



RULE-MAKING ORDER

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

Agency: Department of Revenue

Permanent Rule Only

Effective date of rule:

Permanent Rules

31 days after filing.

Other (specify) _____ (If less than 31 days after filing, a specific finding under RCW 34.05.380(3) is required and should be stated below)

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

Yes No If Yes, explain:

Purpose:

Chapter 23, Laws of 2010 1st sp. sess. changed the apportionment requirements for apportionable activities, effective June 1, 2010. The Department had previously adopted emergency rules while it worked with stakeholders to develop permanent rules explaining the implications of this legislation.

The Department is at this time adopting a new permanent rule WAC 458-20-19403 (Rule 19403) *Apportionable royalty receipts attribution*. This rule explains how to attribute apportionable royalty receipts.

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Repealed: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 :

PERMANENT RULE (Including Expedited Rule Making)

Adopted under notice filed as WSR 12-06-080 on March 7, 2012.

Describe any changes other than editing from proposed to adopted version:

Language was added to subsection (105) to clarify that the examples in the rule are general guides to the application of the rule and that there may be other reasonable methods to determine where the intangible property is used.

If a preliminary cost-benefit analysis was prepared under RCW 34.05.328, a final cost-benefit analysis is available by contacting: An analysis was not prepared.

Date adopted: September 17, 2012

NAME

Alan R. Lynn

SIGNATURE

TITLE

Rules Coordinator

CODE REVISER USE ONLY

OFFICE OF THE CODE REVISER
STATE OF WASHINGTON
FILED

DATE: September 17, 2012

TIME: 4:44 PM

WSR 12-19-072

**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Federal statute:	New	_____	Amended	_____	Repealed	_____
Federal rules or standards:	New	_____	Amended	_____	Repealed	_____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	Amended	_____	Repealed	_____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 September 17, 2012 and becomes effective October 18, 2012. It may be used to determine tax liability on and after the effective date, until the codified version is available from the code reviser's office.

NEW SECTION

WAC 458-20-19403 Apportionable royalty receipts attribution.

PART 1. INTRODUCTION.

(101) **General.** Effective June 1, 2010, Washington changed its method of apportioning royalty receipts. This rule only addresses how apportionable royalty receipts must be attributed for the purposes of economic nexus and single factor receipts apportionment. This rule is limited to the attribution of apportionable royalty receipts for periods after May 31, 2010.

(102) **Guide to this rule.** This rule is divided into two parts as follows:

1. Introduction.
2. How to attribute apportionable royalty receipts.

(103) **Reference to WAC 458-20-19402.** This rule only provides a method to attribute apportionable royalty receipts in lieu of the attribution methods specified in WAC 458-20-19402 (301)(a) and (b). Otherwise, WAC 458-20-19402 controls the apportionment of royalty receipts. Specifically, WAC 458-20-19402 provides: (a) An overview of single factor receipts apportionment (Part 2); (b) guidance on how to attribute apportionable royalty receipts if this rule does not apply (Part 3); (c) guidance on how to calculate the receipts factor (Part 4); (d) guidance on how to determine taxable income (Part 5); and (e) reporting instructions (Part 6).

(104) **Other rules.** Taxpayers may also find helpful information in the following rules:

(a) WAC 458-20-19401 **Minimum nexus thresholds for apportionable activities.** This rule describes minimum nexus thresholds applicable to apportionable activities that are effective after May 31, 2010.

(b) 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.

(c) 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.

(d) 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.

(e) WAC 458-20-14601 **Financial institutions--Income apportionment.** This rule describes the apportionment of income for financial institutions for tax liability incurred prior to June 1, 2010.

(105) **Examples.** 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. The examples in this rule assume all gross income received by the taxpayer is apportionable royalty receipts. Unless otherwise stated, the examples do not apply to tax liability prior to June 1, 2010.

When an example states that a particular attribution method is a reasonable method of proportionally attributing the use of an intangible, this does not preclude the existence of other reasonable methods of proportionally attributing the use depending on the specific facts and circumstances of a taxpayer's situation.

(106) **Definitions.** The definitions included in WAC 458-20-19401 and 458-20-19402 apply to this rule unless the context clearly requires otherwise. Additionally, the definitions in this subsection apply specifically to this rule.

(a) **"Apportionable royalty receipts"** means all compensation for the use of intangible property, including charges in the nature of royalties, regardless of where the intangible property will be used. Apportionable royalty receipts does not include:

(i) Compensation for any natural resources;

(ii) The licensing of prewritten computer software to an end user;

(iii) The licensing of digital goods, digital codes, or digital automated services to an end user as defined in RCW 82.04.190(11); or

(iv) Receipts from the outright sale of intangible property.

(b) **"Intangible property"** includes: Copyrights, patents, licenses, franchises, trademarks, trade names, and other similar intangible property/rights.

(c) **"Reasonable method of proportionally attributing"** means a method of determining where the use occurs, and thus where receipts are attributed that is uniform, consistent, accurately reflects the market, and is not distortive.

PART 2. HOW TO ATTRIBUTE APPORTIONABLE ROYALTY RECEIPTS.

(201) **Attribution of income.** Apportionable royalty

receipts are attributed to states based on a cascading method or series of steps. The department expects that most taxpayers will attribute apportionable royalty receipts based on (a)(i) of this subsection because the department believes that either taxpayers will know the place of use or a "reasonable method of proportionally attributing" receipts will generally be available. These steps are:

(a) **Where the customer uses the intangible property.**

(i) If a taxpayer can reasonably determine the amount of a specific apportionable royalty receipt that relates to a specific use in a state, that royalty receipt is attributable to that state. This may be shown by application of a reasonable method of proportionally attributing use, and thus receipts, among the states. The result determines the apportionable royalty receipts attributed to each state. Under certain situations, the use of data based on an attribution method specified in (b) and (c) of this subsection may also be a reasonable method of proportionally attributing receipts among states.

(ii) If a taxpayer is unable to separately determine, or use a reasonable method of proportionally attributing, the use and receipts in specific states under (a)(i) of this subsection, and the customer used the intangible property in multiple states, the apportionable royalty receipts are attributed to the state in which the intangible property was primarily used. Primarily means, in this case, more than fifty percent.

(b) **Office of negotiation.** If the taxpayer is unable to attribute apportionable royalty receipts to a location under (a) of this subsection, then apportionable royalty receipts must be attributed to the office of the customer from which the royalty agreement with the taxpayer was negotiated.

(c) If the taxpayer is unable to attribute apportionable royalty receipts to a location under (a) and (b) of this subsection, then the steps specified in WAC 458-20-19402 (301)(c) through (g) shall apply to apportionable royalty receipts.

(202) **Framework for analysis of the "use of intangible property."** The use of intangible property and therefore the attribution of apportionable royalty receipts from the use of intangible property will generally fall into one of the following three categories:

(a) **Marketing use** means the intangible property is used by the taxpayer's customer for purposes that include, but are not limited to, marketing, displaying, selling, and exhibiting. The use of the intangible property is connected to the sale of goods or services. Typically, this category includes trademarks, copyrights, trade names, logos, or other intangibles with promotional value. Receipts from the marketing use of intangible property are generally attributed to the location of

the consumer of the goods or services promoted using the intangible property.

Example 1. SportsCo licenses to AthleticCo the right to use its trademark on a basketball that AthleticCo manufactures, markets, and sells at retail on its web site. This is a marketing use. SportsCo is paid a fee based on AthleticCo's basketball sales in multiple states. SportsCo knows that sales from the AthleticCo web site delivered to Washington represent 10% of AthleticCo's total sales. Pursuant to subsection (201)(a)(i) of this section, SportsCo will attribute 10% of its apportionable royalty receipts received from AthleticCo to Washington. The remaining 90% will be attributed to other states.

Example 2. Same facts as Example 1, except that AthleticCo sells its basketballs at wholesale to MiddleCo, a distributor with its receiving warehouse located in Idaho. MiddleCo then sells the basketballs to RetailW, a retailer with stores in Washington, Oregon, and California. SportsCo would generally attribute its apportionable royalty receipts to the location of RetailW's customers. However, SportsCo does not have any data, and cannot reasonably obtain any data, relating to RetailW's customer locations. Pursuant to subsection (201)(a)(i) of this section, SportsCo may reasonably attribute receipts to Washington based on the percentage of RetailW's store locations in Washington as long as such attribution does not distort the number of customers in each state. SportsCo knows that 15% of RetailW's store locations are in Washington therefore it is reasonable for SportsCo to attribute 15% of its apportionable royalty receipts to Washington. The remaining 85% will be attributed to other states.

Example 3. MusicCo licenses to RetailCo the right to make copies of a digital song and sell those copies at retail on the internet for the U.S. market only. This is a marketing use. RetailCo has a single copy of the song on its server in Virginia. Each time a customer comes to RetailCo's web site and makes a purchase of the song, RetailCo creates a copy of the song (e.g., a new file) that is then available for sale to the customer. MusicCo would usually attribute its apportionable royalty receipts to the location of RetailCo's customers. However, MusicCo does not have any data, and cannot reasonably obtain any specific data, relating to RetailCo's customers' locations. Pursuant to subsection (201)(a)(i) of this section, MusicCo may reasonably attribute receipts to each state based on the percentage that each state's population represents in relation to the total market population, which in this case is the U.S. population, as long as such attribution does not distort the number of customers in each state.

Example 4. A local baseball star, Joe Ball, plays for a professional athletic franchise located in Washington. Joe Ball

licenses to T-ShirtCo the right to put his image on t-shirts and sell them on the internet in the U.S. market. This is a marketing use limited to the U.S. by license. Joe Ball does not know where T-ShirtCo's customers are located and cannot reasonably obtain data to reasonably attribute receipts. In the absence of actual sales data from T-ShirtCo, Joe Ball cannot use relative population data to attribute receipts to the states as was done in Example 3 above. This is because Joe Ball is an overwhelmingly "local" celebrity in Washington. Joe Ball does not have a "national appeal" such that t-shirt sales by T-ShirtCo would be significant outside Washington. In this case, Joe Ball is unable to separately determine the use of the intangible property in specific states pursuant to subsection (201)(a)(i) of this section. However, it is reasonable for Joe Ball to assume that sales by T-ShirtCo of Joe Ball shirts are primarily delivered to customers in Washington. Accordingly, Joe Ball should assign all receipts received from T-ShirtCo to Washington, pursuant to subsection (201)(a)(ii) of this section.

Example 5. MegaComputer ("Mega") manufactures and sells computers. SoftwareCo licenses to MegaComputer the right to copy and install the software on Mega's computers, which are then offered for sale to consumers. This is a marketing use by Mega. Mega sells its computers to DistributorX that in turn sells the computers to RetailerY. Mega uses the intangible property at the location of the consumer. If SoftwareCo can attribute its receipts to the location of the consumer (e.g., through the use of software registration data obtained from consumer), SoftwareCo should do so. In the absence of that more precise information, and pursuant to subsection (201)(a)(i) of this section, it would be "reasonable" for SoftwareCo to attribute its receipts in proportion to the number of RetailerY stores in each state.

(b) **Nonmarketing use** means the intangible property is used for purposes other than marketing, displaying, selling, and exhibiting. This use of the intangible property is often connected to manufacturing, research and development, or other similar nonmarketing uses. Typically, this category includes patents, know-how, designs, processes, models, and similar intangibles. Receipts from the nonmarketing use of intangible property are generally attributed to a specific location or locations where the manufacturing, research and development, or other similar nonmarketing use occurs.

Example 6. RideCo licenses the right to use its patented scooter brake to FunRide for the purpose of manufacturing scooters. FunRide will market the scooter under its own brand. This is a nonmarketing use. RideCo knows that FunRide will manufacture scooters in Michigan and Washington and that the scooter design is used equally in Michigan and Washington. Pursuant to subsection (201)(a)(i) of this section, RideCo will

attribute its receipts from the license of its patent equally to Michigan and Washington.

Example 7. BurgerZ licenses to JoeHam the right to use its jumbo hamburger making process and know-how. This is a nonmarketing use. JoeHam markets the jumbo hamburgers under its own brand. JoeHam has two restaurant locations, one in Washington and one in Oregon. BurgerZ's fee for the intangible rights is based on a percentage of sales at each location. Pursuant to subsection (201)(a)(i) of this section, BurgerZ will attribute receipts from its license with JoeHam to each location based on sales at those locations.

Example 8. WidgetCo licenses the use of its patent to ManuCo, to manufacture widgets. ManuCo has three manufacturing plants located in Michigan where it will use the patent for manufacturing widgets. ManuCo also has a single research and development (R&D) facility in Washington where it will use the patented technology to develop the next generation of its widgets. These are nonmarketing uses. WidgetCo charges ManuCo a single price for the use of the patent in manufacturing and R&D. In the absence of information to the contrary, it is reasonable for WidgetCo to assume ManuCo's use of the patent is equal at all of ManuCo's relevant locations. Pursuant to subsection (201)(a)(i) of this section, because there are four locations where the patent is used equally, WidgetCo will attribute 25% of its apportionable royalty receipts to each of the four locations. Accordingly, 75% of the apportionable royalty receipts will be attributed to Michigan to reflect the use of the patent at the three manufacturing locations, and 25% of the apportionable royalty receipts will be attributable to Washington to reflect the use of the patent at the single R&D location.

(c) **Mixed use** means licensing the use of intangible property for both marketing and nonmarketing uses. Mixed use licenses may be sold for a single fee or more than one fee.

(i) **Single fee.** Where a single fee is charged for the mixed use license, it will be presumed that receipts were earned for a "marketing use" pursuant to the guidelines provided in (a) of this subsection, except to the extent that the taxpayer can reasonably establish otherwise or the department of revenue determines otherwise.

Example 9. ProcessCo licenses to KimchiCo, for a single fee, the right to use its patent and trademark for manufacturing and marketing a food processing device. KimchiCo has a single manufacturing plant in Washington and markets the finished product solely in Korea. This mixed use license for a single fee is presumed to be for a marketing use. Accordingly, ProcessCo must attribute receipts under the guidelines established for marketing uses. Pursuant to subsection (201)(a)(i) of this section, KimchiCo is marketing and selling

the device only in Korea; therefore, all receipts will be attributed to Korea.

Example 10. FranchiseCo operates a restaurant franchising business and licenses the right to use its trademark, patent, and know-how to EatQuick for a single fee. EatQuick will use the intangibles to create and market its food product. This is a mixed use license for a single fee and will be presumed to be for a marketing use. EatQuick has a single restaurant location in Washington, where all sales are made. Pursuant to subsection (201)(a)(i) of this section, the intangible property is used by EatQuick in Washington at its restaurant location. Taxpayer will attribute 100% of its apportionable royalty receipts earned under the EatQuick license to Washington.

Example 11. Same facts as Example 10, except that EatQuick has five restaurant locations, one each in: Washington, California, Oregon, Idaho, and Montana. EatQuick pays an annual lump sum to FoodCo. This is a mixed use license for a single fee and will be presumed to be for marketing use. Further, FranchiseCo knows that EatQuick's use of the intangible property is equal at all locations. The intangible property is used equally by EatQuick in five states including Washington. Accordingly, pursuant to subsection (201)(a)(i) of this section, FoodCo will attribute 20% of its apportionable royalty receipts to each location, including Washington.

(ii) **More than one fee.** Where the mixed use license involves separate fees for each type of use and separate itemization is reasonable, then each fee will receive separate attribution treatment pursuant to (a) and (b) of this subsection. If the department determines that the separate itemization is not reasonable, the department may provide for more accurate attribution using the guidelines in (a) and (b) of this subsection.

Example 12. Same as Example 9, except the license agreement states that the nonmarketing use of the patent is valued at \$450,000, and the marketing use of the trademark is valued at \$550,000. This is a mixed use license with more than one fee. The stated values for the separate uses are reasonable. Pursuant to subsection (201)(a)(i) of this section, the receipts associated with the nonmarketing use are \$450,000 and attributable to Washington where the patent is used in manufacturing. The receipts associated with the marketing use are \$550,000 and attributed to Korea where the trademark is used for marketing and selling the finished product.

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