



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:

Effective June 1, 2010, chapter 23, Laws of 2010 1st sp. sess. changed Washington's method of apportioning certain gross income from engaging in business as a financial institution. RCW 82.04.460 requires to based on the Model regulation for the apportionment of income of financial institutions adopted by the Multistate Tax Commission (MTC).

The Department had previously adopted emergency rules while it worked with stakeholders to develop a permanent WAC 458-20-19404 (Rule 19404) *Financial institutions – Income apportionment* to explain the implications of this legislation for financial institutions. The Department is at this time adopting a permanent Rule 19404 to address how such gross income must be apportioned when a financial institution engages in business both within and outside the state.

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Repealed: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 12-06-081** on **March 7, 2012** (date).

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

- Subsection (2)(b) Added language from the MTC's model rule that was inadvertently omitted.
- Subsection (4)(c) Removed a reference to interest on certain loans secured by commercial aircraft as being excluded from the new apportionment calculation. RCW 82.04.43391 treats these amounts as deductions, not exclusions.

If a preliminary cost-benefit analysis was prepared under RCW 34.05.328, a final cost-benefit analysis is available by contacting:

Name: Chris Coffman phone (360) 534-1590
Address: Dept. of Revenue e-mail ChrisC@dor.wa.gov
PO Box 47453
Olympia, Washington 98504-7453

Date adopted: September 14, 2012

NAME

Alan R. Lynn

SIGNATURE

TITLE

Rules Coordinator

CODE REVISER USE ONLY

OFFICE OF THE CODE REVISER
STATE OF WASHINGTON
FILED

DATE: September 14, 2012
TIME: 2:57 PM

WSR 12-19-064

**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	_____
-----	-------	---------	-------	----------	-------

The number of sections adopted in the agency's own initiative:

New	<u>1</u>	Amended	_____	Repealed	_____
-----	----------	---------	-------	----------	-------

The number of sections adopted in order to clarify, streamline, or reform agency procedures:

New	_____	Amended	_____	Repealed	_____
-----	-------	---------	-------	----------	-------

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 14, 2012 and becomes effective October 15, 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 458-20-19404 Financial institutions--Income apportionment. (1) Introduction.

(a) Effective June 1, 2010, section 108, chapter 23, Laws of 2010 1st sp. sess. changed Washington's method of apportioning certain gross income from engaging in business as a financial institution. This rule addresses how such gross income must be apportioned when the financial institution engages in business both within and outside the state.

(b) Taxpayers may also find helpful information in the following rules:

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

(ii) WAC 458-20-19402, Single factor receipts apportionment--Generally. This rule describes the general application of single factor receipts apportionment that is effective after May 31, 2010.

(iii) 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.

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

(v) WAC 458-20-14601, Financial institutions--Income apportionment. This rule describes the apportionment of income for financial institutions for periods prior to June 1, 2010.

(c) Financial institutions engaged in making interstate sales of tangible personal property should also refer to WAC 458-20-193, Inbound and outbound interstate sales of tangible personal property.

(2) Apportionment and allocation.

(a) Except as otherwise specifically provided, a financial institution taxable under RCW 82.04.290 and taxable in another state must attribute and apportion its service and other activities income as provided in this rule. Any other apportionable income must be apportioned pursuant to WAC 458-20-

19402, Single factor receipts apportionment--Generally or WAC 458-20-19403, Single factor receipts apportionment--Royalties. "Apportionable income" means gross income of the business generated from engaging in apportionable activities as defined in WAC 458-20-19401, Minimum nexus thresholds for apportionable activities, including income received from apportionable activities performed outside this state if the income would be taxable under chapter 82.04 RCW if received from activities in this state, less any deductions allowable under chapter 82.04 RCW. All gross income that is not includable from apportionable activities must be allocated pursuant to chapter 82.04 RCW. A financial institution organized under the laws of a foreign country, the Commonwealth of Puerto Rico, or a territory or possession of the United States, except such institutions that are exempt under RCW 82.04.315, whose effectively connected income (as defined under the federal Internal Revenue Code) is taxable both in this state and another state, other than the state in which it is organized, must allocate and apportion its gross income as provided in this rule.

(b) All apportionable income shall be apportioned to this state by multiplying such income by the apportionments percentage. The apportionment percentage is determined by the taxpayer's receipts factor (as described in subsection (4) of this rule).

(c) The receipts factor must be computed according to the method of accounting (cash or accrual basis) used by the taxpayer for Washington state tax purposes for the taxable period. Persons should refer to WAC 458-20-197, When tax liability arises and WAC 458-20-199, Accounting methods for further guidance on the requirements of each accounting method. Generally, financial institutions are required to file returns on a monthly basis. To enable financial institutions to more easily comply with this rule, financial institutions may file returns using the receipts factor calculated based on the most recent calendar year for which information is available. If a financial institution does not calculate its receipts factor based on the previous calendar year for which information is available, it must use the current year information to make that calculation. In either event, a reconciliation must be filed for each year not later than October 31st of the following year. The reconciliation must be filed on a form approved by the department. In the case of consolidations, mergers, or divestitures, a taxpayer must make the appropriate adjustments to the factors to reflect its changed operations.

(d) Interest and penalties on reconciliations under (c) of this subsection apply as follows:

(i) In either event (refund or additional taxes due), interest will apply in a manner consistent with tax assessments.

(ii) Penalties as provided in RCW 82.32.090 will apply to

any such additional tax due only if the reconciliation for a tax year is not completed and additional tax is not paid by October 31st of the following year.

(e) If the allocation and apportionment provisions of this rule do not fairly represent the extent of its business activity in this state, the taxpayer may petition for, or the department may require, in respect to all or any part of the taxpayer's business activity:

(i) Separate accounting;

(ii) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(iii) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's receipts.

(3) **Definitions.** The following definitions apply throughout this rule unless the context clearly requires otherwise:

(a) **"Billing address"** means the location indicated in the books and records of the taxpayer on the first day of the taxable period (or on such later date in the taxable period when the customer relationship began) as the address where any notice, statement and/or bill relating to a customer's account is mailed.

(b) **"Borrower or credit card holder located in this state"** means:

(i) A borrower, other than a credit card holder, that is engaged in a trade or business and maintains its commercial domicile in this state; or

(ii) A borrower that is not engaged in a trade or business or a credit card holder, whose billing address is in this state.

(c) **"Commercial domicile"** means:

(i) The headquarters of the trade or business, that is, the place from which the trade or business is principally managed and directed; or

(ii) If a taxpayer is organized under the laws of a foreign country, or of the Commonwealth of Puerto Rico, or any territory or possession of the United States, such taxpayer's commercial domicile is deemed for the purposes of this rule to be the state of the United States or the District of Columbia from which such taxpayer's trade or business in the United States is principally managed and directed. It is presumed, subject to rebuttal by a preponderance of the evidence, that the location from which the taxpayer's trade or business is principally managed and directed is the state of the United States or the District of Columbia to which the greatest number of employees are regularly connected or out of which they are working, irrespective of where the services of such employees are performed, as of the last day of the taxable period.

(d) **"Credit card"** means credit, travel or entertainment card.

(e) **"Credit card issuer's reimbursement fee"** means the fee a taxpayer receives from a merchant's bank because one of the persons to whom the taxpayer has issued a credit card has charged merchandise or services to the credit card.

(f) **"Department"** means the department of revenue.

(g) **"Employee"** means, with respect to a particular taxpayer, any individual who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee of that taxpayer.

(h) **"Financial institution"** means:

(i) Any corporation or other business entity chartered under Title 30, 31, 32, or 33 RCW, or registered under the Federal Bank Holding Company Act of 1956, as amended, or registered as a savings and loan holding company under the Federal National Housing Act, as amended;

(ii) A national bank organized and existing as a national bank association pursuant to the provisions of the National Bank Act, 12 U.S.C. Sec. 21 et seq.;

(iii) A savings association or federal savings bank as defined in the Federal Deposit Insurance Act, 12 U.S.C. Sec. 1813(b)(1);

(iv) Any bank or thrift institution incorporated or organized under the laws of any state;

(v) Any corporation organized under the provisions of 12 U.S.C. Secs. 611 to 631;

(vi) Any agency or branch of a foreign depository as defined in 12 U.S.C. Sec. 3101 that is not exempt under RCW 82.04.315;

(vii) Any credit union, other than a state or federal credit union exempt under state or federal law;

(viii) A production credit association organized under the Federal Farm Credit Act of 1933, all of whose stock held by the Federal Production Credit Corporation has been retired.

(i) **"Gross income of the business," "gross income," or "income":**

(i) Has the same meaning as in RCW 82.04.080 and means the value proceeding or accruing by reason of the transaction of the business engaged in and includes compensation for the rendition of services, gains realized from trading in stocks, 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; and

(ii) Does not include amounts received from an affiliated

person if those amounts are required to be determined at arm's length per sections 23A or 23B of the Federal Reserve Act. For the purpose of (3)(i) of this subsection, affiliated means the affiliated person and the financial institution are under common control. Control means the possession (directly or indirectly), of more than fifty percent of power to direct or cause the direction of the management and policies of each entity. Control may be through voting shares, contract, or otherwise.

(iii) Financial institutions must determine their gross income of the business from gains realized from trading in stocks, bonds, and other evidences of indebtedness on a net annualized basis.

(j) **"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; noninterest 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 real estate mortgage investment conduit (REMIC), or other mortgage-backed or asset-backed security; and other similar items.

(k) **"Loan secured by real property"** means that fifty percent or more of the aggregate value of the collateral used to secure a loan or other obligation was real property, when valued at fair market value as of the time the original loan or obligation was incurred.

(l) **"Merchant discount"** means the fee (or negotiated discount) charged to a merchant by the taxpayer for the privilege of participating in a program whereby a credit card is accepted in payment for merchandise or services sold to the card holder.

(m) **"Participation"** means an extension of credit in which an undivided ownership interest is held on a *pro rata* basis in a single loan or pool of loans and related collateral. In a loan participation, the credit originator initially makes the loan and then subsequently resells all or a portion of it to other lenders. The participation may or may not be known to the borrower.

(n) **"Person"** has the meaning given in RCW 82.04.030.

(o) **"Regular place of business"** means an office at which the taxpayer carries on its business in a regular and systematic manner and which is continuously maintained, occupied and used by employees of the taxpayer.

(p) **"Service and other activities income"** means the gross

income of the business taxable under RCW 82.04.290, including income received from activities outside this state if the income would be taxable under RCW 82.04.290 if received from activities in this state, less the exemptions and deductions allowable under chapter 82.04 RCW.

(q) **"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.

(r) **"Syndication"** means an extension of credit in which two or more persons fund and each person is at risk only up to a specified percentage of the total extension of credit or up to a specified dollar amount.

(s) **"Taxable in another state"** means either:

(i) The taxpayer is subject to business activities tax by another state on its service and other activities income; or

(ii) The taxpayer is not subject to a business activities tax by another state on its service and other activities income, but that state has jurisdiction to subject the taxpayer to a business activities tax on such income under the substantial nexus standards explained in WAC 458-20-19401. For purposes of (s) of this subsection, "business activities tax" means a tax measured by the amount of, or economic results of, business activity conducted in a state. The term includes taxes measured in whole or in part on net income or gross income or receipts. Business activities tax does not include a sales tax, use tax, or a similar transaction tax, imposed on the sale or acquisition of goods or services, whether or not denominated a gross receipts tax or a tax imposed on the privilege of doing business.

(t) **"Taxable period"** means the calendar year during which tax liability is incurred.

(4) **Receipts factor.**

(a) General. The receipts factor is a fraction, the numerator of which is the apportionable income of the taxpayer in this state during the taxable period and the denominator of which is the apportionable income of the taxpayer inside and outside this state during the taxable period. The method of calculating receipts for purposes of the denominator is the same as the method used in determining receipts for purposes of the numerator.

(b) Interest from loans secured by real property.

(i) The numerator of the receipts factor includes interest and fees or penalties in the nature of interest from loans secured by real property if the property is located within this state. If the property is located both within this state and one or more other states, the income described in this subsection (b)(i) is included in the numerator of the receipts factor if more than fifty percent of the fair market value of

the real property is located within this state. If more than fifty percent of the fair market value of the real property is not located within any one state, then the income described in this subsection (b)(i) must be included in the numerator of the receipts factor if the borrower is located in this state.

(ii) The determination of whether the real property securing a loan is located within 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.

(c) Interest from loans not secured by real property. The numerator of the receipts factor includes interest and fees or penalties in the nature of interest from loans not secured by real property if the borrower is located in this state.

(d) Net gains from the sale of loans. The numerator of the receipts factor includes net gains from the sale of loans. Net gains from the sale of loans includes income recorded under the coupon stripping rules of Section 1286 of the federal Internal Revenue Code.

(i) The amount of net gains (but not less than zero) from the sale of loans secured by real property included in the numerator is determined by multiplying such net gains by a fraction, the numerator of which is the amount included in the numerator of the receipts factor pursuant to (b) of this subsection and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans secured by real property.

(ii) The amount of net gains (but not less than zero) from the sale of loans not secured by real property included in the numerator is determined by multiplying such net gains by a fraction, the numerator of which is the amount included in the numerator of the receipts factor pursuant to (c) of this subsection (4) and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans not secured by real property.

(e) Receipts from credit card receivables. The numerator of the receipts factor includes interest and fees or penalties in the nature of interest from credit card receivables and income from fees charged to card holders, such as annual fees, if the billing address of the card holder is in this state.

(f) Net gains from the sale of credit card receivables. The numerator of the receipts factor includes net gains (but not less than zero) from the sale of credit card receivables multiplied by a fraction, the numerator of which is the amount included in the numerator of the receipts factor pursuant to (e) of this subsection and the denominator of which is the taxpayer's total amount of interest and fees or penalties in the nature of interest from credit card receivables and fees charged to card holders.

(g) Credit card issuer's reimbursement fees. The numerator

of the receipts factor includes all credit card issuer's reimbursement fees multiplied by a fraction, the numerator of which is the amount included in the numerator of the receipts factor pursuant to (e) of this subsection and the denominator of which is the taxpayer's total amount of interest and fees or penalties in the nature of interest from credit card receivables and fees charged to card holders.

(h) Receipts from merchant discount. The numerator of the receipts factor includes receipts from merchant discount if the commercial domicile of the merchant is in this state. Such receipts must be computed net of any cardholder charge backs, but must not be reduced by any interchange transaction fees or by any issuer's reimbursement fees paid to another for charges made by its card holders.

(i) Loan servicing fees.

(i)(A) The numerator of the receipts factor includes loan servicing fees derived from loans secured by real property multiplied by a fraction, the numerator of which is the amount included in the numerator of the receipts factor under (b) of this subsection and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans secured by real property.

(B) The numerator of the receipts factor includes loan servicing fees derived from loans not secured by real property multiplied by a fraction, the numerator of which is the amount included in the numerator of the receipts factor under (c) of this subsection and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans not secured by real property.

(ii) If the taxpayer receives loan servicing fees for servicing either the secured or the unsecured loans of another, the numerator of the receipts factor includes such fees if the borrower is located in this state.

(j) Receipts from services. The numerator of the receipts factor includes receipts from services not otherwise apportioned under this subsection (4) if the service is performed in this state. If the service is performed both inside and outside this state, the numerator of the receipts factor includes receipts from services not otherwise apportioned under this subsection (4), if a greater proportion of the activity producing the receipts is performed in this state based on cost of performance.

(k) Receipts from investment assets and activities and trading assets and activities.

(i) Interest, dividends, net gains (but not less than zero) and other income from investment assets and activities and from trading assets and activities are included in the receipts factor. Investment assets and activities and trading assets and activities include, but are not limited to: Investment

securities; trading account assets; federal funds; securities purchased and sold under agreements to resell or repurchase; options; futures contracts; forward contracts; notional principal contracts such as swaps; equities; and foreign currency transactions. With respect to the investment and trading assets and activities described in (k)(i)(A) and (B) of this subsection, the receipts factor includes the following:

(A) The receipts factor includes the amount by which interest from federal funds sold and securities purchased under resale agreements exceeds interest expense on federal funds purchased and securities sold under repurchase agreements.

(B) The receipts factor includes the amount by which interest, dividends, gains and other receipts from trading assets and activities including, but not limited to, assets and activities in the matched book, in the arbitrage book, and foreign currency transactions, exceed amounts paid in lieu of interest, amounts paid in lieu of dividends, and losses from such assets and activities.

(ii) The numerator of the receipts factor includes interest, dividends, net gains (but not less than zero) and other receipts from investment assets and activities and from trading assets and activities described in (k)(i) of this subsection that are attributable to this state.

(A) The amount of interest, dividends, net gains (but not less than zero) and other income from investment assets and activities in the investment account to be attributed to this state and included in the numerator is determined by multiplying all such income from such assets and activities by a fraction, the numerator of which is the average value of such assets which are properly assigned to a regular place of business of the taxpayer within this state and the denominator of which is the average value of all such assets.

(B) The amount of interest from federal funds sold and purchased and from securities purchased under resale agreements and securities sold under repurchase agreements attributable to this state and included in the numerator is determined by multiplying the amount described in (k)(i)(A) of this subsection from such funds and such securities by a fraction, the numerator of which is the average value of federal funds sold and securities purchased under agreements to resell which are properly assigned to a regular place of business of the taxpayer within this state and the denominator of which is the average value of all such funds and such securities.

(C) The amount of interest, dividends, gains and other income from trading assets and activities including, but not limited to, assets and activities in the matched book, in the arbitrage book and foreign currency transactions (but excluding amounts described in (k)(i)(A) and (B) of this subsection), attributable to this state and included in the numerator is

determined by multiplying the amount described in (k)(i)(B) of this subsection by a fraction, the numerator of which is the average value of such trading assets which are properly assigned to a regular place of business of the taxpayer within this state and the denominator of which is the average value of all such assets.

(D) For purposes of (k)(ii) of this subsection, the average value of trading assets owned by the taxpayer is the original cost or other basis of such property for federal income tax purposes without regard to depletion, depreciation, or amortization.

(iii) In lieu of using the method set forth in (k)(ii) of this subsection, the taxpayer may elect, or the department may require in order to fairly represent the business activity of the taxpayer in this state, the use of the method set forth in this paragraph.

(A) The amount of interest, dividends, net gains (but not less than zero) and other income from investment assets and activities in the investment account to be attributed to this state and included in the numerator is determined by multiplying all such income from such assets and activities by a fraction, the numerator of which is the gross receipts from such assets and activities which are properly assigned to a regular place of business of the taxpayer within this state and the denominator of which is the gross income from all such assets and activities.

(B) The amount of interest from federal funds sold and purchased and from securities purchased under resale agreements and securities sold under repurchase agreements attributable to this state and included in the numerator is determined by multiplying the amount described in (k)(i)(A) of this subsection from such funds and such securities by a fraction, the numerator of which is the gross income from such funds and such securities which are properly assigned to a regular place of business of the taxpayer within this state and the denominator of which is the gross income from all such funds and such securities.

(C) The amount of interest, dividends, gains and other receipts from trading assets and activities including, but not limited to, assets and activities in the matched book, in the arbitrage book and foreign currency transactions (but excluding amounts described in (k)(ii)(A) or (B) of this subsection), attributable to this state and included in the numerator is determined by multiplying the amount described in (k)(i)(B) of this subsection by a fraction, the numerator of which is the gross income from such trading assets and activities which are properly assigned to a regular place of business of the taxpayer within this state and the denominator of which is the gross income from all such assets and activities.

(iv) If the taxpayer elects or is required by the

department to use the method set forth in (k)(iii) of this subsection, it must use this method on all subsequent returns unless the taxpayer receives prior permission from the department to use, or the department requires a different method.

(v) The taxpayer has the burden of proving that an investment asset or activity or trading asset or activity was properly assigned to a regular place of business outside of this state by demonstrating that the day-to-day decisions regarding the asset or activity occurred at a regular place of business outside this state. If the day-to-day decisions regarding an investment asset or activity or trading asset or activity occur at more than one regular place of business and one such regular place of business is in this state and one such regular place of business is outside this state, such asset or activity is considered to be located at the regular place of business of the taxpayer where the investment or trading policies or guidelines with respect to the asset or activity are established. Such policies and guidelines are presumed, subject to rebuttal by preponderance of the evidence, to be established at the commercial domicile of the taxpayer.

(1) Attribution of certain receipts to commercial domicile. All receipts which would be assigned under this rule to a state in which the taxpayer is not taxable are included in the numerator of the receipts factor, if the taxpayer's commercial domicile is in this state.

(5) **Effective date.** This rule applies to gross income that is reportable with respect to tax liability beginning on and after June 1, 2010.

[]