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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. 13-0319
)	
...)	Registration No. . . .
)	

RCW 82.04.460; RCW 82.04.462; WAC 458-20-19402: SERVICE B&O TAX – APPORTIONABLE INCOME – ATTRIBUTING APPORTIONABLE RECEIPTS FROM TECHNICAL PUBLICATION SERVICES. Author of technical publication services for equipment could not determine where the equipment was used, or, where the customer received the benefit of the taxpayer’s services. Therefore, the income from these services was attributed to the state from which its customer orders the services.

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.

Sohng, A.L.J. – [A technical] publication services company protests business and occupation [(“B&O”)] tax on the grounds that none of its income should be attributed to Washington under RCW 82.04.462. The petition is denied.¹

ISSUE

Is income earned by an out-of-state corporation for technical authoring and publication services attributable to Washington under RCW 82.04.462?

FINDINGS OF FACT

[Taxpayer] was an [out-of-state] . . . corporation² that provided technical authoring, editing, illustration, and publication services. Taxpayer was a wholly owned subsidiary of [Parent], a . . . corporation headquartered [out-of-state] . . . that provides information management services to the aerospace, defense, high-tech, publishing, and other industries. Taxpayer is headquartered [out-of-state] . . . , but has offices in . . . [the United States and overseas]. Taxpayer provides services to [Manufacturer], a global technology and manufacturing company that serves the aerospace, automotive, building security, specialty chemical, and advanced materials industries.

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

² Taxpayer was formerly an . . . corporation until it merged with and into [Parent], a . . . corporation on December 22, 2010.

Manufacturer is a . . . corporation headquartered [out-of-state] . . .³ In the aerospace sector, Manufacturer maintains several principal plants [out-of-state] . . . Manufacturer also maintains an office in [Washington].

Taxpayer has the exclusive right to provide technical authoring and publication services and supporting documentation for Manufacturer in the aerospace sector under the [Contract] entered into between Parent and Manufacturer on June 22, 2007. The Contract provides that Parent, through Taxpayer, is required to perform “Technical Publication Authoring Services, Application Access Services and Professional Services . . . in support of the [Manufacturer] Technical Publications Project.”⁴ The manuals created by Taxpayer describe how to install, test, operate, repair, and maintain Manufacturer’s products. Examples of products for which Taxpayer provides manuals include aircraft landing gear, onboard flight computers, and propulsion systems.

A project begins when Manufacturer provides Taxpayer with its requirements regarding the creation of a new manual or the revision of an existing manual. Manufacturer provides Taxpayer with source data, such as engineering specifications, procedures, drawings, and diagrams. Taxpayer uses this source data, its knowledge of technical publications standards, and the skills of its writers, illustrators, and editors to develop the final product. The final deliverable required under the Contract is a PDF version of the manuals, as well as the underlying data files, which are usually electronically delivered to Manufacturer. The digital files consist of images, data, facts, and other information that are essentially a digital manual for equipment that Manufacturer sells. Manufacturer owns all intellectual property rights to the manuals once they are completed by Taxpayer. Manufacturer includes the digital manuals (or provides access to the manuals) as part of the final sale of the underlying products to its customers.

With two exceptions, Taxpayer states that it does not have access to the identity of Manufacturer’s customers, because Manufacturer is either unwilling or unable to share such information.⁵ Taxpayer claims that Manufacturer is prohibited by law or by contract from disclosing the identity of its customers, as such information is classified. Taxpayer speculates that some of Manufacturer’s customers include contractors for the United States Department of Defense. Due to the highly sensitive nature of the aerospace industry and potential national security concerns, access to such information is extremely restricted.

Taxpayer does not maintain offices in Washington, but did have four to six employees in this state who worked from their homes. These employees consisted of technical writers and illustrators who researched source data provided by Manufacturer and authored publications. Taxpayer explains that when the requirements provided by Manufacturer were highly technical in nature, it sometimes needed clarification from Manufacturer, in which case Taxpayer worked directly with Manufacturer subject matter experts and engineers, some of whom were located in the . . . , Washington office.

³ See Manufacturer 10-K at 19 (2013).

⁴ Technical Publications Project Statement of Work, § 1.3.

⁵ Taxpayer delivers the manuals directly to two of Manufacturer’s customers, Technical Publications Project Statement of Work, § 1.3(10).

The Contract provides that Taxpayer's services can be initiated by several Manufacturer site locations, including (among others) [Washington]; . . .⁶ However, the Contract also provides that the "Project Manager" is "responsible for oversight of the planning and monitoring of the Project."⁷ The Contract identifies . . . , based in . . . , as the Project Manager.⁸ In that capacity, [the Project Manager] was the decision-maker for all issues related to the Contract. The Contract also identifies . . . in . . . as the "Site Focal." [The "Site Focal"] reported directly to [the Project Manager] and was responsible for initiating work packages with Taxpayer, gathering and providing source data to Taxpayer, negotiating delivery dates with Taxpayer, and coordinating reviews of Taxpayer's work product.

Although the Contract expressly allows Manufacturer's [Washington] office to initiate a project, [the Project Manager] reviewed the initiation requests and made the ultimate decision whether to engage Taxpayer's services under the Contract with respect to any given deliverable. Taxpayer also claims that it is Manufacturer's . . . office (not the [Washington] office) that: (i) contacts Taxpayer to officially initiate the project; (ii) monitors and manages the deliverables that Taxpayer produces under the Contract; and (iii) controls all interaction with Taxpayer from initiation through completion of a project. Taxpayer's invoices were all sent to and subsequently paid by Manufacturer's . . . office.

The Department of Revenue's (the "Department's") Audit Division examined Taxpayer's books and records for the period . . . (the "Audit Period"). On June 27, 2012, the Audit Division issued Assessment No. . . . in the amount of \$. . . , including \$. . . in service and other activities B&O tax, \$. . . in interest, and \$. . . in penalties. Taxpayer initially reported its income under the service and other activities B&O tax classification according to the number of hours billed by its Washington employees at the average billable rate. Taxpayer then amended its returns for . . . through . . . (the end of the Audit Period), reporting its income under the wholesaling classification of the B&O tax. During the audit, Taxpayer argued that it made wholesale sales of digital products. The Audit Division disagreed, reclassifying Taxpayer's income under the service and other activities classification of the B&O tax. During the audit, Taxpayer provided a spreadsheet summarizing the charges it attributed to Manufacturer's [Washington] office. These services included meetings, telephone conferences, the creation of templates, project training, scanning and converting documents, and miscellaneous processing and administration. The Audit Division apportioned all of this income to Washington.

On appeal, Taxpayer concedes that its income is properly classified under the service and other activities classification of the B&O tax, rather than the wholesaling classification. However, Taxpayer argues that none of its revenue from the Manufacturer contract should be apportioned to Washington because the receipts should be attributed to the state from which the order for the services was received (namely, . . .). The Audit Division, on the other hand, contends that the orders were placed from Manufacturer's [Washington] office and should be attributed in Washington.

⁶ *Id.*

⁷ Technical Publications Project Statement of Work, § 1.14.

⁸ *Id.*, § 1.13.3. In 2012, the Project Manager was replaced by . . . , who is located in . . .

ANALYSIS

The sole issue in dispute here is whether Taxpayer's apportionable income is attributable to Washington for periods after May 31, 2010.⁹ Effective June 1, 2010, RCW 82.04.460(1) provides:

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.

"Apportionable income" is gross income of the business generated from engaging in apportionable activities. RCW 82.04.460(4)(a). "Apportionable activities" specifically include those taxed under RCW 82.04.290, the service and other activities B&O tax classification. RCW 82.04.460(4)(a)(vi). Here, Taxpayer rendered technical writing services, which are taxable under RCW 82.04.290.¹⁰ Therefore, Taxpayer was engaged in "apportionable activities" in Washington and earned "apportionable income." Taxpayer is also taxable in . . . Thus, the income Taxpayer earned from the rendition of its services is subject to apportionment under RCW 82.04.460.

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 rules for purposes of determining which state gross income is attributable to. RCW 82.04.462(3)(b) provides 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

⁹ Although the Audit Period is . . . , there was no assessment attributable to the periods prior to June 1, 2010.

¹⁰ RCW 82.04.050(8) explains the taxation of digital products. Under the statute, the terms "sale at retail" and "retail sale" include sales to consumers of digital goods, digital codes, and digital automated services. RCW 82.04.050(8)(a)(iii). The term "digital goods" does not include "the representation of a personal or professional service in electronic form, such as an electronic copy of an engineering report prepared by an engineer, where the service primarily involves the application of human effort by the service provider, and the human effort originated after the customer requested the service." RCW 82.04.192(6)(b)(iv)(A). And "digital automated services" does not include "any service that primarily involves the application of human effort by the seller, and the human effort originated after the customer requested the service." RCW 82.04.192(3)(b)(i). Both Taxpayer and the Audit Division agree that the digital manuals, a representation of a professional service in electronic form, are not "digital goods" because of the application of [primarily] human effort by Taxpayer after Manufacturer requested the services. Taxpayer and the Audit Division also agree that the technical authoring and publication services Taxpayer provided to Manufacturer do not constitute "digital automated services" because of the application of [primarily] human effort by Taxpayer after Manufacturer requested the services.

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.

(v) If the taxpayer is unable to attribute gross income of the business under the provisions of (b)(i), (ii), (iii), or (iv) of this subsection (3), gross income of the business must be attributed to the state from which the customer sends payment to the taxpayer.

(vi) If the taxpayer is unable to attribute gross income of the business under the provisions of (b)(i), (ii), (iii), (iv), or (v) of this subsection (3), gross income of the business must be attributed to the state where the customer is located as indicated by the customer's address: (A) Shown in the taxpayer's business records maintained in the regular course of business; or (B) obtained during consummation of the sale or the negotiation of the contract for services or 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.

(vii) If the taxpayer is unable to attribute gross income of the business under the provisions of (b)(i), (ii), (iii), (iv), (v), or (vi) of this subsection (3), gross income of the business must be attributed to the commercial domicile of the taxpayer.

(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.

(Emphasis added.)

In sum, if a taxpayer can reasonably determine the amount of a specific apportionable receipt that relates to a specific benefit of the service received in a state, the apportionable receipt is attributable to the state in which the benefit is received. However, if a taxpayer is unable to determine where the benefit of the service is received, use of this method is not appropriate. In such cases, the taxpayer should look to the other methods described in RCW 82.04.462(3)(b)(iii) – (vii), in descending order.

WAC 458-20-19402 (“Rule 19402”) is the Department’s rule implementing RCW 82.04.462. Rule 19402(301) explains how to attribute apportionable receipts and provides as follows:

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 (see subsection (302) of this rule for an explanation and examples of the benefit of the 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).

(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.

(b) If the taxpayer is unable to attribute an apportionable receipt under (a) of this subsection, the apportionable receipt must be attributed to the state from which the customer ordered the service.

(Emphasis added.)

Rule 19402 strongly favors the application of subsection (301)(a), under which the vast majority of taxpayers are expected to “reasonably determine the amount of a specific apportionable receipt that relates to a specific benefit of the services received in a state.” However, in the unusual event that a taxpayer is “unable to attribute an apportionable receipt” under Rule 19402(301)(a), it must attribute it to the state from which the customer ordered the service. RCW 82.04.462(3)(b); Rule 19402(301)(b).

First, we examine whether we can determine where the benefit of Taxpayer’s services are received under Rule 19402(301)(a). Rule 19402(303) explains how to determine where a taxpayer’s customer receives the benefit of the service in attributing apportionable receipts under Rule 19402(301)(a). Rule 19402(303)(b) provides:

If the taxpayer's service relates to tangible personal property, then the benefit is received where the tangible personal property is located or intended/expected to be located.

(i) Tangible personal property is generally treated as located where the place of principal use occurs. If the tangible personal property is subject to state licensing (e.g., motor vehicles), the principal place of use is presumed to be where the property is licensed; or

(ii) If the tangible personal property will be created or delivered in the future, the principal place of use is where it is expected to be used or delivered.

(Emphasis added.)

Rule 19402(303)(b) applies here because the services that Taxpayer provides (authoring technical manuals for the installation, operation, and repair of aerospace equipment) relates to tangible personal property. RCW 82.08.010(7) defines “tangible personal property” as “personal property that can be seen, weighed, measured, felt, or touched, or that is in any other manner perceptible to the senses.” Here, the equipment to which the manuals relate (such as aircraft landing gear) is “tangible personal property” because it can be seen, weighed, measured, felt, and touched. Therefore, the benefit of Taxpayer’s services is received where Manufacturer’s equipment is principally used. In other words, the equipment is treated as being located where Manufacturer’s customers principally use it.

However, Taxpayer does not have access to the identity of Manufacturer’s customers or where such customers principally use the equipment, as Manufacturer either will not or cannot disclose such information by law or by contract. Further, because of the nature of the industry and the information available to Taxpayer, a reasonable proportional method was not available. Thus, Taxpayer is unable to attribute receipts under RCW 82.04.462(3)(b)(i) and Rule 19402(301)(a)(i). We emphasize that the facts of the instant case are atypical and present unique difficulties in attributing apportionable receipts to a specific state due to the highly classified and confidential nature of the aerospace and defense industries. Absent unusual circumstances (as are present here), the Department expects that most taxpayers will attribute apportionable receipts under Rule 19402(301)(a).

Given the difficulty for Taxpayer in determining where Manufacturer’s customers principally use the equipment (and hence, where they receive the benefit of Taxpayer’s services), we must turn to the next step in the cascading series of rules provided in RCW 82.04.462(3)(b)(iii) and Rule 19402(301)(b), which provides that Taxpayer’s income must be attributed to the state from which Manufacturer ordered the services. Taxpayer emphasizes that although Manufacturer maintains an office in [Washington], the ultimate decision whether or not to use Taxpayer’s services for any particular project was made by Manufacturer in Indeed, Taxpayer has demonstrated, through credible testimony and corroborating documentation, that the Manufacturer Project Manager located in . . . made all decisions relating to the Contract.

However, where Manufacturer ultimately *approved* any given project is not equivalent to where Manufacturer *ordered* or initiated a project, as required by Rule 19402(301)(b). The Contract clearly states that Manufacturer’s [Washington] office was authorized to initiate projects. Although [Manufacturer’s Project Manager], based in . . . , approved the initiation requests made by various satellite offices, it does not alter the fact that the services were *ordered* by Manufacturer’s [Washington] office. Given that Manufacturer ordered Taxpayer’s services from

Washington, income that Taxpayer earned from the rendition of such services by employees is attributable to Washington under RCW 82.04.462(3)(b)(iii). Taxpayer's petition is denied.

DECISION AND DISPOSITION

We deny the petition.

Dated this 29th day of October, 2013.