Department of
Revenue
Washington State

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fund Washington's future"

Single Factor Apportionment Overview

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Outline

- Scope of apportionment
- History of apportionment in Washington
- 2010 Legislation
    - Economic Nexus
    - Single factor receipts apportionment
- Calculation of taxable income

Apportionable and allocable activities

- For the State B&O tax certain activities are treated as either in state or out of state
  - Retail and wholesale sales
  - Extracting
  - Manufacturing
  - Warehousing
- These are not apportioned

Apportionable and allocable activities

- Other activities are treated as apportionable:
  - Service and other activities
  - Royalties
  - Inspecting canned salmon owned by others
  - International Investment Management services

History

1935

- Washington adopted B&O tax
- No provision for apportionment

1939

- January 3 – US Supreme Court decides Gwin , White and Prince v. Henneford, 305 US 434
- Ruled lack of apportionment raises the possibility of multiple taxation and therefore violates the Commerce clause
- March 9 – both the Washington Senate and House passed the first apportionment law in Washington
- March 21 – governor signs bill
- Law remained essentially the same until 2010

How apportioned?

- Separate accounting was preferred
- If not cost apportionment
- Based on the economy of the time.
  - There was little interstate provision of services
  - Tax was based on where the production activity occurred

Det. No. 01-006

Background

- Bank was audited and there were two major issues:
  - How much of deduction was a financial institution entitled to for first mortgage interest, were loan origination fees deductible?
  - How should the taxable income be apportioned?

Holding

- The term cost of doing business in Washington did not mean costs incurred in Washington, but rather, Costs of doing business related to the TP's business activities in Washington

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2006 amendment to Rule 194

Implemented 01-006 in Rule 194

- Specifically allocated costs
- Excluded costs
- Costs assigned by formula
  - The formula was Washington receipts divided by total receipts.
  - Further, incorporating market factors.

2010 Legislation

Department Suggested: Economic Nexus and Market Based Attribution

- New methods of doing business
- Internet
- Economy of the 21st Century
- Production models are not conductive to business development

Order of Attribution

1. Where the customer receives the benefit of the service, includes reasonable proportional methods
2. If can't use 1, and in multiple states, then where primarily used
3. If can't use 2, where customer ordered the service from
4. If can't use 3, billing address
5. If can't use 4, from where the customer sends payments
6. If can't use 5, where customer is located
7. If can't use 6, commercial domicile of taxpayer.

Where is the benefit of the service?

Adopted Wisconsin model:

1. Real property
2. Tangible personal property
3. Related business activity
4. Non-business customer
   - If must be present
   - If relates to specific location
   - Customer's residence

Royalties attribution

- Not Where benefit is received, but where intangible used.

- California/Massachusetts model

  1. If marketing use, to market
  2. If production use, to where production occurs
  3. If mixed use, to market.

Paradigm Shift

- After 75 years of using a production model, moved to a market model
- Consistent with trend among states to move from production to market
- Recognized modern economy
- The ability to perform services anywhere for benefit of Washington customers
- Also, recognized trend to move away from physical presence to economic presence

Examples of Impact of Apportionment Change

- Assume an advertising agency is located in State X. It has no other offices and no costs outside of State X. However, its only client is located in State Y and the client only engages in business in State Y.
  - Under pre-2010 law, the taxpayer was taxed on 100% of its income in State X
  - Under Washington's single factor receipts apportionment, all of its receipts would be attributed to State Y. The taxpayer would owe no State X Tax

Examples of Impact of Apportionment Change

- Debt collector is headquartered in Oregon (90% of costs) and has a small office in Washington (10% of costs). It attempts to collect from debtors located equally in Washington and Oregon.
  - Under prior law, Washington would tax the business based on the percentage of costs assigned to Washington (10%)
  - Under the new law, generally Washington would tax 50% of the income

Examples of Impact of Apportionment Change

- Washington accounting firm is located in Wenatchee. All of its clients are in Wenatchee. There is no change in tax consequences.

Examples of Impact of Apportionment Change

- Internet provider is paid to place advertisements on its webpage. All of its costs are incurred in State Q, but the advertisements are viewed everywhere in the US.
  - Under prior law only State Q would impose tax
  - Under the new law, the revenue from such advertisements would be attributed throughout the US. Unless the TP knows where they are viewed, the use of a reasonable proportional method is allowed. E.g., Internet Usage statistics

Questions?