



This Week in State Tax (TWIST)

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Washington: Appellate court remands case involving sourcing and nexus for B&O purposes

A Washington appellate court determined that genuine issues of material fact rendered a lower court's grant of summary judgment improper in a case involving an out-of-state taxpayer's nexus for Business and Occupation (B&O) tax purposes. The taxpayer was a Colorado-based corporation involved in franchising and subfranchising dental practices in various states, including Washington. One taxpayer affiliate sold dental prosthetics to the franchisees and subfranchisees. A sibling corporation, owned by the same shareholders, held the intellectual property and, in Washington, licensed it to a Washington subfranchisor that, in turn, licensed with the local subfranchised practices. Like the taxpayer, both affiliate entities were based in Colorado. Following an audit covering 2012 through 2018 for which the taxpayer provided only limited information, the Washington Department of Revenue issued an estimated B&O tax assessment after determining that certain income received by the taxpayer was attributable to Washington. The taxpayer paid the assessment and filed a refund action, arguing it lacked substantial nexus with Washington and the assessment was based on both improperly attributed and overstated income. Both parties moved for summary judgment. The superior court granted summary judgment to the Department and dismissed the refund action. The taxpayer appealed.

The taxpayer argued it lacked substantial nexus with Washington because the payments received from affiliated entities were profit distributions rather than taxable service income and therefore should not be included in determining substantial nexus with Washington. The taxpayer also challenged the auditor's revised income classifications and allocations. The appellate court concluded that genuine issues of material fact remained regarding whether the payments were profit distributions, service income, or royalties and how they should be attributed for nexus purposes. It agreed, as well, that the basis for certain revisions made by the auditor remained unexplained. Therefore, the appellate court affirmed the denial of the taxpayer's motion for summary judgment because the taxpayer failed to establish as a matter of law that it lacked substantial nexus with Washington. However, it also reversed the grant of summary judgment to the Department because genuine issues of material fact remained. It remanded the matter for a *de novo* review in which the taxpayer will bear the burden of proving that the auditor's classification of income and calculation of liability was incorrect as well as demonstrating whether it has nexus with Washington, and if so, its tax liability.

Contact [Michele Baisler](#) with questions about [M'KNIB Co. v. Washington Department of Revenue](#).

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