

Economic Nexus Q&A

1. **Would the minimum nexus standard be effective once the threshold is met or starting June 1?**

Answer: For purposes of calculating the property, payroll, and sales thresholds for the 2010 tax year, the entire 2010 calendar year is to be used. Starting June 1, 2010, a business will incur Business & Occupation (B&O) tax only if it establishes nexus with Washington under the new economic nexus standards in 2ESSB 6143. (See [Chapter 23, Laws of 2010 1st Special Session](#)). For example, Taxpayer X is an out-of-state business with no physical presence in Washington. In 2010, Taxpayer X has \$100,000 of Washington receipts in February, \$100,000 in June, and \$100,000 in July. Taxpayer X establishes nexus with Washington under 2ESSB 6143 in July for 2010 and will owe B&O tax only on income earned on or after June 1, 2010.

2. **If an out-of-state business meets one or more economic nexus thresholds in one year but not in any subsequent years, is the business subject to B&O tax in any subsequent year?**

Answer: Yes. The bill specifically includes a trailing nexus provision for the next calendar year. In other words, nexus continues for as long as the taxpayer meets the nexus standards in the legislation, plus the following tax year. See 2ESSB 6143 §[102](#).

3. **With a shorter nexus period for economic nexus, is it the intent to have two different nexus periods, one for service and one for tangible personal property?**

Answer: No. Effective June 1, 2010, the one-year trailing nexus provision will apply for all business and occupation tax classifications.

4. **If a Washington business is not subject to tax in another state on income sourced to that state under the new single-factor apportionment law, does Washington tax that income?**

Answer: A Washington business with receipts sourced both inside and outside of Washington can apportion its receipts.

However, the new apportionment law has a throw-out rule. Under the throw-out rule, if a taxpayer is not taxable in the state where receipts are sourced, then the taxpayer must exclude those receipts from the denominator of Washington's sales factor.

A taxpayer is considered not taxable in another state if:

- A. It is not subject to that state's business activity tax, and
- B. The taxpayer would not be considered to have economic nexus in that state using Washington's thresholds.

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As a result of the throw-out rule, exactly 100% of the taxpayer's income is allocated among the states where it is subject to tax. If every state adopted the throw-out rule, 100% of a taxpayer's receipts is subject to tax and there is no "nowhere" income.

5. Will an out of state business with a physical presence in this state have nexus with this state if it does not meet any of the economic nexus thresholds?

Answer: There will effectively be a "safe harbor" for out-of-state businesses that have a physical presence but do not have enough of an "economic" presence as required by the law. For example, an employee visiting Washington to solicit sales would have created nexus under the previous nexus standard for service businesses. Under the new law, however, the business will only have nexus if it meets any of the economic nexus thresholds established in the law.

Physical presence nexus, however, continues to be required for retailing, wholesaling, and any other B&O tax classification not subject to the new single-factor apportionment formula.

6. Are accounts receivable to be reported as income?

Answer: If the taxpayer maintains its books and records on an accrual tax basis, then the income is reported when the income is accrued. If the amount accrued is later treated as a bad debt, then the taxpayer gets a deduction for the amount written off.
WAC 458-20-199.

7. Is foreign-sourced income included in the apportionment calculation under the single-factor sales apportionment method?

Answer: Yes. The denominator of the sales factor is the taxpayer's total gross income from engaging in an apportionable activity everywhere in the world during the tax year. Also, under the throw-out rule, income that would be sourced to a foreign jurisdiction would be thrown out of the denominator of the sales factor if (1) the taxpayer is not subject to a business activities tax in that foreign jurisdiction and (2) the taxpayer does not have nexus with that foreign jurisdiction under Washington's nexus standards. The receipts factor is applied against the taxpayer's worldwide income.

8. Are deductions made before or after gross income is calculated?

Answer: By definition, gross income is always calculated before deductions. With respect to the \$250,000 threshold for the receipts factor for nexus, deductions are not taken into account. With respect to apportionment, the sales factor is applied to "apportionable income," which is gross income from engaging in apportionable activities less exemptions and deductions (other than an interstate and foreign sales – apportionment deduction) allowed under the B&O tax statutes.

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9. Does the economic nexus bill apply to businesses domiciled outside of the United States?

Answer: If a foreign entity meets the minimum economic presence tests in 2ESSB 6143 §104, then Washington will impose its B&O tax on that entity unless the state is federally preempted.

10. If a business engages in activities that fall under the service and other activities and retailing or wholesaling classifications and has economic nexus (e.g., has over \$250,000 of gross receipts from this state) but does not have a physical presence in this state, does the business also owe retailing and/or wholesaling B&O tax?

Answer: No. A business does not have nexus for retailing or wholesaling B&O tax purposes unless it has a physical presence, which need only be more than the slightest physical presence. See 2ESSB 6143 §104(6).

The economic nexus standards only apply to apportionable activities, which are those activities taxed under the following tax classifications:

- Service and other activities,
- Royalties,
- Travel agents and tour operators,
- International steamship agent, international customs house broker, international freight forwarder, vessel and/or cargo charter broker in foreign commerce, and/or international air cargo agent,
- Stevedoring and associated activities,
- Disposing of low-level waste,
- Title insurance producers, title insurance agents, or surplus line brokers,
- Public or nonprofit hospitals,
- Real estate brokers,
- Research and development performed by nonprofit corporations or associations,
- Inspecting, testing, labeling, and storing canned salmon owned by another person,
- Representing and performing services for fire or casualty insurance companies as an independent resident managing general agent licensed under the provisions chapter 48.17 RCW,
- Contests of chance,
- Horse races,
- International investment management services,
- Aerospace product development,
- Printing or publishing a newspaper (but only with respect to advertising income),
- Printing materials other than newspapers and publishing periodicals or magazines (but only with respect to advertising income), and

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- Cleaning up radioactive waste and other by-products of weapons production and nuclear research and development, but only with respect to activities that would be taxable as an “apportionable activity” if this special tax classification did not exist.

11. Is separate accounting no longer applicable under the new apportionment rules?

Answer: Separate accounting will no longer be a specifically authorized method of apportioning income. However, taxpayers may ask the department for separate accounting if the allocation and apportionment provisions of 2ESSB 6143 do not fairly represent the extent of their business activity in this state.

12. Concerning royalties it seems that *separate accounting* and apportionment based on the receipts factor would yield the same result. Consequently, for ease of administration, would DOR allow the business to report Washington royalties based on the location of the person paying the royalties?

- a. For example, Washington royalties of \$5 million and world-wide royalties of \$100 million yield an apportionment factor of 5 percent. Income subject to apportionment of \$100 million times the 5 percent apportionment factor yields \$5 million, the same amount that is attributable to Washington based on the location of the person paying the royalties.

Answer: While separate accounting might result in the same taxable amount as single factor sales, there are differences. Historically, we have looked at separate accounting based on where the taxpayer performed the service. Single factor sales starts at where the customer receives the benefit of the service. This could be significantly different.

Additionally, the new law has a throw-out rule that removes from the denominator receipts that would be assigned to a state where the taxpayer is not taxable and part of the income-producing activity is performed in Washington. The effect is to increase the measure of tax in those situations.

13. How are services sourced?

Answer: Services are sourced under the following hierarchy.

1. Where the purchaser receives the benefit of the services.
2. If the benefit is received in multiple states, then where the benefit of the service is primarily received.
3. If 1 or 2 do not apply, then to where the service was ordered.
4. If 1 – 3 do not apply, then to where the bill is sent.
5. If 1 – 4 do not apply, then to where the customer sends the payment from.
6. If 1 – 5 do not apply, then to the customer’s address maintained in the seller’s records.

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7. If 1 – 6 do not apply, then to the seller’s commercial domicile.

For financial businesses, the receipts are sourced in a manner similar to that currently used in WAC 458-20-14601.

14. How are royalties sourced?

Answer: Royalties are sourced under the following hierarchy.

1. Where the customer used the taxpayer’s intangible property.
2. If the customer used the intangible property in more than one state, then where intangible property was primarily used.
3. If 1 or 2 do not apply, then to where royalty agreement with the taxpayer was negotiated.
4. If 1 – 3 do not apply, then to where the bill is sent.
5. If 1 – 4 do not apply, then to where the customer sends the payment from.
6. If 1 – 5 do not apply, then to the customer’s address maintained in the seller’s records.
7. If 1 – 6 do not apply, then to the seller’s commercial domicile.

15. Under the new sourcing rules, will the taxpayer need to prove a negative (e.g. – why it would not be sourced to Washington)?

Answer: The sourcing rules specify a hierarchical method of determining where receipts should be sourced. The resolution of disputes between taxpayers and the department will be the same as other disputes. In a dispute, the taxpayer will have the burden to show that the department’s findings are incorrect. This would normally be done by demonstrating how the receipts are sourced under the statute.

16. Tier 2 sourcing rule (*if the benefit of the service is received in multiple states, income is sourced where the benefit of the service primarily received*): **How is “primarily” defined?**

Answer: “Primarily” means more than 50%. However, if receipts under a contract can be readily sourced to multiple states, then the appropriate amounts are sourced to each state. For example, if a single contract is entered into for the franchises in three states and the fee for each is specified in the contract, then if a franchise were located in Washington, then the receipts related to the Washington franchise would be considered Washington sales.

17. Tier 3 sourcing rule (*income is sourced to the state from which the customer ordered the service or, in the case of royalties, where the customer negotiated the royalty agreement*): **How is the seller going to know or confirm from where the customer ordered the service or where the royalty agreement is negotiated?**

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Answer: Examples of where the seller would know this information include when a sales person obtains an order directly from the buyer or when the seller and buyer negotiate terms. If the taxpayer does not know this information, then the taxpayer moves to the next tier.

18. Can a different sourcing rule be used for each transaction within an appropriate activity or tax classification?

Answer: Generally yes. However, the Department reserves the right to question taxpayers who seem to be using this method of allocation to improperly avoid payment of taxes.

19. What is the Department's thinking on internet advertising services? We know now that it is not considered a digital good, so it appears that Internet advertising is taxable under the service and other activities classification. In the past, income has been apportioned based on WAC 458-20-194. With single factor apportionment will it be sourced based on the customer location, based on the sequence of sourcing rules? We don't know where the customer received the benefit of the service, but we do know where the customer ordered the service.

Answer: You will need to use the sourcing hierarchy provided. The state from which the customer ordered is appropriate provided that you are not able to use the first two sourcing rules.

20. Does the bill apply to Co-ops?

Answer: To the extent that a co-op's business activities are subject to apportionable B&O taxes and not otherwise exempt, then the bill applies to co-ops. The bill does not specifically address co-ops.

21. Which "year" applies, the calendar year or the tax year?

Answer: Under RCW 82.04.020, the tax year is a calendar year unless the taxpayer requests and the Department approves the use of a fiscal year.

22. Regarding Economic Nexus, is there an amnesty period?

Answer: No. There is no specific amnesty period written into the legislation and it does not appear that the Legislature intended for there to be amnesty. The department is currently notifying Taxpayers of their obligations under the new law.

However, the law does provide a great deal of flexibility in enforcement. The bill does not impact the existing [voluntary disclosure](#) provisions that will fully or partially waive penalties for qualifying taxpayers. Additionally, the new law requires an annual

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reconciliation that, if completed by October 31 of the following year, allows taxpayers to amend previously filed returns with no additional penalties. Interest, however, will be assessed or refunded.

23. Why is interest added to corrected returns?

Answer: The law provides taxpayers a method to make essentially estimated tax payments throughout the year. Taxpayers are then required to reconcile those payments with their actual liability. When that reconciliation results in a refund, interest will be paid to the taxpayer and if the taxpayer owes additional taxes, interest will apply that amount as well.

NEXUS EXAMPLES

The following examples identify a number of facts and then state a conclusion; they should be used only as a general guide. The tax results of all situations must be determined after a review of all the facts and circumstances.

Example 1

Company A is domiciled (headquartered) in State X. In a calendar year it has \$150,000 in royalty receipts assigned to Washington per WAC 458-20-19403 and \$150,000 in gross income from other apportionable activities assigned to Washington per WAC 458-20-19402.

Company A has substantial nexus with Washington because it has a total of \$300,000 in receipts in a calendar year. It does not matter that the receipts were from apportionable activities that are subject to tax under different B&O tax classifications. Substantial nexus is determined by the totality of the taxpayer's apportionable activities in Washington.

Example 2

Company B is domiciled in state Y. In a calendar year it has \$45,000 in property, \$45,000 in payroll, and \$240,000 in gross income assigned to Washington. Its total property is valued at \$200,000; its world-wide payroll is \$200,000; and its total gross income is \$2,000,000. Company B does not have substantial nexus with Washington during the calendar year based on the minimum nexus standards.

Example 3

Assume the same facts as Example 2 except world-wide payroll is \$150,000. With the changed facts, Company B has substantial nexus with Washington because thirty percent (30%) of its payroll is located in Washington.

Example 4

Company C is domiciled in Canada. It has \$200,000 of gross income assigned to Washington and \$300,000 of gross income assigned to Canada. Company C has no property or payroll located in Washington. Company C has substantial nexus with Washington because forty percent of its receipts are located in Washington.

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Example 5

Company D has no property located in Washington on January 1 and on December 31 of a calendar year. However, it brought \$100,000 in property into Washington on January 15 and removed it from Washington on November 15 of that calendar year. The department may compute the value of Company D's property on a monthly basis in this situation because doing so is required to properly reflect the average value of Company D's property in Washington ($\$100,000$ multiplied by ten divided by 12). Company D has nexus with Washington based on the value of the property averaged over the calendar year.

Example 6

Company E receives \$100,000 in gross income assigned to Washington on each of March 15, 2010; July 12, 2010; and November 1, 2010. Company E has substantial nexus with Washington for the period June 1, 2010, through December 31, 2010, because it received \$300,000 in gross income during 2010. Company E will also have substantial nexus with Washington for 2011 regardless of the amount of gross income attributed to Washington in 2011.