taxnotes®

state & local

Volume 87, Number 11 ■ March 12, 2018

Relocating 'Dissociation' Under the Fair Apportionment Prong

by Dirk Giseburt

Reprinted from *State Tax Notes*, March 12, 2018, p. 987

Relocating 'Dissociation' Under the Fair Apportionment Prong

by Dirk Giseburt

Dirk Giseburt

Dirk Giseburt is a partner with Davis Wright Tremaine LLP in Seattle in its state and local tax practice. In January 2017, Tax Analysts recognized him as one of the state tax practitioners of the year for pursuing certiorari petitions on the validity of retroactive tax legislation under the due process clause in the *Dot Foods* and *Hambleton* cases.

In this viewpoint, Giseburt argues for the theory and value of relocating dissociation under the fair apportionment prong for assessing the validity of gross receipts taxes on the sale of goods.

An Opening in the Conversation

The 2017 issues of *State Tax Notes* saw multiple authors opining on the vitality of the doctrine of "dissociation" in nexus disputes under gross receipts taxes on the sale of goods — stimulated largely by the 2016 decisions in Ohio and Washington in *Crutchfield Corp. v. Testa*[1] and *Avnet Inc. v. Washington Department of Revenue*.[2] Those courts denied taxpayers relief under the dissociation theory. John Swain, a professor at the University of Arizona, likened the original source of the dissociation doctrine — the opinion in *Norton Co. v. Department of Revenue*[3] — to a "ghoul in a late-night horror movie" that, despite having been killed repeatedly, "stalks our [Commerce] Clause jurisprudence."[4] Richard Cram of the Multistate Tax Commission opined that subsequent U.S. Supreme Court cases "dissolved the foundations for the use of the dissociation concept as a transactional nexus argument."[5] American Bar Association Section of Taxation state and local tax panels, too, have debated the persistence of transactional nexus — "Is *McLeod* Immortal? Transactional Nexus in the 21st Century" was the title of a session at the May 2017 meeting in Washington, D.C.[6]

Then the U.S. Supreme Court denied a petition for certiorari expressly based on a Washington state court's failure to follow *Norton* as a nexus precedent — *Irwin Naturals v. Washington Department of Revenue*.[7]

It does seem like a wave of bad news for fans of dissociation, but Cram also pointed the way forward for the continued doctrinal relevance of dissociation. It lies in "fair apportionment." This prospect follows from the nub of the *Norton* opinion — what Cram called "the *Norton* rule":

> Where a corporation chooses to stay at home in all respects except to send abroad

[1] ___ N.E.3d ___, 2016 WL 6775765 (Ohio 2016). With the reader's indulgence, this essay will omit detailed reiteration of the facts and analysis in the main cases. They have received expert treatment in the works cited below.

[2] 384 P.3d 571 (Wash. 2016).

[3] 340 U.S. 534 (1951).

[4] Swain, "The Zombie Precedent: *Norton Co. v. Department of Revenue*," *State Tax Notes*, Apr. 17, 2017, p. 301 (quoting *Lamb's Chapel v. Center Moriches Union Free School District*, 508 U.S. 384, 398 (1993) (Scalia, J., concurring)) (internal quotation marks omitted).

[5] Cram, "Dissociation — A Valid Transactional Nexus Argument?" *State Tax Notes*, June 19, 2017, p. 1184.

[6] My colleagues in the Washington state SALT bar have addressed the topic in these pages as well. *See* Michelle DeLappe, "Washington's Ever-Expanding Definition of Tax Nexus," *State Tax Notes*, Oct. 16, 2017, p. 225 ("These decisions may signal the demise of transactional nexus for practical purposes, even though *Norton* remains good law in theory."); and Garry G. Fujita, "2016 Year in Review," *State Tax Notes*, Jan. 9, 2017, p. 209.

[7] 138 S. Ct. 238 (Oct. 2, 2017) (denying cert. from *Irwin Naturals v. State*, 382 P.3d 689 (Wash. Ct. App. 2016)).

> advertising or drummers to solicit orders which are sent directly to the home office for acceptance, filling, and delivery back to the buyer, it is obvious that the State of the buyer has no *local grip* on the seller. Unless some *local incident* occurs sufficient to bring the transaction within its taxing power, the vendor is not taxable.[8]

In other words, is the transaction "local" or "not local"? This is, and always could have been treated as, a question of "separate accounting."

As Cram says:

> To the extent that the *Norton* local incident requirement once addressed the concern about multiple taxation, that issue is outside the scope of substantial nexus analysis. It belongs under the "fair apportionment" prong of the *Complete Auto* test.[9]

Exactly!

The Gimmick of *Tyler Pipe* Exposed

The theory and value of relocating dissociation under the fair apportionment prong have been evident at least since the Supreme Court's decision in *Tyler Pipe Industries Inc. v. Washington Department of Revenue*,[10] given how the Court resolved the apportionment issue presented by Tyler Pipe. Per the Court, Tyler Pipe argued that some portion of the value inherent in its gross receipts from wholesaling tangible personal property was generated by its manufacturing of those articles outside Washington, and consequently Washington could not, in fairness, claim to tax all the gross receipts.

The Court dismissed this argument easily via a gimmick: that the *activity* of selling tangible personal property occurs in *only* one place.

> The apportionment argument rests on the erroneous assumption that through the B&O tax, Washington is taxing the unitary activity of manufacturing and wholesaling. We have already determined, however, that the manufacturing tax and wholesaling tax are not compensating taxes for substantially equivalent events in invalidating the multiple activities exemption. Thus the activity of wholesaling — whether by an in-state or an out-of-state manufacturer — *must be* viewed as a separate activity *conducted wholly within Washington* that no other State has jurisdiction to tax.[11]

How could the Court insist that the activity of wholesaling occurs *wholly* within one state? The *facts* of *Norton* clearly showed that, already in 1951, the taxpayer in that case was selling goods at retail to Illinois customers "from" or even "in" more than one state.[12] The taxpayer in *Norton* escaped the Illinois gross receipts tax on some sales to Illinois customers precisely because those sales were conducted entirely by the sales team at the home office in Massachusetts.

Tyler Pipe's idea that wholesaling is conducted 100 percent within the "state of sale" has always been a formalistic fiction. It has never been worthy of a Court that emphasized in *Complete Auto*, just 10 years earlier, that commerce clause jurisprudence should be grounded on "consideration of the practical effect of the tax."[13] Consistent with this impulse, the Court had then announced in *Container*, in 1983, that a fair apportionment of income among states "must actually reflect a reasonable sense of how income is generated."[14]

Rather than apply *Container*'s new external consistency test consistently, the *Tyler Pipe* Court

[8] 340 U.S. at 537, *quoted in* Cram, "Dissociation," *supra* note 5, at 1179 (emphasis added). As readers know, the Court later recognized that sales solicitations alone could also constitute a "local incident," which prompted Congress to pass P.L. 86-272. But this development itself did not undermine the requirement for a "local incident."

[9] Cram, "Dissociation," *supra* note 5, at 1184-85.

[10] 483 U.S. 232 (1987).

[11] *Id.* at 251 (emphasis added) (citations omitted). My law school professor of constitutional law, Richard Parker, used to say that whenever the Court puffs itself up with an absolutist phrase like "must be" or "cannot be," you know it is avoiding a difficult issue for the sake of a result.

[12] 340 U.S. at 535-36. *See also American Oil Co. v. Neill*, 380 U.S. 451 (1965) (invalidating under the due process clause the imposition of Idaho's fuel tax upon sales made by an Idaho-licensed dealer at its Utah office for transfer to a U.S. government customer in Idaho).

[13] *Complete Auto Transit Inc. v. Brady*, 430 U.S. 274, 278 (1977); *see id.* at 279 ("Practical effect"), 280 (praising evaluation of the tax's "economic effects rather than its formal phrasing"), and 281 ("actual effect").

[14] *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 169 (1983) (announcing the "external consistency" test for fair apportionment for the first time).

adopted an apparently mandatory scheme of separate accounting for "selling" taxes, with a single allocation principle based on place of delivery. The Court relied on the near-throwaway line from Justice Douglas's glib opinion in *Standard Pressed Steel Co. v. Washington Department of Revenue*[15] that a "tax on the gross proceeds of sales made to a local consumer" is "'*apportioned* exactly to the activities taxed,' *all of which are intrastate*."[16]

It did not take the development of the internet to expose *Tyler Pipe*'s gimmick. *National Bellas Hess*[17] and *Quill*[18] obviously rested their conclusions that the commerce clause does not permit imposing a use tax collection obligation on a remote seller on the *fact* that the remote seller is not actually engaged in selling activities within the destination state. The Court's later discussion of why retail sales taxes may be levied on the full price of goods in *Jefferson Lines*[19] also recognized that a gross receipts tax *on the seller* might be levied in a different place from the state of consumption.[20] It turns out that the apportionment method implicitly adopted in *Norton*, not in *Tyler Pipe*, "actually reflect[s] a reasonable sense of how income is generated."

Tales From a Dissociation Practice

It is simply common, practical knowledge that many sellers of goods employ multiple sales channels to reach different markets. In my practice in Washington state over 30-plus years, the differences between those markets and the corresponding differences in sales efforts have frequently produced a reasonable apportionment result under the guise of dissociation.

Three examples:

(a) Springs Industries

In the early 2000s, the state of Washington determined that Springs Industries, a manufacturer of textiles, was underpaying business and occupation (B&O) tax, taking the view that tax applied to the gross proceeds of sales of all products delivered in Washington. The nexus hook was that Springs personnel made occasional customer-relations visits to regional buyers at Macy's local sister department store of the time, The Bon Marché, in Seattle.

The Bon Marché carried Springs's branded products, Wamsutta and Springmaid, but Springs also produced private-label sheets and towels for a number of well-known national retailers. With the private-label customers, the sales relationship was conducted entirely outside Washington — at Fashion Week in New York, at the retailers' central locations outside Washington, and at Springs's offices and factories. Only if those chains had a distribution center located in Washington was there any connection to the state (and the state made no claim to tax sales delivered to other customers with regional distribution centers in Oregon, though perhaps an equivalent stock of goods was destined for the Washington market).

Springs had one Seattle-based customer, a clothing brand, that a salesperson visited in Seattle. But all of that customer's purchases were delivered to East Asia at the factories of OEM suppliers.

It was foolish, factually and economically, to say that all of this selling activity was "wholly intrastate," but only regarding goods delivered in Washington. Yet this was the tax agency's position.

Our claim against the state was based squarely on dissociation, and the refund claim was settled favorably before trial.[21]

[15] 419 U.S. 560 (1975), *cited in Tyler Pipe*, 483 U.S. at 251.

[16] *Standard Pressed Steel*, 419 U.S. at 564 (quoting *Gwin, White & Prince Inc. v. Henneford*, 305 U.S. 434, 440 (1939), and citing *Ficklen v. Shelby County Taxing District*, 145 U.S. 1 (1892)) (emphasis added). The genealogy of *Tyler Pipe*'s gimmick thus reaches back just as far into the era of formalism as *Norton*'s distinction between local and interstate commerce.

[17] *National Bellas Hess Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967).

[18] *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

[19] *Oklahoma Tax Commission v. Jefferson Lines Inc.*, 514 U.S. 175 (1995).

[20] *Id.* at 187-88 (citing *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33, 53 (1940), and *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981)).

[21] In a prior case, we assisted Springs in defeating a city of Seattle B&O tax assessment on different apportionment grounds. For taxpayers located outside the city, the city's code allocated to the city the gross proceeds of "all sales in which the taxpayer's business activity within the city is either a determining element in the transaction or, under the facts and circumstances, a significant factor in making or holding the market here." Former Seattle Mun. Code 5.44.422.A (1996). Seattle obviously recognized that "significant factors" in a sales relationship could occur in more than one place. Given the sweep of Seattle's tax, and the fact that Springs' encounters with The Bon Marché (and its parent Allied Stores) at Fashion Week in New York were also a "significant factor" in the relationship, the trial court held that Seattle's apportionment/allocation method violated the internal consistency principle.

(b) Private-Label Food Products

Another client, a food products manufacturer (Food Products) based in the Midwest, was unregistered in Washington and was assessed B&O tax on all goods delivered to customers in Washington. The customers included major national and regional integrated grocery retailers as well as independent grocers and their purchasing cooperatives. Almost all the production was private label, so the company engaged in no local marketing whatsoever.

The nexus hook was the practice of some segments of the grocery industry to affiliate with "in-house brokers" that suppliers then work through and compensate as their own commission representatives. These in-house brokers had employees in Washington assisting the grocers with product selection and supply. Given that Food Products compensated the in-house brokers, the Washington Department of Revenue insisted that this arrangement was an in-state activity attributable to Food Products and was significantly associated with its ability to establish and maintain a market in Washington (in *Tyler Pipe*'s famous formulation of the substantial nexus standard).

It was obvious that Food Products' sales to other national grocery chains, which did not employ an in-house broker go-between, and where the sales relationship was conducted directly between buyer and seller entirely outside Washington, was a textbook example of sales that were dissociated from the local "activity," such as it was. Nevertheless, the DOR's appeals division upheld the assessment on the flimsy ground that making deliveries in company-owned trucks disallowed any dissociation relief.

However, faced with Food Products' decision to appeal further, the DOR's audit division readily settled the assessment, and provided instructions for future reporting, based on separate accounting for sales made in conjunction with an in-house broker relationship (taxed) and sales made through direct customer relationships conducted outside the state (not taxed).

(c) Craft Products

Another client was an out-of-state company (Craft Products) engaged in manufacturing and selling products for the home crafts and sewing market. The nexus hook was that for a period of years, the company put up a booth annually at a big regional sewing fair in Puyallup, Washington. Craft Products sold some items at the fair and collected and reported sales tax. Its far-larger sales channel, however, was via direct mail and internet. The company collected no sales tax and paid no B&O tax on such sales. Readers will recognize the fact pattern of *Department of Revenue v. Share International Inc.*,[22] in which the Florida courts held that the taxpayer's three days' attendance at annual seminars and conventions did not establish substantial nexus for imposing a sales tax collection obligation regarding mail-order sales.

At some point, Craft Products stopped participating in any of the big regional sewing fairs, but continued its remote sales channel. Some years later, the Washington DOR audited the company and assessed both B&O and sales tax on all remote sales in the years following discontinuation of attendance at the sewing fair. At the time, the DOR's regulations asserted a five-year trailing nexus period (now reduced by statute to one year).

In addition to arguing that five years of trailing nexus violates the due process clause, we offered substantial evidence that the sewing fair booth had no impact on mail-order sales. The company (for better or worse) never collected contact information from folks who purchased goods at the fair, so there was no follow-up by mail or email or coordination with the remote sales channel. Moreover, it so happened that the company's remote sales to Washington customers (and in the other states where it discontinued prior tradeshow booths) in the years after ceasing participation tracked exactly the trends in national sales and in other specific states that saw sales volumes like Washington but had no in-state tradeshow appearances.

Hence, Craft Products disproved any causal link between the sewing fair booth and its remote sales. The DOR did not concede as a matter of law that Craft Products was entitled to dissociate the remote sales from the sewing fair sales, but

[22] 676 So. 2d 1362 (Fla. 1996), *aff'g and adopting Florida Department of Revenue v. Share International Inc.*, 667 So. 2d 226 (Fla. Dist. Ct. App. 1995).

ultimately settled for just over 5 percent of the assessment.

Incoherence of State Law Beyond *Tyler Pipe*

The apportionment gimmick in *Tyler Pipe*, which treated wholesaling activity as inherently and solely "local," was undermined (but not abandoned) by the Washington Supreme Court in *Ford Motor Co. v. City of Seattle, Executive Services Department*.[23] In that case, Ford argued that its sales of vehicles and parts to Seattle dealers occurred out of state, and hence the wholesale sale could not be attributed to Washington for gross receipts tax purposes. Ford claimed that its in-city activities were instead a separately classifiable "service" to dealers. Ford had no business location in the city but (per the court) admitted that its activities within the city — "advertising, sending representatives to meet with its dealers and their parts managers, imparting information about new products, discussing problems and customer satisfaction concerns," etc. — were for the business purposes of selling Ford products to dealers and stimulating sales to retail customers.[24]

The court emphasized that the city B&O tax was imposed on the taxable incident of "'engaging within the City in the business of making sales . . . at wholesale,' not merely 'making sales at wholesale.'"[25] The court then reasoned, "Because we conclude that the taxable incident is engaging in the business of wholesaling . . . *it does not matter in which jurisdiction the actual sales at wholesale occur*."[26]

The court did not deny that the actual sales were part of the business of making sales at wholesale, and consequently it is admitted, in practical and economic terms, that Ford engaged in the activity of making sales at wholesale to Washington customers in multiple states. The court recognized that, for example, Ford accepted dealer orders and received payment outside Washington.[27]

And yet, in a move typical of the gimmickry in this area, the court then rejected Ford's apportionment argument on the *false* ground that the city code limited the measure of the tax to sales delivered within the city[28] (see footnote 25) and on *Tyler Pipe*'s view that making sales at wholesale is "an activity separate from manufacturing, design, and the like, which . . . must be considered conducted entirely within the destination city."[29]

The incoherence of *Ford*'s holding, in Paragraph A, that the business of making sales at wholesale encompasses all the interactions with the wholesale customer, regardless of where the sale occurs, and then holding, in Paragraph B, that nevertheless we are forced to pretend that the activity is conducted entirely within the jurisdiction of destination, is the child of a "ghoul in a late-night horror movie," as Swain would say. But the formalistic, anachronistic ghoul is *Tyler Pipe*.

After *Ford*, readers may know, the Washington Legislature has abandoned the physical presence nexus test for the "selling" taxes (wholesaling and retailing).[30] Consequently, the seller's "business activity" and the product's "destination" have become one and the same thing (if you exceed a low annual sales threshold). Would such a derangement of concepts be possible without *Tyler Pipe*?

Toward Honest Apportionment of Selling Taxes

David Brunori of Quarles & Brady LLP observed, at the ABA meeting referenced above, that "fair apportionment" under the commerce clause is really a due process concern in other clothing. What does due process require? Fairness and rationality.

[23] 156 P.3d 185 (Wash. 2007).

[24] *Id.* at 187.

[25] *Id.* at 189 (quoting Seattle Mun. Code 5.45.050(C)) (emphasis deleted).

[26] *Id.* at 190 (emphasis added). In fact, the city code said the same thing: The measure of the B&O tax upon wholesalers was "the gross proceeds of such sales of the business *without regard to the place of delivery* of articles, commodities or merchandise sold." *Id.* at 191 (quoting Seattle Mun. Code 5.45.050(C)) (emphasis added).

[27] *Id.* We know from *Jefferson Lines* that payment is an essential element of sales. 514 U.S. at 190.

[28] *Id.*

[29] *Id.* at 194.

[30] *See* 2015 Wash. Laws 3rd Spec. Sess. ch. 5, section 204 (establishing economic nexus threshold for wholesalers, effective Sept. 1, 2015); 2017 Wash. Laws 3rd Spec. Sess. ch.28, section 302 (same for retailers, effective July 1, 2017).

The courts' lie that wholesaling (or retailing) occurs solely in the state of destination is most vivid when you consider a business that engages only in selling tangible personal property and has no manufacturing operation to segregate from the supposedly separate selling operation. The Supreme Court's crutch that the design, manufacturing, and managerial operations conducted in another state constitute an entirely distinct activity is not available.

Pure wholesalers and retailers pose the question relevant to the external consistency test: Can the work of the employees of a pure wholesaler or retailer, located entirely outside the state of destination, be ignored when the constitutional goal is to "reflect a reasonable sense of how income is generated"?[31] When the destination state ignores the effort of staff and the business's capital investment by attributing all receipts to the destination, if no payroll or property is present in the destination state, does it reach "beyond that portion of value that is fairly attributable to economic activity within the taxing State"?[32]

The classic dissociation formula provides one ready answer to these external consistency questions, both when all payroll and property are located outside the destination state and when the business employs multiple sales channels, only some of which are active within the destination state. The test, as framed in *Standard Pressed Steel*, is whether a "nexus between the local office and interstate sales" is lacking.[33] That "nexus" between local activities and a sale (a "local incident," in *Norton*'s terms) answers the "fair attribution" question, as *Jefferson Lines* posed the external consistency test. If the taxpayer carries its burden of proof that there is no nexus between a local operation and some sales made by the seller's remote employees, the consequence is to use separate accounting for sales. In other words, if the taxpayer carries its burden, the taxable base in the locality of destination is determined by separate allocation.[34]

State Tax Notes has reported a number of recent cases that together amount to something of a rebellion against allocating receipts based solely on customer location. They are aligned with the use of dissociation as a tool of fair apportionment. Most pertinent to the present argument is *Florida Department of Revenue v. American Business USA Corp.*[35] That case involved Florida's sales tax, which in formal terms is imposed on sellers for exercising the privilege of engaging "in the business of selling tangible personal property at retail, including the business of making mail order sales."[36] The taxpayer was engaged in making sales of fresh flowers and related goods via the internet. It operated solely as a sales function (in Florida), and it relied on contracted local florists across multiple states to fulfill its sales.

The court easily affirmed the state's assessment of tax on 100 percent of sales, notwithstanding delivery to customers outside the state, under the fair apportionment prong. It found that internal consistency would exist if each state taxed only the entity receiving the order for flowers. It further found that *Jefferson Lines*' fair attribution standard for external consistency was met, because the tax is imposed on "the business engaged in business, and not on the items sold or the activities occurring out of state," and because the taxpayer engaged in its business activities solely in Florida.[37] In effect, the taxpayer failed to carry the burden of dissociation, because every

[31] *Container*, 463 U.S. at 169. From all that appears in the *Avnet* opinion, the taxpayer in that case was a wholesaler and perhaps retailer as well, and not a manufacturer, but it did not make a fair apportionment claim. 384 P.3d at 573-574 (business facts), 576 (parties disputed the first *Complete Auto* prong, substantial nexus).

[32] *Jefferson Lines*, 514 U.S. at 185. The pending case at the Supreme Court on whether *Quill* and *National Bellas Hess* should be overturned, *South Dakota v. Wayfair Inc.*, U.S. S. Ct. Docket No. 17-494, should give us a sense whether a threshold substantial nexus exists for commerce clause purposes based solely on the presence of customers in a state, but there is no reason to think it will address the fair apportionment of a tax on the exercise of the privilege of doing business measured by gross receipts.

[33] 419 U.S. at 563 (discussing the agreed "governing principle" of *Norton*). In *Avnet*, the Washington Supreme Court said that proving this lack of a local "nexus" "require[s] that a company show a complete absence of any connection between the local office and the underlying sales." 384 P.3d at 579. The Washington court should not, in theory, be able to uphold the 2015 and 2017 amendments to the wholesaling and retailing nexus standards and their attendant single receipts factor without overruling *Avnet* and confronting dissociation head on.

[34] Nothing said here suggests that multifactor formulary apportionment is inappropriate for resolving the external consistency problems of a single destination factor.

[35] 191 So. 3d 906 (Fla. 2016), *cert. denied*, 137 S. Ct. 1037 (2017).

[36] *Id.* at 911 (quoting Fla. Stat. section 212.05 (2012)).

[37] *Id.* at 915-16.

sale had a "nexus" with its Florida place of business.[38]

Several other recent opinions have treated as essentially irrational the failure of an apportionment formula to recognize the contributions of out-of-state employees to the generation of income from service-business customers within the state. As the line continues to blur between transactions in goods, intangible property, and services, there is every reason why similar economic inputs in each industry should be treated similarly.

In *Upper Moreland Township v. 7 Eleven Inc.*,[39] the court held that a municipality violated external consistency by attributing all franchise income from Pennsylvania franchisees to the location of the 7-Eleven regional office in the township, when operations out of state helped generate the receipts. In *Target Brands Inc. v. Department of Revenue*,[40] the trial court held that the department's proposed alternative apportionment formula for net income — a single receipts factor — was not reasonable or equitable because it did not account for material contributions to income of the taxpayer's employees and property outside the state.[41] The trial court later held (in an unappealed order not publicly available) that a four-factor formula, with receipts double-weighted, reasonably accomplished "external consistency" under the facts.

The point has been reiterated in the converse situation in *Corporate Executive Board v. Virginia Department of Taxation*.[42] In that case, the taxpayer was in the business of providing business management data and research to customers nationwide via an online subscription service. Its headquarters and primary base of operations was in Virginia. Virginia's income tax employed a four-factor formula (payroll, property, and double-weighted sales), with sales allocated by the location where the greater proportion of "income-producing activity" is performed, based on costs of performance.[43] The taxpayer argued that the standard formula was unreasonable and that sales should be attributed to the customer location.

The taxpayer's property factor in Virginia exceeded 80 percent and its payroll factor exceeded 60 percent for all years in question; for the court, this "demonstrat[ed] that most of its operations (that is, the creation, development and improvement of information and data) occurred in Virginia."[44] As a matter of law, the court held:

> There is no direct evidence or reasonable inference that using a customer's zip code negates the type or extent of business CEB conducted within Virginia in relation to its income, or to generate its income. . . . Virginia's apportionment formula captures *in a reasonable sense* how CEB's income is generated.[45]

Thus, the court insisted that the value generated by staff and property could not be ignored. If the receipts factor of this income tax had instead been a gross receipts tax, one could say again that, in effect, the taxpayer failed to carry its burden of dissociating the out-of-state sales from their "nexus" with the Virginia business activities.

These cases dealing with income tax receipts factors, I would submit, suggest that a reasonable adjudication of a dissociation claim in the gross receipts context cannot ignore reasonable inferences from the actual commercial practices of the taxpayer and its customers. The three

[38] The Florida court did not conduct the inquiry sometimes addressed under external consistency whether the apportionment method, though internally consistent, nevertheless constitutes a substantial risk of multiple taxation. *See, e.g.*, *Jefferson Lines*, 514 U.S. at 190. If the Florida seller were making sales over the internet to customers in Washington of sufficient volume, based on the presence of "click-through" affiliates in Washington, Washington would presumably assert B&O tax under the retailing classification. Washington would not provide a credit for the Florida tax under current law, *see* Wash. Rev. Code section 82.04.440, so it could be that one state may need to provide a credit for tax paid to the other, analogous to how Washington resolved the discrimination issue in *Tyler Pipe*. But which state? Between two states with the requisite "nexus" to a sale for dissociation purposes and with a credit mechanism, perhaps a tiebreaker similar to cost of performance would be appropriate. *See* the discussion of credits in Hellerstein et al., *State Taxation*, para 8.02[1][ia][ii] (2017 Cum. Supp. No. 3 at S8-11).

[39] 2017 WL 1365591 (Commw. Ct. Pa. 2017).

[40] Findings of Fact and Conclusions of Law, Colo. Dist. Ct., City and County of Denver, No. 2015CV33831 (Jan. 27, 2017).

[41] *See* Roxanne Bland, "UDITPA Section 18 and Alternative Apportionment Formulas," *State Tax Notes*, May 15, 2017, p. 675.

[42] 2017 WL 3879140 (Va. Cir. Ct. Sept. 1, 2017).

[43] *Id.* at *1 (quoting Va. Code Ann. section 58.1-416).

[44] *Id.* at *4.

[45] *Id.* at *6 (emphasis added).

dissociation cases from my practice related above show the potential for using dissociation to save a single receipts allocation principle from unconstitutionality.

Now, one might object to the suggestion that a single receipts allocation principle for selling taxes could be unconstitutional, on the grounds that the Supreme Court has already endorsed single receipts formulas in *Moorman Manufacturing*.[46] A few thoughts about why *Moorman* is not the last word. First, the decision was issued before the Court announced the external consistency prong for fair apportionment in *Container*, which refined the analysis. The Court in *Moorman* essentially acknowledged the absence of this issue in the case, when it said, "The Iowa statute afforded appellant an opportunity to demonstrate that the single-factor formula produced an arbitrary result in its case. But this record contains no such showing."[47] Dissociation provides a ready option for demonstrating the arbitrariness of a single-factor formula.

Second, *Moorman* obviously preceded the advent of economic nexus. Moorman had over 500 "salesmen" in Iowa and owned six warehouses there.[48]

Third, even though a majority of the Court has reiterated that it finds no difference between a gross income tax and a net income tax for commerce clause purposes,[49] the genealogy of this position, as shown in the footnote, reaches back to *Standard Pressed Steel*. This history shows that dissociation, as a means of showing unreasonableness or external inconsistency in a gross receipts context, is baked into the Court's acceptance of a single-factor formula.

We leave this discussion with citation to another Washington Supreme Court opinion, which articulated in advance of *Container* "a reasonable sense of how income is generated." That case is *State v. J.C. Penney Co. Inc.*, in which the taxpayer was represented by my late mentor and friend, Jim Judson.[50] The dispute was over whether Washington had authority to tax service charges J.C. Penney received from Washington customers who bought goods over time. Penney operated its regional credit function primarily in Portland, Oregon, though Washington stores accepted credit applications and processed some layaway functions. The state assessed tax on 100 percent of the service charges, and Penney argued that the Washington connections were insufficient to support the tax. The court held that tax could be imposed but must be apportioned: "*All activities* which establish credit status for customers, as well as the credit sale itself and those services provided to customers in the Portland office, are business activities which give rise to the finance charge. [The state now] concedes that apportionment is required because some of the activity relating to the finance charge takes place outside of Washington."[51]

If rational insights as exemplified by the *Penney* decision are allowed, the courts should feel impelled to abandon the gimmick of *Tyler Pipe* and support an honest apportionment of selling taxes.

A Parting Thought

It hardly needs to be repeated that the supposed goal of reasonably apportioning income from a multistate operation is disserved by the courts' repeated withdrawal into formalisms and unreality. For this practitioner, the tradition that treats dissociation as a transactional nexus principle is long overdue for revision. I am with Cram, but I am not so clear that dissociation is about multiple taxation so much as reasonably reflecting how income is generated. The rise of single receipts allocation principles, paired with economic nexus, puts new pressure on gross receipts tax systems to align the analysis of external consistency better between sales of tangible goods and other services and intangibles. Dissociation is one serviceable tool in this project. ■

[46] *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978). The decision was recognized as part of the accepted history of apportionment in *Jefferson Lines*, 514 U.S. at 186.

[47] *Id.* at 275.

[48] *Id.* at 269.

[49] *See Comptroller of Treasury of Maryland v. Wynne*, 135 S. Ct. 1787, 1795-96 (2015) (citing, e.g., *Jefferson Lines*, 514 U.S. at 190, and *Moorman*, 437 U.S. at 280 (itself citing *Standard Pressed Steel*, 419 U.S. at 564)).

[50] 633 P.2d 870 (Wash. 1981).

[51] *Id.* at 874 (emphasis added), 876.