreme Court?

Washington's Tax Structure

Washington's tax structure is unique. The retail sales tax and its companion use tax are Washington's principal tax sources. These taxes are made up of a state rate and a local rate. The state retail sales tax rate is .065. Local rates vary depending on location. The second largest source of state revenue is the B&O tax, which is a tax on gross, rather than net, income. Washington does not impose a corporate or personal net income tax.

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It is the buyer's responsibility to pay the retail sales tax, but it is the seller's responsibility to collect the sales tax and pay it to the state. In other words, the seller is liable to the DOR for sales tax, whether or not it is collected. The tax is collected by retail merchants from the buyers on sales of most items of tangible personal property and certain services. Businesses that make a purchase for resale must provide a resale certificate to the seller. If not, the seller must charge the buyer for the retail sales tax on the total purchase.

The use tax, which is imposed at the same rate as the retail sales tax, generally applies in instances where the retail sales tax is not collected, such as when goods are purchased in another state and brought into Washington for use in the state. Think of this primarily as a tax that Washington residents are supposed to voluntarily pay in lieu of sales tax on their out-of-state retail purchases. Both the sales tax and use tax chapters of the Revised Code of Washington (RCW) contain numerous exemptions.

If the sales tax is not collected by the seller from the buyer in a retail transaction, the DOR can recover it from the seller. There is a two year statute of limitations on any claim by a seller against a buyer for failure to pay sales tax, and the limitation period begins to run from the time of the sale. If the seller is audited more than two years after the sale, and it ends up paying sales tax, the statute of limitations as to any claim by the seller against the buyer will have expired.

Unless exempted, every person or entity doing businesses in Washington is subject to the B&O tax. In addition to the state B&O tax, many Washington cities levy their own B&O taxes. The state B&O tax is imposed on the gross receipts from business conducted within the state. The tax is imposed regardless of the profitability of the business. The basic rate on manufacturing, wholesaling and most retailing activities is approximately one-half of one percent. Service firms pay a higher tax rate. Like the sales and use taxes, the B&O tax chapter of RCW contains numerous deductions and exemptions from the tax.

Persons engaged in selling activities in Washington are required to be registered with the DOR. If a business should have, but did not register with the DOR, the agency has authority to extend its audit period back seven years, rather than the standard four years. Under the DOR's rules, the retail sales tax must be collected and reported in every case where the retailing B&O tax is due.

What is nexus?

Most business lawyers are comfortable with the process of determining whether or when a client is transacting business in another state so that it is subject to service of process and suit in the other state or is required to qualify to do business in the other state. We also understand that whether service of process on an unqualified foreign corporation violates the Constitution turns on "traditional notions of fair play and substantial justice."

What we also need to understand is that, even if your client is not transacting business in Washington for the foregoing purposes, Washington asserts the right to levy its taxes on foreign businesses if there is some minimum connection or "nexus" with the state that supports the conclusion that the business somehow benefits from services provided by the state. The DOR defines nexus to mean any "activity carried on by the seller in Washington which is significantly associated with the seller's ability to establish or maintain a market for its products in Washington."

Each case must be considered and decided in the light of its distinctive factual situation. We can be relatively sure that maintaining an office or other physical presence in Washington will establish nexus; that delivering goods to customers in Washington by any means other than the Post Office, UPS or FedEx will establish nexus; but that merely soliciting Washington residents by mail and telephone should not.

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The Next Step

If your client does not believe that it is transacting business in Washington for purposes of establishing nexus, it needs to make the considered business decision whether and to what extent it is willing to do business in Washington. If it decides to register with the Secretary of State and to be subject to Washington taxes, that will take it in one direction. If, on the other hand, it wishes to eliminate nexus with the state and simply transact business in interstate commerce, that will take it in another direction.

If your client takes the first course, you can help the company register with the Secretary of State and comply with Washington's tax laws. Among other actions, you can counsel the company on how it can insure that its transactions are properly classified for sales tax purposes.

If your client takes the second course, you need to work with it to structure its future dealings with Washington customers so that they do not create nexus. Note, however, that the DOR maintains that, once nexus is established, it will continue for five years even though the nexus creating activity ceases. That assertion is questionable on constitutional grounds.

At the very least, you will need to work with your client to resolve its tax liability for past sales. The company needs to look backward to see if nexus existed during the entire period covered by the DOR's audit. If the DOR claims that sales tax is owing because your client did not obtain resale certificates from its customers, you will need to work with the company to document that the sales were not retail sales for which a tax had to be collected. Also, if sales tax is found owing, you can work with the company to determine what right, if any, it has to be indemnified by its customers.

If your clients are not intentionally doing business in Washington, you should counsel them concerning how to be sure that nexus is not created. If your client's customer base includes Washington residents, make sure that Washington residents pick up their merchandise in Oregon. If products need to be delivered by any means other than UPS, FedEx or the Post Office, the client's customers need to make their own arrangements.

And your clients should be instructed to seek your counsel before responding to questionnaires sent to it by the DOR.

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