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Avnet and the Rise of "Passive Nexus" in Washington

May 12, 2017

We are all familiar with the concept of tax nexus. In order to lawfully impose tax, the taxpayer must have sufficient contacts – or nexus – with the taxing state. The *Avnet* case dealt with the concept of dissociation – or transactional nexus. At issue in *Avnet* was whether the taxpayer could bifurcate – or dissociate – certain transactions from taxable in-state activities for purposes of the Washington B&O tax. The taxpayer sought to make the distinction between "general" tax nexus and "transactional" nexus.

The facts in *Avnet* were relatively straightforward. The taxpayer was a nationwide wholesale distributor of electronic components, computer products, and embedded technology. Avnet had two categories of sales – national sales and third party drop-shipped sales. National sales were sales made by the taxpayer directly to customers in Washington. Drop-shipped sales involved transactions where the Avnet's customer placed a wholesale order and Avnet delivered the product to the customer's Washington customers.

During the years in dispute, the taxpayer had a sales office in Washington. However, the employees of this office were not involved in soliciting or filling orders or providing any technical support to end users relating to the specific national and drop-shipped transactions at issue in the case. As a result, while Avnet acknowledged that it had general taxpayer nexus with Washington, it argued that it was entitled

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to dissociate all national and drop-shipped transactions. In other words, because the local Washington office did not participate in these transactions, Washington lacked the requisite transactional nexus over these wholesale sales for B&O tax purposes.

At the heart of Avnet's defense was a decades-old decision of the United States Supreme Court – *Norton Company v. Department of Revenue of State of Illinois*. In Norton, the Court held that a taxpayer is entitled to dissociate certain sales where it can show that its in-state activities did not help to establish or maintain a market for the taxpayer's out-of-state sales. While affirming the continued relevance of the holding in Norton, the Washington Supreme Court held that Avnet was not entitled to dissociate its national and drop-shipped sales into the state. Although the court recognized that the taxpayer's Washington office did not play a direct role in the disputed sales, it concluded that the office was involved in the "passive sense of being present, aware of the transaction, and available to assist if necessary."

It is difficult to square the holding in *Avnet* with that in Norton. As noted by the dissent in *Avnet*, it was a 4-3 decision in favor of the Department of Revenue, and the facts of the case were substantively identical to those in dispute in Norton. If a "passive" in-state presence were enough to demonstrate maintaining a market for out-of-state sales, the result in *Norton* would certainly have been different. The court's approach in Avnet can fairly be viewed as an aggressive re-write of the *Norton* decision to expand the reach of B&O tax nexus.