This rule was adopted on an emergency basis effective October 1, 2010. It may be used to determine tax liability until January 29, 2011, unless the Department adopts a permanent rule prior to this date.

NEW SECTION

WAC 458-20-19403 Single factor receipts apportionment – Royalties. (1) **Introduction.** Effective June 1, 2010, section 105, chapter 23, Laws of 2010 1st sp. sess. changed Washington's method of apportioning the gross income from royalties. This rule addresses how such gross income must be apportioned when the business receives royalty payments from both within and outside the state.

(a) This rule is limited to the apportionment of gross income from royalties. This rule does not apply to apportionment or allocation of income from any other business activity.

(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 thresholds that are effective June 1, 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 June 1, 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 458-20-194 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.

(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.

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

(a) "Apportionable activity" means those activities conducted by a person in the business of receiving gross income from royalties.

(b) "Apportionable income" means gross income of the business generated from engaging in apportionable activity, including income received from apportionable activity performed outside Washington if the income would be taxable under the business and occupation tax if received from activities in Washington less any allowable exemptions and deductions under chapter 82.04 RCW.

(c) "Business activities tax" means a tax measured by the amount of, or economic results of, business activity conducted in a state by a person. The term includes taxes measured in whole or in part on net income or gross income or receipts. The term includes personal income taxes if the gross income from royalties is included in the gross income subject to the personal income tax. The term "business activities tax" does not include a sales tax, use tax, or similar transaction tax, imposed on the sale or acquisition of goods or services, whether or not referred to as a gross receipts tax or a tax imposed on the privilege of doing business.

(d) “Customer” means a person who pays royalties or charges in the nature of royalties for the use of the taxpayer’s intangible property.

(e) “Gross income from royalties” means compensation for the use of intangible property, including charges in the nature of royalties regardless of where the intangible property will be used. “Gross income from royalties” does not include compensation for any natural resources, the licensing of prewritten computer software to the end user, or the licensing of digital goods, digital codes, or digital automated services to the end user as defined in RCW 82.04.190(11).

(f) “Intangible property” includes: copyrights, patents, licenses, franchises, trademarks, trade names and similar items.

(g) “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.

(h) “Taxable in another state” means either:

(i) The taxpayer is actually subject to a business activities tax by another state on its income received from engaging in apportionable activity; or

(ii) The taxpayer is not subject to a business activities tax by another state on its income received from engaging in apportionable activity, but the other state has jurisdiction to subject the taxpayer to a business activities tax on such income under the substantial nexus thresholds described in WAC 458-20-19401.

(iii) “Not Taxable” with respect to a particular state means the taxpayer is not actually subject to a business activities tax by that state on its income received from engaging in apportionable activities and that state does not have jurisdiction to subject the taxpayer to a business activities tax on such income under the substantial nexus thresholds described in WAC 458-20-19401.

(3) **How does a taxpayer apportion its gross income from royalties?** A taxpayer earning gross income from royalties generated on or after June 1, 2010, must apportion such income when the taxpayer is taxable in another state. Gross income is apportioned to Washington by multiplying apportionable income by the receipts factor. The resulting amount of taxable income is then multiplied by the applicable tax rate.

(4) **What is the receipts factor?** The “receipts factor” is a fraction with the following numerator and denominator:

(a) Numerator: is the total gross income from royalties attributable to Washington during the tax year. Generally, a tax year is the same as a calendar year. For the purposes of this rule, tax years will be referred to as calendar years.

(b) Denominator: is the total gross income from royalties attributable to everywhere in the world during the calendar year, less amounts that are attributed to states where the taxpayer is not taxable if at least some of the apportionable activity is performed in Washington.

(5) **How are royalty receipts attributed to Washington?** To compute the numerator of the receipts factor, gross income from royalties is attributable to states as follows:

(a) Place of use: where the customer used the taxpayer’s intangible property. The location of the use of the intangible is determined on a license use basis.

(b) Primary place of use: if the customer used the intangible property in more than one state, gross income of the business must be attributed to the state in which the intangible property was primarily used.

(c) Office of negotiation: if the taxpayer is unable to attribute gross income to a location under (a) or (b) of this subsection (5), then gross income must be attributed to the office of the customer from which the royalty agreement with the taxpayer was negotiated.

(d) Billing state: if the taxpayer is unable to attribute gross income to a location under (a), (b), or (c) of this subsection (5), then gross income must be attributed to the state to which the billing statement or invoices are sent to the customer by the taxpayer.

(e) Payment state: if the taxpayer is unable to attribute gross income to a location under (a), (b), (c), or (d) of this subsection (5), then gross income must be attributed to the state from which the customer sends payment to taxpayer.

(f) Customer's address: if the taxpayer is unable to attribute gross income under (a), (b), (c), (d), or (e) of this subsection (5), then gross income must be attributed to the state where the customer is located as indicated by customer's address:

(i) As shown in the taxpayer's business records maintained in the regular course of business; or

(ii) Obtained during negotiation of the contract for the use of the taxpayer's intangible property, including any address of a customer's payment instrument when readily available to the taxpayer and no other address is available.

(g) Taxpayer's domicile: if the taxpayer is unable to attribute gross income under (a), (b), (c), (d), (e), or (f) of this subsection (5), then gross income must be attributed to the commercial domicile of the taxpayer.

(6) **Examples.** Examples included in this subsection 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.

(a) **Example 1:** Taxpayer has its domicile in California and runs a national restaurant franchising business. Taxpayer enters into a contract with Company A under which Taxpayer licenses the right to use its trademark to Company A's so that Company A can display that trademark on its restaurant, menus, marketing materials, etc. Company A has a single restaurant that is located in Washington. Company A pays Taxpayer $500,000 per calendar year for the right to use the trademark at its restaurant in Washington. Pursuant to the first sourcing rule, the intangibles (trademark) are used in Washington. Therefore, Taxpayer would attribute the $500,000 in receipts from Company A to Washington.

(b) **Example 2:** Same facts as Example 1 except Company A in a single contract receives the right to use Taxpayer's trademark in as many restaurants as it wants in Washington and Idaho and pays $500,000 for each restaurant when the restaurant opens and each calendar year thereafter. Company A opens two restaurants in Idaho and one in Washington. Taxpayer would attribute $500,000 it received from Company A to Washington and $1,000,000 to Idaho.

(c) **Example 3**: Same facts as Example 1 above, except that Company A now has many locations in Idaho but still only one in Washington. Further, Company A enters into a new contract with Taxpayer under which Company A must now pay $1,500,000 per calendar year for the exclusive and unlimited right to the use of the trademark in Idaho but only a single location in Washington. Because the intangible is used in more than one state, but is primarily used in Idaho, Taxpayer would attribute all receipts received from Company A, (i.e. $1,500,000) to Idaho pursuant to the second sourcing rule.

(7) **What data can be used for calculating the receipts factor?**

(a) A taxpayer may calculate the receipts factor for the current calendar year based on the most recent calendar year for which information is available for the full calendar year. Taxpayers may refer to WAC 458-20-19402 for an example of the application of the use of the most current information available.

(b) If a taxpayer does not calculate the receipts factor for the current calendar year based on the previous calendar year information as authorized in this rule, the business must use current year information to calculate the receipts factor for the current tax year.

(c) In either case, a taxpayer must correct the reporting for the current calendar year when complete information is available to calculate the receipts factor for that year, but not later than October 31st of the following calendar year. Taxpayers may refer to WAC 458-20-19402 for an example of the reconciliation.

(8) **What interest applies to underpayments and overpayments?**

(a) Interest will apply to any additional tax due on a corrected tax return. Interest must be assessed at the rate provided for delinquent excise taxes under RCW 82.32.050 retroactively to the date the original return was due and will accrue until the additional taxes are paid.

(b) Interest as provided in RCW 82.32.060 will apply to any tax paid in excess of that properly due on a return as a result of a taxpayer using previous calendar year data or incomplete current year data to calculate the receipts factor.

(9) **What penalties may apply?** Penalties as provided in RCW 82.32.090 will apply to any additional taxes due only if the current calendar year reporting is not corrected and the additional tax is not paid by October 31st of the following calendar year.