



RULE-MAKING ORDER

CR-103E (May 2009)
(Implements RCW 34.05.360)

Agency: Department of Revenue

Emergency Rule Only

Effective date of rule:

Emergency Rules

- Immediately upon filing.
- Later (specify) _____

Any other findings required by other provisions of law as precondition to adoption or effectiveness of rule?

- Yes
 - No
- If Yes, explain:

Purpose: Part I of Chapter 23, 2010 Laws 1st Special Session (2ESSB 6143) changed the apportionment and nexus requirements for apportionable activities, effective June 1, 2010. The Department has adopted the following emergency rule to explain how these requirements apply:

- WAC 458-20-19401 (Rule 19401) *Minimum nexus thresholds for apportionable activities*

Changes from the previous emergency rule filed January 28, 2011 under WSR 11-04-068 were made as follows:

- Rule 19401 – Changes to same language as proposed final rule. These changes include formatting, adding examples, clarifying language, and additional details.

Citation of existing rules affected by this order:

- Repealed:
- Amended:
- Suspended:

Statutory authority for adoption: RCW 82.32.300 and 82.01.060 (2)

Other authority :

EMERGENCY RULE

Under RCW 34.05.350 the agency for good cause finds:

- That immediate adoption, amendment, or repeal of a rule is necessary for the preservation of the public health, safety, or general welfare, and that observing the time requirements of notice and opportunity to comment upon adoption of a permanent rule would be contrary to the public interest.
- That state or federal law or federal rule or a federal deadline for state receipt of federal funds requires immediate adoption of a rule.
- That in order to implement the requirements or reductions in appropriations enacted in any budget for fiscal years 2009, 2010, or 2011, which necessitates the need for the immediate adoption, amendment, or repeal of a rule, and that observing the time requirements of notice and opportunity to comment upon adoption of a permanent rule would be contrary to the fiscal needs or requirements of the agency.

Reasons for this finding: **An emergency adoption of this new rule is necessary because the permanent rule cannot be adopted at this time.**

Date adopted: May 27, 2011

NAME Alan R. Lynn

SIGNATURE

TITLE Rules Coordinator

CODE REVISER USE ONLY

OFFICE OF THE CODE REVISER
STATE OF WASHINGTON
FILED

DATE: May 27, 2011

TIME: 2:48 PM

WSR 11-12-064

**Note: If any category is left blank, it will be calculated as zero.
No descriptive text.**

**Count by whole WAC sections only, from the WAC number through the history note.
A section may be counted in more than one category.**

The number of sections adopted in order to comply with:

Federal statute:	New	_____	Amended	_____	Repealed	_____
Federal rules or standards:	New	_____	Amended	_____	Repealed	_____
Recently enacted state statutes:	New	<u>1</u>	Amended	_____	Repealed	_____

The number of sections adopted at the request of a nongovernmental entity:

New	_____	Amended	_____	Repealed	_____
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The number of sections adopted in the agency's own initiative:

New	<u>1</u>	Amended	_____	Repealed	_____
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The number of sections adopted in order to clarify, streamline, or reform agency procedures:

New	_____	Amended	_____	Repealed	_____
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The number of sections adopted using:

Negotiated rule making:	New	_____	Amended	_____	Repealed	_____
Pilot rule making:	New	_____	Amended	_____	Repealed	_____
Other alternative rule making:	New	_____	Amended	_____	Repealed	_____

This rule was adopted on an emergency basis effective May 27, 2011. It may be used to determine tax liability until September 24, 2011, unless the Department adopts a permanent rule prior to this date.

NEW SECTION

WAC 458-20-19401 – Minimum nexus thresholds for apportionable activities. (1)

Introduction.

(a) This rule only applies to periods after May 31, 2010.

(b) The State of Washington imposes Business and Occupation (B&O) tax on “apportionable activities” measured by the gross income of the business. B&O tax may only be imposed if a person has “substantial nexus” with this state. For the purposes of apportionable activities, substantial nexus does not require a person to have physical presence in this state.

(c) The following rules may also be helpful:

(i) WAC 458-20-19402 Single factor receipts apportionment – Generally. This rule describes the general application of single factor receipts apportionment and applies only to tax liability incurred after May 31, 2010.

(ii) WAC 458-20-19403 Single factor receipts apportionment – Royalties. This rule describes the application of single factor receipts apportionment to gross income from royalties and applies only to tax liability incurred after May 31, 2010.

(iii) WAC 458-20-19404 Single factor receipts apportionment – Financial institutions. This rule describes the application of single factor receipts apportionment to certain income of financial institutions and applies only to tax liability incurred after May 31, 2010.

(iv) WAC 458-20-193 Inbound and outbound interstate sales of tangible personal property.

(v) WAC 458-20-194 Doing business inside and outside the state. This rule describes separate accounting and cost apportionment and applies only to tax liability incurred from January 1, 2006 through May 31, 2010.

(d) Examples included in this rule 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. For the examples in this rule, gross income received by the taxpayer is from engaging in apportionable activities. Also, unless otherwise stated, the examples do not apply to tax liability for periods prior to June 1, 2010.

(2) Definitions. Unless the context clearly requires otherwise, the definitions in this subsection apply throughout this rule.

(a) “Apportionable activities” includes only those activities subject to B&O tax under the following classifications:

(i) Service and other activities;

(ii) Royalties;

(iii) Travel agents and tour operators;

(iv) 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;

(v) Stevedoring and associated activities;
(vi) Disposing of low-level waste;
(vii) Title insurance producers, title insurance agents, or surplus line brokers;
(viii) Public or nonprofit hospitals;
(ix) Real estate brokers;
(x) Research and development performed by nonprofit corporations or associations;
(xi) Inspecting, testing, labeling, and storing canned salmon owned by another person;
(xii) Representing and performing services for fire or casualty insurance companies as an independent resident managing general agent licensed under the provisions of chapter 48.17 RCW;

(xiii) Contests of chance;
(xiv) Horse races;
(xv) International investment management services;
(xvi) Room and domiciliary care to residents of a boarding home;
(xvii) Aerospace product development;
(xviii) Printing or publishing a newspaper (but only with respect to advertising income);
(xix) Printing materials other than newspapers and publishing periodicals or magazines (but only with respect to advertising income); and

(xx) 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” under any of the tax classifications listed in (b)(i) through (xix) of this subsection (1) if this special tax classification did not exist.

(b) “Credit card” means a card or device existing for the purpose of obtaining money, property, labor, or services on credit

(c) “Gross income of the business” means the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, gains realized from trading in bonds or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any 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.

(d) The term “gross receipts” means gross income of the business from engaging in from apportionable activities.

(e) “Loan” means any extension of credit resulting from direct negotiations between the taxpayer and its customer, and/or the purchase, in whole or in part, of such extension of credit from another. “Loan” includes participations, syndications, and leases treated as loans for federal income tax purposes. “Loan” does not include: futures or forward contracts; options; notional principal contracts such as swaps; credit card receivables, including purchased credit card relationships; non-interest bearing balances due from depository institutions; cash items in the process of collection; federal funds sold; securities purchased under agreements to resell; assets held in a trading account; securities; interests in a REMIC, or other mortgage-backed or asset-backed security; and other similar items.

(f) “Net annual rental rate” means the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

(g) The terms “nexus” and “substantial nexus” are used interchangeably in this rule.

(h) “Property” means tangible, intangible, and real property owned or rented and used in this state in apportionable and non-apportionable activities during the calendar year, except property does not include ownership of or rights in computer software, including computer software used in providing a digital automated service; master copies of software; and digital goods or digital codes residing on servers located in this state. Refer to RCW 82.04.192 and 82.04.215 for definitions of the terms “computer software,” “digital automated services,” digital goods,” “digital codes,” and “master copies.”

(i) “State” means a state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any foreign country or political subdivision of a foreign country.

(j) “Securities” includes any intangible property defined as a security under Section 2(a)(1) of the Securities Act of 1933, including, but not limited to, negotiable certificates of deposit and municipal bonds.

(3) Substantial nexus.

(a) Substantial nexus with Washington exists where a person is:

(i) An individual and is a resident or domiciliary of this state during the calendar year;

(ii) A business entity and is organized or commercially domiciled in this state during the calendar year; or

(iii) A nonresident individual or a business entity that is organized and commercially domiciled outside this state, and in any calendar year the person has:

(A) More than fifty thousand dollars of property in this state;

(B) More than fifty thousand dollars of payroll in this state;

(C) More than two hundred fifty thousand dollars of receipts attributed to this state; or

(D) At least twenty-five percent of the person’s total property, total payroll, or total receipts attributed to this state.

(b) The Department will adjust the amounts listed in (a) of subsection (3) based on changes in the consumer price index as required by RCW 82.04.067.

(c) The minimum nexus thresholds in subsection (3)(a), above, are determined on a tax year basis. Generally, a tax year is the same as a calendar year. See RCW 82.32.270. For the purposes of this rule, tax years will be referred to as calendar years. This means that if a person meets the minimum nexus thresholds in a calendar year, that person is subject to B&O taxes for the entire calendar year.

Example 1. Company C is commercially domiciled in Washington and has only one employee in Washington who earns \$30,000 per year. Company C has substantial nexus with Washington because it is commercially domiciled in Washington. The minimum nexus thresholds described in subsection (3)(a)(iii) do not apply to business entities commercially domiciled in this state.

Example 2. Company Q is organized and domiciled outside of Washington. In a calendar year, Company Q maintains an office in Washington which houses a single employee. Company Q has \$40,000 in property located in Washington, the employee receives \$45,000 in compensation, and has \$200,000 in apportionable receipts attributed to Washington. Company Q’s total property is valued at \$200,000, total payroll compensation is \$400,000, and total apportionable receipts is \$5,000,000. Although Company Q has physical presence in Washington, it does not have substantial nexus with Washington for apportionable activities because: (a) it is not organized or domiciled in Washington and (b) does not have sufficient

property, payroll, or receipts to meet the minimum nexus thresholds identified in subsection 3(a) of this rule. See table below:

	Total	Washington	Percentage in Washington
Property	\$200,000	\$40,000	20%
Payroll	\$400,000	\$45,000	11.25%
Receipts	\$5,000,000	\$200,000	4%

(4) Property threshold.

(a) Location of property.

(i) Real property -- Real property owned or rented is in this state if the real property is located in this state.

(ii) Tangible personal property -- Tangible personal property is in this state if it is physically located in this state.

(iii) Intangible property -- Intangible property is in this state based on the following:

(A) A loan is located in this state if:

(I) More than fifty percent (50%) of the fair market value of the real and/or personal property securing the loan is in this state. Property that is subject to ownership registration (e.g., motor vehicles, aircraft, watercraft) is in the state where it is properly registered. For other property (not subject to ownership registration), the determination of whether the real or personal property securing a loan is in this state must be made as of the time the original agreement was made, and any and all subsequent substitutions of collateral must be disregarded; or

(II) If (I) above does not apply and the borrower is located in this state.

(iv) A borrower located in this state if:

(A) The borrower is engaged in business and the borrower's commercial domicile is located in this state; or

(B) The borrower is not engaged in business and the borrower's billing address is located in this state.

(v) A credit card receivable is in this state if the billing address of the card holder is located in this state.

(vi) A non-negotiable certificate of deposit is property in this state if the issuing bank branch is in this state.

(vii) Securities

(A) A negotiable certificate of deposit is property in this state if the owner is located in this state.

(B) A municipal bond is property in this state if the owner is located in this state.

(b) Value of property.

(i) Property the taxpayer owns and uses in this state, other than loans and credit card receivables, is valued at its original cost basis.

Example 3. In January 2008, ABC Corp. bought Machinery for \$65,000 for use in State X. On January 1, 2011, ABC Corp. brought that Machinery into Washington for the remainder of the year. ABC Corp. has nexus with Washington based on Machinery's original cost basis value of \$65,000. The value is \$65,000 even though the property has depreciated prior to entering the state.

(ii) Property the taxpayer rents and uses in this state is valued at eight times the net annual rental rate.

Example 4. Out-of-state Business X rents office space in Washington for \$6,000 per year and has \$5,000 of office furniture and equipment in Washington. Business X has nexus with Washington because the value of the rented office space (\$6,000 multiplied by eight, which is \$48,000) plus the value of office furniture and equipment exceeds the \$50,000 property threshold.

(iii) Loans and credit card receivables owned by the taxpayer are valued at their outstanding principal balance, without regard to any reserve for bad debts. However, if a loan or credit card receivable is actually charged off as a bad debt in whole or in part for federal income tax purposes (see 26 USC 166), the portion of the loan or credit card receivable charged off is deducted from the outstanding principal balance.

(c) Determining substantial nexus based on property value.

To determine whether the \$50,000 property threshold has been met, average the value of property in this state on the first and last day of the calendar year. The Department may require the averaging of monthly values during the calendar year if reasonably required to properly reflect the average value of the taxpayer's property in this state throughout the taxable period.

Example 5. Company Y has property in Washington valued at \$90,000 on January 1 and \$20,000 on December 31 of the same year. The value of property in Washington is \$55,000 $((90,000+20,000)/2)$. Company Y has substantial nexus with Washington.

Example 6. Company A has no property located in Washington on January 1st and on December 31st of a calendar year. However, it brought \$100,000 in property into Washington on January 15th and removed it from Washington on November 15th of that calendar year. The Department may compute the value of Company A's property on a monthly basis in this situation because it is required to properly reflect the average value of Company A's property in Washington (\$100,000 multiplied by ten (months) divided by 12 (months), which is \$83,333). Company A has substantial nexus with Washington based on the value of the property averaged over the calendar year.

Example 7. Company B has no property located in Washington on January 1st and on December 31st of a calendar year. However, it brought \$100,000 in property into Washington on January 15th and removed it from Washington on February 15th of that calendar year. The Department may compute the value of Company A's property on a monthly basis in this situation because it is required to properly reflect the average value of Company B's property in Washington (\$100,000 multiplied by one (month) divided by 12 (months), which is \$8,333.) Company B does not have substantial nexus with Washington based on the value of the property averaged over the calendar year, unless this amount exceeds 25% of Company B's total property value.

Example 8. IT Co. is domiciled in State X with Employee located in Washington who works from a home office. IT Co. provided to Employee \$5,000 of office supplies and \$15,000 of equipment owned by IT Co. IT Co. does not have nexus with Washington based on the value of the property in this State (\$20,000) because it does not exceed \$50,000, unless this amount exceeds 25% of IT Co.'s total property value. This example does not address the payroll threshold.

(5) Payroll threshold.

“Payroll” is the total compensation defined as gross income under 26 U.S.C. Sec. 61 (section 61 Internal Revenue Code of 1986), as of June 1, 2010, earned from apportionable and non-

apportionable activities paid during the calendar year to employees and to third-party representatives who represent the taxpayer in interactions with the taxpayer's clients and includes sales commissions.

(a) Employee compensation is received in this state if it is properly reportable in this state for unemployment compensation tax purposes, regardless of whether it was actually reported to this state.

Example 9. Company D is commercially domiciled in State X and has a single Employee whose payroll of \$80,000 is properly reportable in Washington for unemployment compensation purposes. Company D has substantial nexus with Washington during the calendar year based on compensation paid Employee.

Example 10. Assume the same facts as Example 9 except only 50% of Employee's payroll is properly reportable in Washington for unemployment compensation purposes for the calendar year. Employee's Washington compensation of \$40,000 does not meet the payroll threshold to establish substantial nexus with Washington, unless this amount exceeds 25% of total payroll compensation.

(b) Third party representatives receive payroll compensation in this state if the service(s) performed occurs entirely or primarily within this state.

(6) Receipts threshold.

The receipts threshold is met if a taxpayer receives more than \$250,000 from apportionable activities that is attributed to Washington.

(a) All receipts from all apportionable activities are accumulated to determine if the receipts threshold is satisfied. Receipts from activities that are not subject to apportionment (e.g., retailing, wholesaling, and extracting) are not used to determine if the receipts threshold has been satisfied.

(b) Receipts are attributed to Washington per WAC 458-20-19402 (General attribution), 19403 (Royalties), and 19404 (Financial institutions).

Example 11. Company E is commercially domiciled in State X. In a calendar year it has \$150,000 in royalty receipts attributed to Washington per WAC 458-20-19403 and \$150,000 in gross receipts from other apportionable activities attributed to Washington per WAC 458-20-19402. Company E has substantial nexus with Washington because it has a total of \$300,000 in receipts from apportionable activities attributed to Washington 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. The receipts threshold is determined by the totality of the taxpayer's apportionable activities in Washington.

Example 12. Calculation of minimum nexus thresholds during the 2010 transition year. Company F receives \$200,000 in gross receipts attributed to Washington on March 15, 2010; \$100,000 on July 12, 2010; and \$100,000 on November 1, 2010. Company F has substantial nexus with Washington for the period June 1, 2010, through December 31, 2010, because it received \$400,000 in gross receipts during 2010.

(7) Application of 25% threshold.

If at least twenty-five percent (25%) of a non-resident taxpayer's property, payroll, or receipts from apportionable activities is in Washington, then the taxpayer has substantial nexus with Washington. The twenty-five percent (25%) threshold is determined by dividing:

- (a) The value of property located in Washington by the total value of taxpayer's property;
- (b) Payroll located in Washington by taxpayer's total payroll; or
- (c) Apportionable receipts attributed to Washington by total apportionable receipts.

Example 13. Company G is organized and commercially domiciled in State X. In a calendar year it has \$45,000 in property, \$45,000 in payroll, and \$240,000 in gross receipts attributed to Washington. Its total property is valued at \$200,000; its world-wide payroll is \$150,000; and its total gross receipts are \$2,000,000. The percentages of property, payroll, and receipts are shown in the table below:

	Total	Washington	Percentage in Washington
Property	\$200,000	\$45,000	22.5%
Payroll	\$150,000	\$45,000	30%
Receipts	\$2,000,000	\$240,000	12%

Company G has substantial nexus with Washington because more than twenty-five (25%) percent of its payroll is located in Washington.

(8) Application to local gross receipts business and occupations taxes.

This rule does not apply to the nexus requirements for local gross receipts business and occupation taxes.

(9) Continuing substantial nexus.

Pursuant to RCW 82.04.220, if a person meets any of the minimum nexus thresholds in subsection 3, above, in a calendar year, the person has nexus for the following calendar year and will owe B&O tax on its gross receipts attributable to Washington for that additional year.

Example 14: Assume Corporation J earns receipts attributable to Washington that do not exceed the minimum threshold from apportionable activities in any year, and whose physical presence in Washington ends on July 20, 2008. Corporation J's B&O tax reporting obligation for any gross receipts earned in Washington ends on Dec. 31, 2010.

Example 15: Assume Corporation K earns receipts attributable to Washington from July 1, 2008 through March 1, 2010 and exceeds the minimum threshold from apportionable activities in 2010. Assuming Corporation K does not exceed any of the minimum nexus thresholds in 2011, the taxpayer's B&O tax reporting obligation for any gross receipts attributable to Washington ends on Dec. 31, 2011.

Example 16: Assume Corporation L exceeded Washington's minimum nexus thresholds for apportionable income from 2010 through 2012, but does not meet them in 2013. Corporation L's B&O tax reporting obligation for any gross receipts earned in Washington ends on December 31, 2013.