

Tax Law Update

03/26/2012

Hearing On Proposed New Rules Could Dramatically Impact B&O Taxes For Service Industry Businesses

The Washington State Department of Revenue (“Department”) has recently announced that it will be holding a hearing on April 19 in Olympia on [two proposed permanent rules](#) implementing single factor receipts apportionment. Proposed Rule 19402 is the general rule that will apply to most businesses that report under apportionable business and occupation (“B&O”) tax classifications, which includes the “service and other” classification. Proposed Rule 19403 addresses apportionment of royalty income.

Under the single factor receipts apportionment, a business’s Washington taxable gross income is determined by multiplying “apportionable gross income” by a “receipts factor,” the numerator of which is gross income “attributable” to Washington business activities. The denominator of the receipts factor is world-wide gross income from the same class of activity.

Determining the receipts factor is potentially complex, and the Department’s proposed rule is controversial because it does not conform to the controlling statute enacted by the Legislature in 2010, RCW 82.04.462. The statute establishes a cascading hierarchy for attributing receipts. At the top of the statutory hierarchy, receipts are attributed to the state in which the “benefit of the service” is “received,” or if the benefit is received in more than one state, to the single state in which the benefit is “primarily received,” RCW 82.04.462(3)(b)(ii). When the benefit of the service is not “primarily received” in a single state, receipts are sourced according to one of the other, lower-tier sourcing provisions in the statute. Consequently, for many businesses the statute would source receipts according to the customer’s billing address.

Although this aspect of the statute was expressly acknowledged in the Department’s initial temporary Emergency Rule, the proposed rule instead (and contrary to the statute) would require most businesses to develop a “reasonable method of proportionally attributing receipts” among the various states in which their customers receive the benefit of their services. The 16 pages and 41 examples in the proposed rule suggest that developing a method for “proportionally attributing” receipts will be burdensome, administratively complicated and involve significant subjective review by the department as to whether the method adopted by a taxpayer is “reasonable.”

Moreover, the proposed rule appears to provide conflicting guidance. For instance, example 4 says that it would be reasonable for a law firm to proportionally attribute its legal fees by client billing address, yet on the other hand, example 16 states it would be “reasonable” for a law firm representing a manufacturer in a class action lawsuit to “proportionally attribute” its legal fees “to the locations where Manufacturer’s Widgets were delivered,” a factor seemingly unrelated to the law firm’s services. It also requires information the law firm is unlikely to have and would be a difficult and administratively burdensome undertaking. Unfortunately, most of the examples in the proposed rule are more like example 16 than like example 4 and would require a receipt-by-receipt analysis.

The proposed rule addresses a number of aspects of the new single factor receipts apportionment method, including: (a) determination of where the benefit is received (there are different standards depending on whether the service relates to real or personal property, whether it relates to the customer’s business, and whether the customer needs to be physically present for the service); (b) attribution of receipts; (c) the “throw out” of receipts from the denominator; and (d) annual reconciliation of the apportionment percentage.

The Legislature anticipated that the single factor receipts apportionment formula would reduce the overall tax burden on Washington-based businesses (whose infrastructure in Washington is no longer a factor in determining their tax liability and will be able to shift more of their income outside the state proportional to their customer base), while increasing the overall tax burden on businesses based outside Washington (whose Washington customer base will increase the proportion of their income subject to B&O tax). Consequently, both in-state and out-of-state businesses need to review their Washington B&O tax reporting for compliance with the state’s single factor receipts apportionment.

**For more information, please contact the Tax Law Practice Group
at Lane Powell: taxlaw@lanepowell.com**

1.800.426.5801 ■ Your Pacific Northwest Law Firm® ■ www.lanepowell.com

This is intended to be a source of general information, not an opinion or legal advice on any specific situation, and does not create an attorney-client relationship with our readers. If you would like more information regarding whether we may assist you in any particular matter, please contact one of our lawyers, using care not to provide us any confidential information until we have notified you in writing that there are no conflicts of interest and that we have agreed to represent you on the specific matter that is the subject of your inquiry.

Copyright © 2012 [Lane Powell PC](http://www.lanepowell.com)
Seattle | Portland | Anchorage | Olympia | Tacoma | London