

Cite as Det. No. 16-0031, 38 WTD 001 (2019)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for Correction of )	<u>D E T E R M I N A T I O N</u>
Assessment of )	
) )	No. 16-0031
) )	
. . . )	Registration No. . . .
) )	

[1] RCW 82.04.462; WAC 458-20-19402: BUSINESS AND OCCUPATION TAX – APPORTIONMENT. It was appropriate for the Department to apportion an electronic payment processing service to the location of the purchaser rather than the merchant billing address.

[2] RCW 82.32.105; WAC 458-20-228: PENALTIES – WAIVER AS CIRCUMSTANCE BEYOND THE TAXPAYER’S CONTROL. Taking a tax reporting position that the taxpayer argues is “reasonable” does not qualify as a circumstance beyond the control of the taxpayer and is akin to a misunderstanding of how the law applies.

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.

Yonker, A.L.J. – A provider of electronic payment processing solutions (Taxpayer) for eCommerce merchants protests the attribution method employed by the Department’s Audit Division to determine Taxpayer’s taxable income. . . . Taxpayer argues that, for the period beginning June 1, 2010, the attribution method used should have been based on the merchant billing address. We deny the petition.<sup>1</sup>

ISSUES

. . .

1. For the time period of June 1, 2010, through December 31, 2012, was it proper, pursuant to RCW 82.04.462 and WAC 458-20-19402, to attribute Taxpayer’s gross income to Washington-based [purchaser locations]?
2. Is Taxpayer entitled to a waiver of penalties under RCW 82.32.105 and WAC 458-20-228?

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

## FINDINGS OF FACT

. . . (Taxpayer) is a wholly-owned subsidiary of . . . (Parent), and provides “electronic payment and risk management solutions.”<sup>2</sup> More specifically, Taxpayer “partners with and connects a large network of payment processors and other payment service providers to offer merchants a single source solution that simplifies electronic payment management.” Put more simply, Taxpayer offers access to the global electronic payment processing system (System) for eCommerce merchants, which primarily conduct their business via the internet, as opposed to traditional “brick-and-mortar” stores. In exchange for access to the System, the merchants pay Taxpayer certain monthly fees, including an authorization fee for each electronic payment the merchant seeks to have processed through the System. Throughout the time period at issue, Taxpayer maintained an office in . . . Washington.

In general, a typical transaction involving Taxpayer begins when a purchaser wishes to buy something from one of Taxpayer’s participating eCommerce merchants. The purchaser provides the necessary purchase information, including the credit or debit card information, to the merchant. Generally this occurs directly on that merchant’s website. The merchant, either manually, from some remote location, or automatically through its website, then transmits that purchase information to Taxpayer, who then facilitates the further transmission of that purchase information to the System. Then the System, in turn, transmits the purchase information ultimately to the bank that issued the purchaser’s credit or debit card (Issuer) for authorization of the purchase. Once the Issuer authorizes the purchase, that authorization passes back through the System, then to Taxpayer, then to the merchant, or, often, to the merchant’s website. From there, the purchaser receives notice of authorization, and, if authorized, the purchase is complete. Delivery of the goods or service purchased follows as agreed to between the purchaser and the merchant.

During the time period at issue, Taxpayer reported its gross income attributed to Washington under a variety of business and occupation (B&O) tax classifications. For the portion of its gross income that Taxpayer reported under the service and other activities B&O tax, Taxpayer attributed its reported gross income based on the billing address of the merchants using Taxpayer’s service.

In 2012, the Department’s Audit Division commenced a review of Taxpayer’s books and records for the time period of January 1, 2008, through December 31, 2012 (audit period). During the course of that review, the Audit Division found, among other things, that Taxpayer’s method for attributing gross income to Washington based on merchant billing address was not appropriate, and instead, the Audit Division found that Taxpayer should have attributed its gross income based on the location of the individual purchasers. . . .

On November 18, 2014, as a result of the Audit Division’s review, the Department issued a tax assessment for a total of \$ . . . , which included \$ . . . in service and other activities B&O tax, \$ . . . in use tax and/or deferred sales tax, a five-percent assessment penalty of \$ . . . , and \$ . . . in interest. Taxpayer subsequently appealed only the assessment of service and other activities B&O tax and the five-percent assessment penalty.<sup>3</sup>

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<sup>2</sup> Taxpayer was an independent entity prior to 2010, when Parent acquired Taxpayer.

<sup>3</sup> As such, the use tax and/or deferred sales tax assessed is beyond the scope of this determination.

## ANALYSIS

Washington imposes a B&O tax on “the act or privilege of engaging in business” in this state. RCW 82.04.220. The B&O tax “is measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be.” *Id.* The B&O tax rate used is determined by the nature of the business activity in which a taxpayer engages. *See generally* Chapter 82.04 RCW.

The B&O tax is “extensive and is intended to impose . . . tax upon virtually all business activities carried on in the State.” *Analytical Methods, Inc. v. Dep’t of Revenue*, 84 Wn. App. 236, 241, 928 P.2d 1123 (1996) (quoting *Palmer v. Dep’t of Revenue*, 82 Wn. App. 367, 371, 917 P.2d 1120 (1996)). “Business” is defined broadly to include “all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly.” RCW 82.04.140. Generally, if a taxpayer is engaged in an activity “other than or in addition to an activity taxed explicitly” under Chapter 82.04 RCW, that activity is subject to the “catch-all” service and other activities B&O tax. RCW 82.04.290(2)(a). There is no dispute that the taxable gross income at issue here was properly classified under the service and other activities B&O tax pursuant to RCW 82.04.290(2)(a).

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1. Apportionment from June 1, 2010, through December 31, 2012

As of June 1, 2010, the method of apportioning certain gross income for businesses like Taxpayer, that earn income under the service & other activities B&O tax classification, was set forth under RCW 82.04.460(1), which provided as follows:

Except as otherwise provided in this section, any person earning apportionable income taxable under this chapter and also taxable in another state must, for the purpose of computing tax liability under this chapter, apportion to this state, in accordance with RCW 82.04.462, that portion of the person’s apportionable income derived from business activities performed within this state.

Income apportioned to Washington is multiplied by a “receipts factor,” the numerator of which is the gross income of the business attributed to Washington and the denominator of which is the gross income of the business worldwide. RCW 84.04.462(1), (3)(a). The statute provides a series of cascading criteria for purposes of determining to which state gross income should be attributed. As of June 1, 2010, RCW 82.04.462(3)(b) provided as follows:

[F]or purposes of computing the receipts factor, gross income of the business generated from each apportionable activity is attributable to the state:

- (i) Where the customer received the benefit of the taxpayer's service or, in the case of gross income from royalties, where the customer used the taxpayer's intangible property.

(ii) If the customer received the benefit of the service or used the intangible property in more than one state, gross income of the business must be attributed to the state in which the benefit of the service was primarily received or in which the intangible property was primarily used.

(iii) If the taxpayer is unable to attribute gross income of the business under the provisions of (b)(i) or (ii) of this subsection (3), gross income of the business must be attributed to the state from which the customer ordered the service or, in the case of royalties, the office of the customer from which the royalty agreement with the taxpayer was negotiated.

(iv) If the taxpayer is unable to attribute gross income of the business under the provisions of (b)(i), (ii), or (iii) of this subsection (3), gross income of the business must be attributed to the state to which the billing statements or invoices are sent to the customer by the taxpayer.

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(viii) For purposes of this subsection (3)(b), "customer" means a person or entity to whom the taxpayer makes a sale or renders services or from whom the taxpayer otherwise receives gross income of the business. "Customer" includes anyone who pays royalties or charges in the nature of royalties for the use of the taxpayer's intangible property.

WAC 458-20-19402 (Rule 19402) is the Department's administrative rule implementing RCW 82.04.462.<sup>4</sup> Rule 19402(301) provides the following additional information regarding the attribution of apportionable income:

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

(a) Where the customer received the benefit of the taxpayer's service . . . ;

(i) If a taxpayer can reasonably determine the amount of a specific apportionable receipt that relates to a specific benefit of the services received in a state, that apportionable receipt is attributable to the state in which the benefit is received. This may be shown by application of **a reasonable method of proportionally attributing the benefit among states**. The result determines the receipts attributed to each state. Under certain situations, the use of data based on an attribution method specified in (b) through (f) of this subsection may also be a reasonable method of proportionally attributing receipts among states (see Examples 4 and 5 below).

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<sup>4</sup> Rule 19402 was originally issued on an emergency basis on June 2, 2010, and then extended on an emergency basis in successive installments until it was permanently adopted on September 17, 2012, finally becoming effective October 18, 2012.

- (ii) If a taxpayer is unable to separately determine or use a reasonable method of proportionally attributing the benefit of the services in specific states under (a)(i) of this subsection, and the customer received the benefit of the service in multiple states, the apportionable receipt is attributed to the state in which the benefit of the service was primarily received. Primarily means, in this case, more than fifty percent.

(Emphasis added). Rule 19402(301) goes on to describe additional cascading steps in the series that a taxpayer is to follow if either (a)(i) or (a)(ii) are not feasible. These additional steps mirror the steps described in RCW 82.04.462(3)(b)(iii) – (vii), listed, in part, above. As Rule 19402(301) makes clear, most taxpayers will generally be able to attribute their apportionable gross income under Rule 19402(301)(a)(i) because the location of the “benefit of that taxpayer’s service” is easily determined, or through some “reasonable method” of determining such location.

Rule 19402(303)(c) defines the “benefit of the taxpayer’s service” in particular situations, stating, in relevant part, “[i]f the taxpayer’s service does not relate to real or tangible personal property, the service is provided to a customer engaged in business, and the service relates to the customer’s business activities, then the benefit of the taxpayer’s service is **received where the customer’s related business activities occur**.” *Id.* (Emphasis added).

Here, we conclude that (1) Taxpayer’s electronic payment processing services for its merchant customers do not relate to real or tangible personal property, (2) Taxpayer provides those services to its merchant customers, who are engaged in business, and (3) those services relate to those merchants’ business activities of completing online sales of goods or services. As such, pursuant to Rule 19402(303)(c), Taxpayers’ merchant customers receive the benefit of Taxpayer’s service where those merchants’ related business activity occurs.

To determine where Taxpayer’s customers’ related business activity occurs, we must first determine *what* Taxpayer’s customers’ “related business activity” is, and then, *where* that activity occurred. As discussed above, Taxpayer’s customers are the merchants, and we conclude that the merchants’ “related business activity” is completing online sales of goods or services. As to *where* the merchants make those online sales of goods or services, we conclude that the most reasonable method here is to treat such online sales as occurring at the purchaser’s location, where the purchaser ultimately receives notice that the sale was authorized, and is, thereby, completed.<sup>5</sup> . . . This method is authorized under RCW 82.32.100(1).

As such, Taxpayer’s original method of using the merchants’ billing addresses to attribute its gross income to Washington, presumably pursuant to RCW 82.04.462(3)(b)(iv) and its counterpart in Rule 19402(301)(c), was incorrect. This is because, as Rule 19402(301) makes clear, the attribution methods are arranged in a “cascading . . . series of steps,” requiring a taxpayer to attribute based on the first feasible step it encounters in that series. We have concluded that Taxpayer’s gross income should be attributed to the purchasers’ locations under RCW

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<sup>5</sup> Unlike cases in which a merchant completes a sale at its brick-and-mortar physical location, an internet sale allows the purchaser the convenience of completing the sale electronically from any location of the purchaser’s choosing, so long as the internet is available from that location.

82.04.462(3)(b)(i), and its counterpart in Rule 19402(301)(a)(i).<sup>6</sup> Accordingly, Taxpayer is not entitled to “drop down” to lower steps in the series for attribution of its gross income, and, therefore, may not attribute based on the merchants’ billing addresses.

Taxpayer also argues that the “reasonable method of proportionally attributing receipts” language under Rule 19402(301)(a)(i) should be disregarded, and, without such language, Taxpayer argues its gross income should be attributed pursuant to one of the lower cascading steps. Taxpayer maintains that because RCW 82.04.462(3)(b)(i), the statutory basis for Rule 19402, did not contain any language permitting a “reasonable method” until RCW 82.04.462 was amended in 2014, the Department exceeded its statutory authority when it included the “reasonable method” language in Rule 19402(301)(a)(i) beginning on June 2, 2010.<sup>7</sup>

We find this argument unpersuasive. The 2014 amendment to RCW 82.04.462(3)(b)(i) was the codification of the Department’s interpretation of the original version of RCW 82.04.462(3)(b)(i), in effect from June 1, 2010, which interpretation was formally announced with the Department’s promulgation of Rule 19402 on the following day. The 2014 amendment was merely a technical corrections bill. *See* Laws of 2014, ch. 97, § 101. Thus, the 2014 amendment to RCW 82.04.462 was effective retroactively to the original effective date of that statute, which was June 1, 2010. *See State v. Dunaway*, 109 Wn.2d 207, 216 n.6, 743 P.2d 1237 (1987) (recognizing that “subsequent enactments that only clarify an earlier statute can be applied retrospectively.”).

For these reasons, we affirm the attribution method used by the Audit Division to determine Taxpayer’s apportionable gross income in Washington under RCW 82.04.462 and Rule 19402.

## 2. Waiver of Penalties

The authority to waive or cancel penalties or interest is found in RCW 82.32.105. Specifically, RCW 82.32.105(1) provides that if the failure to pay a tax when due is the result of circumstances beyond the control of the taxpayer, the Department shall waive penalties. Rule 228 provides

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<sup>6</sup> We note that Rule 19402(301)(a)(i) states that “[u]nder certain situations, the use of data based on an attribution method specified in (b) through (f) of this subsection may also be a reasonable method of proportionally attributing receipts among states (see Examples 4 and 5 below).” Thus, Rule 19402(301)(a)(i) contemplates that in “certain situations” even customer billing addresses may be a reasonable method of attribution. However, the two cited examples make clear that using customer billing addresses is a reasonable method under Rule 19402(301)(a)(i) if the taxpayer’s customers generally receive the benefit of the taxpayer’s services at that billing address location. Here, as we have concluded above, the merchants do not receive the benefit of Taxpayer’s services at their respective billing address locations, but at the purchasers’ locations. As such, Taxpayer is not entitled to use the billing addresses of the Issuers and Acquirers as a reasonable method under Rule 194(301)(a)(i).

<sup>7</sup> RCW 82.04.462(3)(b)(i) was amended as of June 12, 2014, adding the bold language below:

Where the customer received the benefit of the taxpayer’s service or, in the case of gross income from royalties, where the customer used the taxpayer’s intangible property. **When a customer receives the benefit of the taxpayer’s services or uses the taxpayer’s intangible property in this and one or more other states and the amount of gross income of the business that was received by the taxpayer in return for the services received or intangible property used by the customer in this state can be reasonably determined by the taxpayer, such amount of gross income must be attributed to this state.**

guidance on “circumstances beyond the control of the taxpayer” within the meaning of RCW 82.32.105. The circumstances that are generally considered beyond the control of a taxpayer are “immediate, unexpected, or in the nature of an emergency.” Rule 228(9)(a)(ii). Examples include the death or serious illness of the taxpayer or members of his or her immediate family. Rule 228(9)(a)(ii)(C). Other examples include the destruction of files or records by fire or other casualty, or the unavoidable absence of the taxpayer. Rule 228(9)(a)(ii)(D), (E).

Taxpayer claims that penalties should be waived because it made a good faith and reasonable method of attributing apportionable income to Washington. We interpret this argument as implying that Taxpayer misunderstood its tax liability in Washington. However, Rule 228 explicitly provides that “[m]isunderstanding or lack of knowledge of a tax liability” is generally not considered to be beyond the control of the taxpayer and will not qualify for a waiver or cancellation of the penalty. Rule 228(9)(a)(iii)(B). Rule 228 does not provide relief if a taxpayer has a “reasonable basis” for its filing position. The Department has consistently held that lack of knowledge of Washington’s tax obligations does not constitute circumstances beyond the control of the taxpayer. *See e.g.* Det. No. 05-0174, 25 WTD 48 (2006) (holding that out-of-state business’ good-faith belief that it was not required to register and pay Washington taxes is not a circumstance beyond the control of the taxpayer); Det. No. 06-0088, 26 WTD 201 (2007) (holding lack of knowledge of Washington tax obligation is not grounds for waiver). As Taxpayer has not offered any other circumstances that were beyond its control under Rule 228(9), we deny Taxpayer’s request for waiver of penalties.

#### DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 19th day of January 2016.