

Breaking Developments in Tax Law

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U.S. Supreme Court Refuses to Restrict Imposition of B&O Tax on Wholesale Sales

Municipalities in the state of Washington which impose a business and occupation (“B&O”) tax were handed a big victory on February 19, 2008, when the United States Supreme Court denied *certiorari* of the Supreme Court of Washington’s ruling in *Ford Motor Company v. City of Seattle, et al.* 160 Wn.2d 32, 156 P.3d 185 (2007). By refusing to hear the appeal by Ford Motor Company (“Ford”), the U.S. Supreme Court has, again, refused to restrict Washington cities from collecting unapportioned gross receipts tax that some argue is unconstitutional. The denial of *certiorari* allows assessments against Ford in the amount of \$402,000 by the city of Seattle, and \$1.3 million by the city of Tacoma.

City B&O Tax

In Washington, municipalities may impose a B&O tax on businesses for the privilege of doing business within the applicable city. The B&O tax is imposed on the gross proceeds of a business operating in the municipality. Among the activities taxed by Seattle and Tacoma (the “Cities”) is the wholesaling of goods. The B&O tax on wholesaling is measured by applying a tax rate of 0.00215 to the gross receipts received from wholesale sales of goods made within either City.

The Ford Case

Ford, a Delaware corporation with its principal place of business in Michigan, is registered to do business in the state of Washington. Although Ford has no manufacturing plants in Washington, Ford does sell automobiles, parts, and accessories to independent dealers located in various cities, including Seattle and Tacoma. These independent dealers then sell the Ford automobiles, automobile parts and accessories to retail customers.

Ford also conducts a variety of other business activities in Seattle and Tacoma, including advertising, sending representatives to meet with its dealers and their parts managers, conveying information about new products, discussing problems and customer satisfaction concerns, and marketing and selling warranties on its automobiles.

The Cities assessed B&O tax on the entire gross proceeds arising from vehicles sold to Seattle and Tacoma dealers on the ground that Ford was engaging in the business of making sales at wholesale within the Cities.

Although Ford admitted engaging in some activity in the Cities, the majority of the multiple step process that ultimately results in the dealers' receipt of vehicles and parts takes place outside of Washington. As such, Ford argued that its Washington activities were improperly classified as wholesale sales within the Cities. Further, Ford argued, the B&O tax violated the Commerce Clause of the Constitution, placing an undue burden on interstate commerce by failing to fairly apportion the tax to Ford's activities conducted within the Cities.

Washington Supreme Court's Decision

In a 5-4 majority opinion, the Washington Supreme Court rejected Ford's arguments, stating "a B&O tax on engaging in the business of wholesaling is levied upon the privilege of doing business as a wholesaler, not upon the actual sales at wholesale ... a tax imposed on the actual sale of products is, by definition, a sales tax. B&O taxes, on the other hand, are not sales taxes. The cities municipal codes plainly tell us that their B&O taxes are imposed on the act or privilege of engaging in business activities within the city."

According to the Washington Court, engaging in the business of wholesaling encompasses more business activities than merely making sales. Instead, all activities engaged in with the object of gain, benefit, or advantage to the taxpayer constitutes the conduct of business. As such, the location where title is transferred under the terms of the contract does not determine whether a city can impose a privilege tax; but rather, the substance of each transaction must be examined to determine whether it occurs within the jurisdiction of the City imposing the taxes.

Unconstitutionality of Imposing Tax on 100% of the Wholesale Sales

Ford also argued that the Cities' failure to apportion the tax to Ford's activities conducted within each City's jurisdiction was a violation of the Commerce Clause as an undue burden on interstate commerce. In response to this argument, the Washington Court ruled that the Cities' B&O taxes did not violate the Commerce Clause because the tax meets the four prong test of constitutionality set forth in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977) as it is (1) applied to an activity with a substantial nexus with the Cities; (2) is fairly apportioned; (3) doesn't discriminate against interstate commerce; and (4) is fairly related to the services provided by the Cities.

Businesses engaged in business activity within the state of Washington should consider the cost and administrative burden of complying with the municipal level B&O tax as well as the state level B&O tax. Given the action of the U.S. Supreme Court in the Ford case, businesses will need to confront these tax burdens for the foreseeable future.

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