

Cite as Det. No. 93-372, 13 WTD 219 (1994).

BEFORE THE INTERPRETATION AND APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition	)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> <u>N</u>
For Correction of Assessment of	)	
	)	No. 92-372
	)	
. . .	)	Registration No. . . .
	)	FY . . . /Audit No. . . .

[1] RULE 194: APPORTIONMENT -- SEPARATE ACCOUNTING METHOD.  
Separate accounting methods must accurately reflect that portion of gross receipts from services rendered in Washington by using the same standards to determine whether the receipts generated are from out-of-state services or are from services performed in Washington when apportioning income. Deductions are not allowed for out-of-state employees and subcontractors unless amounts are included for Washington employees and subcontractors.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

. . .

NATURE OF ACTION:

[A consulting] firm disputes an assessment of service B&O tax resulting from apportionment of in-state activities.

FACTS AND ISSUES:

Pree, A.L.J. -- [The taxpayer] is engaged in the business of . . . consulting. The taxpayer is headquartered outside Washington, but has offices here, as well as in other states.

The taxpayer's records were examined for the period January 1, 1987 through September 30, 1990, resulting in the issuance of [an assessment].

In its petition, the taxpayer protested the assessment of additional service business and occupation tax computed under the auditor's apportionment formula. . . . The taxpayer paid the undisputed use tax. . . .

The taxpayer computed its Washington income based on its separate accounting method of apportionment. Under that method, the taxpayer took the billings from its Washington office and subtracted out amounts for work done by the taxpayer's branch offices located outside Washington and charges to out-of-state customers. No amounts billed from the taxpayer's out-of-state offices to Washington customers were added back to the measure of tax.

The auditor disallowed the deduction for out-of-state customers. Billings from the Washington office to all customers were used as the Washington measure of tax. The only deduction allowed was for work performed by the taxpayer's out-of-state offices included in the invoices from the Washington office.

The taxpayer now contends that it should be able to deduct from its measure of Washington tax any charges attributed to its employees working outside Washington, as well as charges from subcontractors located outside Washington. It has failed to provide records showing amounts billed from the taxpayer's offices outside Washington, even if employees from other offices were working in Washington or if charges from Washington subcontractors were included in the billings.

The issue is, may a taxpayer adopt a separate accounting method where a different standard is used to exclude income from Washington taxation than the standard used to include the income for taxation.

#### DISCUSSION:

[1] RCW 82.04.460(1) provides:

Any person rendering services taxable under RCW 82.04.290 and maintaining places of business both within and without this state which contribute to the rendition of such services shall, for the purpose of computing tax liability under RCW 82.04.290, apportion to this state that portion of his gross income which is derived from services rendered within this state. Where such apportionment cannot be accurately made by separate accounting methods, the taxpayer shall apportion to this state that proportion of his total income which the cost of doing business within the state bears to the total cost of doing business both within and without the state.

(Emphasis supplied.)

This is repeated in WAC 458-20-194 (Rule 194). To accurately apportion gross income, a separate accounting method should use the same standards for including income in Washington's tax measure as are used to exclude it. That is, a mirror image rule should apply.

Here the taxpayer's proposed system starts with income only billed from the Washington office, then deducts that income attributed to any of its employees traveling outside of Washington. No compensating increase is added back for the taxpayer's employees who travel from other offices to Washington when their services are billed from offices outside Washington. The same treatment applies to subcontractors. When subcontractors are located outside Washington, the taxpayer deducts their charges from the work on projects billed from the taxpayer's Washington office. However, nothing is included in the taxpayer's measure of Washington receipts for subcontractors located here if they are billed from the taxpayers' offices outside of Washington.

Under the taxpayer's original method of reporting, charges to customers outside the state were deducted from Washington billings, but no amounts were added back for Washington customers billed from out-of-state offices. Neither the taxpayer's original method of reporting these receipts, nor its proposed method use the same standards for including receipts as used to exclude receipts. Therefore, they do not accurately reflect the proper portion of receipts from services taxable by Washington.

We might also note that in the case of employee charges, the taxpayer's invoices showed the employees' wage or salary and travel costs. These figures were then totalled and multiplied by 2.5 which is labeled "overhead." This total was added to other charges and multiplied by a profit factor resulting in the amount invoiced.

"Overhead" is defined as the general continuing costs involved in running a business enterprise, such as breakage, rent, furnishings, lighting, heating, taxes, insurance, office expenses, etc., Webster's New Universal Unabridged Dictionary (1983). These are all expenses incurred at the employee's office in Washington. Therefore, for every dollar of salary paid to an employee, \$1.50 is charged for overhead from the Washington office.

The taxpayer's separate method does not accurately reflect its gross receipts generated in Washington. If such a method was used for all states, receipts identified from out-of-state subcontractors and receipts from employees working outside the

state where the billing office is located would not be taxed anywhere. In the assessment, the auditor rectified this by including those receipts in the state of the billing office. The alternative would have been to add in out-of-state billings regarding out-of-state employees working in Washington as well as adding in receipts related to Washington subcontractors. The taxpayer has not offered any computation under this alternative method. We believe that the auditor's adjustments to the taxpayer's apportionment method accurately reflects its receipts generated in Washington.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 18th day of December, 1992.