IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON
DIVISION ONE

BLISTEX BRACKEN, a Washington limited Partnership, Respondent,	)	No. 62006-1-I
v.	)	UNPUBLISHED OPINION
CITY OF SEATTLE, a municipal corporation, Appellant.	)	FILED: September 21, 2009

Schindler, C.J. — Since 1947, the Bracken family has licensed the trademarks it owns for lip balm and skin care products to an Illinois corporation, Blistex, Inc. Blistex, Inc. uses the trademarks to develop, market, license, and sell lip balm and skin care products. The question in this case is whether there is a sufficient nexus between the activities of the Bracken's limited partnership and the City of Seattle to justify assessment of the City's business and occupation (B&O) tax on the royalty income the family received from 1996 to 2005. We affirm the trial court's decision that the B&O tax violated due process, and entry of the judgment in favor of the Bracken family's limited partnership.

FACTS

The facts are undisputed. Louis D. Bracken invented a formula for lip balm. In 1947, Louis entered into an agreement giving an Illinois corporation, Blistex, Inc., the

exclusive right to use the trademarks he owned, including "BLISTEX, BLISTIK and BLIST-FZE."[1] In exchange, Blistex, Inc. agreed to pay Louis royalties based on a percentage of sales of the products. Blistex, Inc. uses the trademarks to develop, manufacture, and license lip balm and skin care products throughout the United States and worldwide.

After Louis died, his wife Nora H. Bracken and their son Jim L. Bracken inherited the trademarks. In 1965, Nora and Jim entered into an agreement giving Blistex, Inc. "the sole and exclusive right and license to use the trademarks BLISTEX, BLISTIK and BLIST-FZE on pharmaceutical and medical products in the United States and worldwide" in exchange for the right to continue to receive royalties.

When Jim died in 1984, the Sharon Bracken Marital Trust and the Bracken Family Trust inherited the trademarks. Jim's spouse, Sharon, was named as the Trustee for both Trusts. To avoid probate and reregistering the trademarks each time an heir died, the "Blistex Bracken Limited Partnership" (the BBLP) was formed under the Uniform Limited Partnership Act, chapter 25.20 RCW, to hold the trademarks the family owned and to receive the royalty payments from Blistex, Inc.[2] John Bracken described the reasons the family formed the BBLP, as follows:

> When my grandfather passed away, ownership of the trademarks passed to my father, Jim L. Bracken. Because the Blistex trademarks were held in my grandfather's name personally, the process of transferring ownership from my grandfather's name into my father's name was complicated. Blistex trademarks were

[1] For clarity, the Brackens are herein referred to by their first names.

[2] The Blistex Bracken Company was also formed in April 1985 to hold certain trademarks for the BBLP in countries where a limited partnership is not permitted to hold trademarks. The Articles of Incorporation state that the purpose of the Blistex Bracken Company is "[t]o hold certain trademarks as nominee for the Sharon Bracken Marital Trust and the Bracken Family Trust, for the Blistex Bracken Limited Partnership and for any successors or assigns of the Trusts or the partnership."

> licensed around the United States and all over the world, and there was a lot of red tape involved in changing the name of the owner in each licensing agreement.
>
> When my father passed away and my mother was to inherit the trademarks, estate planning attorneys at the law firm of Short Cressman suggested a device that would prevent the sea of red tape generated by the inheritance process. Instead of passing the trademarks through individuals, we would establish a limited partnership, in the name of which the trademarks would be held. That way, the trademarks would be permanently held in one name for the benefit of all current and future Bracken heirs. The creation of the LP, with my mother as general partner and I and my siblings as limited partners, simplified the inheritance process.

The 1985 "Certificate and Agreement of Limited Partnership of Blistex Bracken Limited Partnership" states that the purpose of the BBLP is to "acquire, own, manage and maintain certain trademarks described on Exhibit A attached hereto (the 'Partnership Property'), together with all business activities related thereto." Sharon, as the Trustee of the Sharon Bracken Marital Trust, is identified as the general partner of the BBLP and the Bracken Family Trust is identified as the limited partners.

The Certificate identifies the attorney's office, Suite 3000, First Interstate Center, or such other places as the General Partner may hereafter determine" as the principle place of business. After moving into a condominium, Sharon rented an office in downtown Seattle to store BBLP records and receive mail. The registration form filed with the Secretary of State identifies the BBLP as a "profit" corporation.

The BBLP entered into an "Amendment to Royalty Agreement" with Blistex, Inc. The purpose of the 1985 Amendment was to identify the BBLP as the current holder of the trademarks and reaffirm the prior agreements with Blistex Inc.[3] In 2000, the

[3] Blistex, Inc. agreed to pay the BBLP a 5% royalty on its first $500,000 of domestic annual gross sales, 4% on the next $500,000, and 3% thereafter. Blistex, Inc. also pays 3% royalties on foreign sales, and 20% of net proceeds from licensing the trademarks.

BBLP entered into an "Amended and Restated License Agreement" with Blistex, Inc.[4] The Agreement states that the BBLP owns the trademarks and that it grants Blistex, Inc. the "sole and exclusive right and license to use the trademarks." In the Agreement, the BBLP also agrees to "do such things as are reasonable to maintain current registrations for the Trademarks. "Upon the written request, of [Blistex, Inc.], [the BBLP] will seek and maintain the registration of the Trademarks in countries" that Blixtex, Inc. "contemplates the sale of Blistex Products." The Agreement includes an amended schedule for the determination and payment of the royalties based on sales of the products.

Sharon and Jim Bracken's three children, John Bracken, Carol Bracken Clemency, and Laura Bracken Clough are the current general partners of the BBLP.[5] John is the managing partner. The current limited partners of the BBLP are three generation skipping trusts, the John Bracken Generation Skipping Trust, the Laura Bracken Clough Generation Skipping Trust, and the Carol Bracken Clemency Generation Skipping Trust.

John testified that as managing partner of the BBLP, "I do precisely what my mother, father, and grandfather did: I make sure that the trademarks stay current for the benefit of the estate and I make sure that all of the Bracken heirs receive their share of the royalty income from the trademarks."[6] The royalty payments the BBLP receives from Blistex, Inc. are either mailed or sent by wire transfer to a banking

[4] The Agreement is expressly governed by the laws of the State of Illinois.

[5] Sharon is deceased.

[6] John Bracken also periodically travels to Blistex, Inc. in Illinois.

account in Seattle. An accounting firm prepares the federal tax return.

The certified public accountant who prepared the federal income tax returns for the BBLP from 1990 to 2006, testified that from its inception, the royalty income received by the BBLP has been reported as "portfolio income."

> In general, the Internal Revenue Service defines 'portfolio income' as gross income that is not derived in the ordinary course of a trade or business and that is derived from royalties, interest, dividends or other types of investments. In the early years of the partnership, there was some investment income in bonds in addition to royalty income, but in later years the only income to the partnership (other than some interest on partnership savings) was from trademark royalties. The primary source of income to the partnership was always trademark royalties.

According to the long-time Bracken family attorney who formed the BBLP, after entering into the original agreement with Blistex, Inc., other than collecting the royalty payments, Louis and his heirs have had little to do with Blistex, Inc.

> I started to represent the legal matters concerning Blistex in 1950. The Bracken family has a royalty interest only with a token share of stock. This has existed in the Bracken family since its inception when it was started by the Charles Arch family, an Illinois resident where the Blistex factory is located. . . . When Mr. Bracken was alive, he conducted any minor Blistex matters out of his downtown pharmacy in the Cobb Building at 4th Avenue and University Street, in Seattle, Washington. There wasn't much to do then or now insofar as collecting the royalty payments, some correspondence with the Arch family, and attending an annual meeting in Illinois of the Blistex Company.

In 2006, a City tax auditor noticed the BBLP name and the "BLISTEX" logo on the door of the office rented by the BBLP. In a letter dated June 2, the City tax auditor notified the BBLP of a B&O tax review, stating that "it has come to our attention that Blistex Bracken LP is engaging in business in the City of Seattle without a City of Seattle Business License." After examining the articles of incorporation, the

agreements with Blistex, Inc., and various other documents, the City issued an assessment notice. In the January 19, 2007 assessment notice, the City auditor concluded that because the BBLP was "'engaging in business'" as defined by the City of Seattle Municipal Code (SMC), the royalty income was subject to the City's B&O tax. The City assessed the BBLP $131,439.84 in unpaid B&O taxes, interest and penalties from January 1, 1996 through December 31, 2005 based on the BBLP's receipt of royalty income from Blistex, Inc.[7]

The BBLP paid the assessment and then filed an action in superior court to refund the B&O taxes, interest and penalties it paid. The BBLP and the City filed cross motions for summary judgment. The City argued the BBLP was subject to the B&O tax because it engaged in business activities as defined by the SMC. The City also argued that the tax was related to the services provided by the City that allow the BBLP to own, maintain, and manage the trademarks. The BBLP asserted that Blistex Inc., not the BBLP, engaged in the business activities that generated income. The BBLP argued that it was an estate planning mechanism and the receipt of royalty income, preparing federal income tax returns, and maintenance of an office did not constitute engaging in business under the SMC. The BBLP also argued that imposition of a B&O tax violated due process and the Commerce Clause.

The court granted summary judgment in favor of the BBLP. The court ruled there was an insufficient nexus between the nature and extent of the business activities of the BBLP and the services provided by the City.

The more difficult question and the one most thoroughly briefed by

[7] The City assessed the BBLP $80,406.28 in unpaid B&O taxes plus interest and penalties, for a total of $131,439.84.

> the parties concerns whether the royalty amounts *are* subject to Seattle's B&O tax. The code provision uses 'gross income of the business' as the basis for the tax determination. This income is defined in SMC 5.55.035D as 'the value proceeding or accruing, by reason of the transaction of the business activity engaged in. . . .' The code provision then lists at length the various means by which income can be accrued. The list intends to be exhaustive ending with 'other emoluments however designated.' Significant to this case the list includes royalties.
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> SMC *5.55.035* does not define what constitutes a 'transaction of the business activity....' which is the key issue in the instant case. The cases cited by the parties generally assume the transaction of a business activity and then address either the propriety and/or method of apportioning the resultant tax on that activity and are thus of limited value.
>
> I find that [] the facts of this case do not demonstrate a sufficient relationship between services and resources provided by Seattle to Blistex compared to the nature and extent of Blistex'[s] commercial activity in this case, to justify the imposition of the B&O tax assessed. As a result, imposition of the B&O tax in this matter would violate the due process clause of the United States and Washington constitutions.

The court entered a judgment in favor of the BBLP and ordered the City to refund to the BBLP the B&O taxes and penalties paid with interest. The City appeals.

ANALYSIS

The City contends the trial court erred in concluding that the BBLP is not subject to the B&O tax and that there is an insufficient connection between the business activities of the BBLP and the City to justify imposition of the tax.

We review summary judgment de novo. KMS Financial Services, Inc. v. City of Seattle, 135 Wn. App. 489, 146 P.3d 1195 (2006). We also review questions of statutory interpretation de novo. Dot Foods, Inc. v. Dep't of Revenue, 141 Wn. App. 874, 173 P.3d 309, 313 (2007) rev. granted, 163 Wn.2d 1052, 187 P.3d 751 (2008). Because the facts are not in dispute in this tax refund action, the only issues are

questions of law. Simpson Inv. Co. v. Dep't of Revenue, 141 Wn.2d 139, 148, 3 P.3d 741 (2000).

The City argues that the royalty income received by the BBLP is subject to the B&O tax. Although the City concedes the BBLP is an estate planning mechanism, the City contends that under the SMC, the BBLP is engaged in business activities by owning, managing, and maintaining the trademarks.[8]

A B&O tax is an excise tax the City can impose for the privilege of doing business. The authority to impose a B&O tax is based on exercising the privilege of doing business that generates the income that is subject to the tax. City of Seattle v. Paschen Contractors, Inc., 111 Wn.2d 54, 57, 758 P.2d 975 (1988).

The SMC imposes a B&O tax on "every person . . . for the privilege of engaging in business activities within the City." SMC 5.45.050. There is no dispute that in order to impose a B&O tax on the royalty income, the BBLP must be "engaged in business activities" that generate that income. SMC 5.30.030(B).[9] SMC 5.30.030(B)(1) defines "engaging in business" as:

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[8] Two different code provisions applied during the ten year assessment against the BBLP for the B&O tax, 1996 to 2005. Former SMC 5.44.400 imposed a B&O tax "for the privilege of engaging in business activities within the City." SMC 5.45.050 superseded SMC 5.44.400. Because the code changes do not affect our analysis, the opinion cites the current code provisions.

[9] In Paschen, the Washington Supreme Court also addressed the meaning of the term "activity" in the context of the B&O tax:

> The term 'activity' appears to mislead those who would understand the impact of the tax. 'Activity', insofar as relating to that upon which tax is to be imposed, relates not to the honey made by the bees in the hive during a segment of time but to the monetary worth of the entire hive. It is the value of the business enterprise for which services are available that forms the base upon which the tax rate is to be applied, not solely some portion thereof which is completed within the environs of the taxing authority that comprises only a part of the protected enterprise.

Paschen, 111 Wn.2d at 63.

> commencing, conducting, or continuing in business, and also the exercise of corporate or franchise powers, as well as liquidating a business when the liquidators thereof hold themselves out to the public as conducting such business.

The definition is then followed by a list of examples of activities that constitute "engaging in business." SMC 5.30.030(B)(2),(3)(a) and (b), provide in pertinent part:

> 2. This section sets forth examples of activities that constitute engaging in business in the City. . . . The activities listed in this section are illustrative only and are not intended to narrow the definition of 'engaging in business' in subsection (1), above. If an activity is not listed, the issue of whether it constitutes engaging in business in the City shall be determined by considering all the facts and circumstances and applicable law.
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> 3. Without being all inclusive, any one of the following activities conducted within the City by a person, or its employee, agent, representative, independent contractor, broker or another acting on its behalf constitutes engaging in business and requires a person to register and obtain a business license:
>
> a. Owning, renting, leasing, maintaining, or having the right to use, or using, tangible personal property, intangible personal property, or real property permanently or temporarily located in the City;
>
> b. Owning, renting, leasing, using, or maintaining, an office, place of business, or other establishment in the City. . . .

For purposes of the B&O tax, "gross income of the business" is defined in SMC 5.30.040(D) as:

> [T]he value proceeding or accruing <u>by reason of the transaction of the business activity</u> engaged in and includes gross proceeds of sales, compensation for rendition of services, gains realized from trading in stocks, bonds, or other evidence of indebtedness, interest, discount, rents, <u>royalties</u>, fees, commissions, dividends. . . all without deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.[10]

[10] (Emphasis added).

SMC 5.45.050 also provides:

> The tax shall be in amounts to be determined by application of rates against gross proceeds of sale, gross income of business, or value of products, including by-products, as the case may be . . ."[11]

In addition, the City cites SMC 5.45.050(G) to support its position that receipt of royalties is subject to the B&O tax. SMC 5.45.050(G) provides:

> Upon every other person engaging within the City in any business activity other than or in addition to those enumerated in the above subsections; as to such persons, the amount of tax on account of such activities shall be equal to the gross income of the business multiplied by the rate of one percent [00415%]. This subsection includes . . . persons engaged in the business of developing, or producing custom software or of customized canned software, producing royalties or commissions . . .[12]

The fact that the BBLP received royalties does not make that income taxable. The BBLP must be engaged in business activities that generate or produce the royalties. Here, there is no dispute that Blistex, Inc., not the BBLP, engages in the business activities that generate the sales and royalty income. Nonetheless, assuming, without deciding that the BBLP is engaged in business activity as broadly defined under the SMC, based on the undisputed record in this case, we conclude the nexus between the minimal business activities of the BBLP and the City is insufficient to justify imposition of the B&O tax on the receipt of royalties.

"Our Supreme Court, in molding limits upon the exercise of a municipal corporation's power to impose a business and occupation tax on local business

[11] (Emphasis added).

[12] (Emphasis added.)

activities, has analogized from decisions of the United States Supreme Court in cases involving state taxation of interstate commerce." Tacoma v. Fiberchem, Inc., 44 Wn. App. 538, 543, 722 P.2d 1357 (1986). In Dravo Corp. v. City of Tacoma, 80 Wn.2d 590, 496 P.2d 504 (1972), the Supreme Court defined the due process limits on the exercise of a municipal corporation's power to impose a B&O tax on business activities and adopted a three-part test to determine whether due process is violated.

First, the taxable event upon which the B&O tax is levied must be identified. Dravo, 80 Wn.2d at 595. Second, the taxable event must occur within the territorial limits of the municipality to determine whether due process is violated. Dravo, 80 Wn.2d at 595-97. Third, there must be a nexus or "definite link or minimum connection" between the City and the taxable event. Dravo, 80 Wn.2d at 598-99. The test to determine whether there is a sufficient nexus is twofold.

> First, is there a reasonable relationship between the taxing entity and the taxable event sufficient to justify taxation? Dravo Corp., 80 Wn.2d at 597-99, 496 P.2d 504 (citing Miller Bros. Co. v. Maryland, 347 U.S. 340, 344-45, 74 S.Ct. 535, 538-39, 98 L.Ed. 744 (1954)). Second, is the measure of taxation required by the taxing statute so fairly and closely related to the taxed activities of the taxpayer within the boundaries of the municipality as to complete the 'definite link,' the 'minimum connection,' between the taxing entity and the taxed event? Dravo Corp., 80 Wn.2d at 599, (citing General Motors Corp. v. Washington, 377 U.S. 436, 448, 84 S.Ct. 1564, 1571, 12 L.Ed.2d 430 (1964)); see also Tacoma v. Hyster Co., 93 Wn.2d 815, 820, 613 P.2d 784 (1980).

Fiberchem, 44 Wn. App. at 543-44.

Here, there is no dispute that the City imposed the B&O tax on the royalty income the BBLP received from Blistex Inc. The City contends the taxable event is the privilege of doing the business activities the BBLP engages in that are related to

owning, managing and maintaining the trademarks. The parties dispute whether there is a sufficient nexus between the nature and extent of the business activities of the BBLP and the City to justify imposing the B&O tax.

The City relies on Dravo to argue that the business activities of the BBLP related to owning, managing, and maintaining the trademarks establish a sufficient nexus to impose the B&O tax. In Dravo, Tacoma imposed a B&O tax on the gross income of a company that executed contracts in Tacoma to build a dam outside the City. Dravo, 80 Wn.2d at 591-92. The court concluded that accepting the bid and executing the contracts in Tacoma was the taxable event. Dravo, 80 Wn.2d at 600-01. The court held that the "transaction of making the contract . . . was a substantial income producing activity fairly related to the gross proceeds that accrued therefrom," thereby establishing a sufficient nexus to impose a B&O tax on the gross income. Dravo, 80 Wn.2d at 600. However, the court expressly noted that a definite link between the taxable event and the B&O tax is not established if the gross proceeds taxed do not "reasonably relate" to the taxable event. Dravo, 80 Wn.2d at 599.

The BBLP relies on Fiberchem, 44 Wn. App. at 543-44 to argue that the relationship between the limited activities related to managing and maintaining the trademarks and the services provided by the City do not establish a sufficient nexus for purposes of due process. In Fiberchem, a company sold products to customers in Tacoma from an outside office. Fiberchem, 44 Wn. App. at 540-41. The company's field representative spent a relatively small amount of time with only a portion of the company's customers in Tacoma. Fiberchem, 44 Wn. App. at 540-41. The court held that the City's imposition of the B&O tax on the company's gross proceeds from sales

to customers in Tacoma violated due process because limited activities in Tacoma did not "bear any fair and reasonable relation to the proceeds of sales to Tacoma customers." Fiberchem, 44 Wn. App. at 545.

Based on the undisputed facts, this case is more like Fiberchem than Dravo. Unlike in Dravo, Blistex Inc., not the BBLP, develops, manufacturers, markets, licenses, and sells products using the trademarks, and generates the royalty income. The record reveals very minimal activities that the BBLP engages in related to owning, managing and maintaining the trademarks.

The City argues that maintenance of an office, use of banking services, and hiring accountants and lawyers satisfies the nexus requirement. Whether the BBLP maintains an office and hires accountants to prepare yearly federal income tax returns is not a determining factor in deciding whether the City exceeded its taxing authority. KMS Financial Services, Inc. v. City of Seattle, 135 Wn. App. 489, 512, 146 P.3d 1195 (2006). And although the licensing agreement requires the BBLP to register trademarks if requested by Blistex, Inc., there is nothing in the record that indicates that the BBLP actually did so during the assessment period.[13] Nor is there any evidence in the record that the BBLP retained or paid attorneys for activities concerning the trademarks during the assessment period. Moreover, if the BBLP ceased to exist, the trademarks would continue in effect, the Bracken family would continue to receive the same royalty income, retain accountants and attorneys when needed, maintain an office to receive mail and store records, and pay federal income

[13] Also Contrary to the assertion of the City at oral argument, there is no evidence in the record that the BBLP took any legal action to protect the trademarks it owns.

taxes.

We conclude there is an insufficient nexus between the limited business activities of the BBLP and imposition of the B&O tax on the royalties received. We affirm the decision to grant summary judgment and entry of the judgment against the City to refund the B&O taxes and penalties paid.[14]

WE CONCUR:

[14] Because we affirm, we need not address the alternative argument that the City was required to apportion the B&O tax or that the City lacked authority to collect ten years of back B&O taxes.