

Cite as Det. No. 16-026, 36 WTD 344 (2017)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction)	<u>D E T E R M I N A T I O N</u>
of Assessment of)	
)	No. 16-0226
)	
...)	Registration No. . . .
)	

RULE 19401; RCW 82.04.462(3)(c): B&O TAX – APPORTIONMENT – WASHINGTON BUSINESS ACTIVITY. The term “business activity” must be read broadly to include “all activities” engaged related to the activities that produce income, which activities necessarily include administrative activities such as scheduling, developing travel plans, billing, filing, and taking phone calls relative to the business.

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.

Bauer, T.R.O. – A Washington limited liability company (LLC) that provides services in and outside Washington objects to the Department of Revenue’s (Department) calculation of “throw-out income” for purposes of apportioning its income. Taxpayer’s petition is denied.¹

ISSUE

In accordance with RCW 82.04.462(3)(c) and WAC 458-20-19402(403), did the Department correctly calculate “throw-out income?”

FINDINGS OF FACT

[Taxpayer] is a single member Washington LLC domiciled in this state. Taxpayer did not have more than \$. . . of receipts, more than \$. . . of property or payroll, or at least 25% of its total property or total payroll in any jurisdiction other than Washington. Taxpayer earned more than 25% of its 2011 receipts [out-of-state], and more than 25% of its 2012 receipts [out-of-state].

Taxpayer, through its FAA-certified member . . . (Member), performed FAA Designated Airworthiness Representative certification services (certifications) on various aircraft worldwide. Member performed certifications, including all required paperwork, in the jurisdictions where the various aircraft were located.

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

Work requests were generally initiated by referral and by Member's involvement in various associations. Taxpayer's contact number was Member's cell phone. When Member was at his Washington home, he answered the phone, scheduled appointments, and initiated billings from his home office. Taxpayer did not keep a record of the business activities that he performed in his home. Member travelled most of the time, and performed much of Taxpayer's business on the computer he carried with him.

Taxpayer originally filed "no business" tax returns for the 4th quarter of 2011, and an annual return for 2013. When [Taxpayer's] representative took over Taxpayer's account, it amended those returns and submitted annual returns for 2012 and 2014.²

Upon reviewing Taxpayer's amended returns, the Taxpayer Account Administration Division (TAA) of the Department determined that annual apportionment reconciliations were needed. TAA requested Taxpayer to provide additional information as to its activities and gross income. Based on a review of that information, TAA issued the above-referenced assessment on June 31, 2015, for the period April 1, 2011, through December 31, 2014, in the following total amounts:³

\$. . .	Adjustment to Small Business Credit
. . .	Service and Other Activities B&O Tax
. . .	Total Tax Due
. . .	Delinquent Penalty
. . .	Interest ⁴
. . .	5% Assessment Penalty (Substantial Underpayment)
\$. . .	Total Due

Taxpayer, after the application of the small business credit, owed no taxes for 2011 and 2012, [but had] tax deficiencies of \$. . . for 2013, and \$. . . for 2014. Taxpayer has not paid the assessment, but appealed it on July 11, 2015, arguing that revenues from aircraft certifications performed outside of Washington were incorrectly designated as "throw-out" income in calculating the receipts factor of the apportionment formula.

Taxpayer asserts that it performed no work relative to the out-of-state certifications in Washington.

Based on the information provided by Taxpayer, and reasoning that Taxpayer had performed at least a portion of the activity of each job at Taxpayer's Member's home office in Washington, TAA calculated the throw-out income and the receipts factors as follows for the audit years in question:

² Taxpayer did not claim any apportionment during the first three quarters of 2011, so that only the 4th quarter of that year was amended.

³ Taxpayer did not open its account until March 1, 2011.

⁴ Interest has continued to accrue.

2011:

State	Gross Receipts	% of Total Receipts	Work Performed in WA
Washington	\$...	4.43	Yes
...	...	21.36	Yes
...	...	24.91	Yes
...	...	49.32	Yes
<u>Worldwide Revenue</u>	\$...		
<u>Throw-out Income:</u>⁵	\$...		
<i>Washington Revenue</i>		...	8.19%
<i>Worldwide Revenue - Throw-out Income</i>		\$...	Receipts Facto

2012:

State	Gross Receipts	% of Total Receipts	Work Performed in WA
Washington	\$...	00.24	Yes
...	...	18.25	Yes
...	...	10.85	Yes
...	...	04.28	Yes
...	...	10.52	Yes
...	...	12.02	Yes
...	...	27.28	Yes
...	...	07.16	Yes
...	...	06.21	Yes
...	...	03.19	Yes
<u>Worldwide Revenue</u>	\$...		
<u>Throw-out Income:</u>	\$...		
<i>Washington Revenue</i>	89%
<i>Worldwide Revenue – Throw-out Income</i>		...	Receipts Factor

⁵ Throw-out income = ... (... , where Taxpayer was not taxable)

2013:

State	Gross Receipts	% of Total Receipts	Work Performed in WA?
Washington	\$...	1.83	Yes
...	...	2.60%	Yes
...	...	11.57	Yes
...	...	23.29	Yes
...	...	8.53	Yes
...	...	6.3	Yes
...	...	3.40	Yes
...	...	8.17	Yes
...	...	6.21	Yes
...	...	4.07	Yes
...	...	2.20	Yes
...	...	7.46	Yes
...	...	11.48	Yes
...	...	2.89	Yes

Worldwide Revenue \$...

Throw-out Income \$...

$$\frac{\text{Washington Income}}{\text{Worldwide Revenue} - \text{Throw-out Income}} = \frac{\$ \dots}{\$ \dots} = \text{100\% Receipts Facto}$$

2014:

State	Gross Receipts		
Washington	\$...	31.92	Yes
...	...	6.89	Yes
...	...	6.13	Yes
...	...	10.65	Yes
...	...	3.62	Yes
...	...	6.39	Yes
...	...	10.64	Yes
...	...	8.61	Yes
...	...	1.73	Yes
...	...	13.42	Yes
Worldwide Revenue	\$...		
Throw-out Income	\$...		
	<i>Washington Revenue</i>	<u>\$...</u>	100%
	<i>Worldwide Revenue - Throw-out Income</i>	\$... =	Receipts Factor

TAA found that each out-of-state activity was, in part, performed in Washington. TAA's presumption that the out-of-state contracts involved Washington activities increased the amount of throw-out income, and thus impacted the receipts factor calculation, thereby increasing Taxpayer's tax liability. Taxpayer objects to TAA's presumption that any work at all was done in Washington on its out-of-state contracts.

ANALYSIS

Effective June 1, 2010, amendments to the Revenue Act and new Rule 19402 significantly changed Washington's method of apportionment for service businesses. Revenue from service activities is now apportioned to Washington based on a receipts factor formula. Under the new apportionment methodology, income is apportioned to Washington by multiplying a business's apportionable income by a "receipts factor." For any apportionable activity, the numerator of the receipts factor is the business's gross annual income attributable to Washington State, and the denominator is the business's gross annual income received worldwide from that activity less throw-out income.

With respect to when apportionment is proper, RCW 82.04.460(1) provides:⁶

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

⁶ See also WAC 458-20-19402.

accordance with RCW 82.04.462, that portion of the person's apportionable income derived from business activities performed within this state.” RCW 82.04.460(1).

(Emphasis added.) Under RCW 82.04.460(4)(b), the term “taxable in another state” means that:⁷

...the taxpayer is subject to a business activities tax by another state on its income received from engaging in apportionable activities; or the taxpayer is not subject to a business activities tax by another state on its income received from engaging in apportionable activities, but any other state has jurisdiction to subject the taxpayer to a business activities tax on such income under the substantial nexus standards in RCW 82.04.067(1).

(Emphasis added.) The substantial nexus standards in RCW 82.04.067(1)(2010) are as follows:⁸

(1) A person engaging in business is deemed to have substantial nexus with this state if the person is:

- (a) An individual and is a resident or domiciliary of this state;
- (b) A business entity and is organized or commercially domiciled in this state; or
- (c) A nonresident individual or a business entity that is organized or commercially domiciled outside this state, and in any tax year the person had:
 - (i) More than fifty thousand dollars of property in this state;
 - (ii) More than fifty thousand dollars of payroll in this state;
 - (iii) More than two hundred fifty thousand dollars of receipts from this state; or
 - (iv) At least twenty-five percent of the person's total property, total payroll, or total receipts in this state.

In accordance with WAC 458-20-19402(202), the “receipts factor” applies to each tax year, which is the calendar year unless the Department has granted permission to use another period. When a taxpayer’s worldwide receipts are multiplied by the receipts factor for that year, the calculation results in the amount taxable by Washington.

Thus, in order for a Taxpayer located in Washington to be able to apportion income, the Taxpayer must have earned income from an apportionable activity and have been taxable in another state during the calendar year. The language in WAC 458-20-19402 clarifies that a taxpayer is only entitled to apportion income outside of Washington when it is “conducting business in another state.” Under WAC 458-20-19402, a person is “conducting business in another state” when they are “taxable in another” state as described in WAC 458-20-19401 above.

Under these authorities, businesses located in Washington are only entitled to apportion their income when they are “taxable in another state” during that year⁹ To be “taxable in another

⁷ See also WAC 458-20-19402.

⁸ See also WAC 458-20-19401. RCW 82.04.462(4)(c) provides that a company is deemed to have substantial nexus if it meets the standards of RCW 82.04.067(1), regardless of whether that state actually imposes such a tax.

state” means they are subject to a business activities tax, have substantial nexus in another state under Washington’s standards (e.g., economic standards \$250,000 in receipts, or 25% receipts attributed to that other state), or are formed under the laws or domiciled in another state. Further, if a taxpayer does not have substantial (i.e., economic) nexus or pay a business tax in the foreign state, all receipts are taxable in Washington even though the taxable activity may have been performed outside of Washington for customers that received the benefit of the service outside of Washington.

In this case, Taxpayer concedes that it was not subject to a business activities tax in another state, and it was not formed under the laws or domiciled in another. TAA determined that Taxpayer was deemed to have established substantial nexus (under the more than 25% of receipts from a foreign jurisdiction) in only two jurisdictions: in 2011, and . . . in 2012. Thus, for 2011, TAA designated income from 2 out of 3 jurisdictions (. . . and . . .), which were the jurisdictions other than . . . , to be throw-out income, resulting in a receipts factor of 8.19%. For 2012, TAA similarly threw out the income from the 8 foreign jurisdictions other than . . . , resulting in a receipts factor of .89%. Taxpayer did not establish substantial nexus in any foreign state in 2013 and 2014; thus, TAA concluded that all receipts were taxable in Washington.¹⁰

Taxpayer objects to TAA’s conclusion that any work was performed in Washington on its foreign contracts. Taxpayer asserts that his being available at his Washington home to take phone calls or do scheduling, billing, or other administrative tasks does not meet the meaning of the language in RCW 82.04.462(3)(c) – “at least some of the activity is performed in this state.” Taxpayer asserts that the term “the activity” for purposes of the apportionment formula is referring to those certification activities for which he is being hired and which are taxable under RCW 82.04.290(2)(a). Taxpayer argues that it is not being hired to perform administrative activities in Member’s home office.

RCW 82.04.290(2)(a), however, includes “any business activity other than or in addition to an activity taxed explicitly under another section in this chapter” “Business” includes 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. Taxpayer, however, argues that the term “any business activity” should not be so broadly construed as to include minor administrative activities performed in this state that support the out-of-state work such as answering a cell phone or scheduling jobs, none of which are business activities that customers are hiring Taxpayer for performing. Therefore, Taxpayer objects to TAA’s finding of “yes” in the audit (see above) that “work was performed in Washington.” Taxpayer asserts that no work was performed in Washington in support of work in foreign jurisdictions, and so those activities would not qualify as “throw-out” income.

⁹ In accordance with WAC 458-20-19402(202), the “receipts factor” applies to each tax year, which is the calendar year unless the Department has granted permission to use another period.

¹⁰ Throw-out income” is defined by WAC 458-20-19402(403) and is quoted and is explained below. In short, designating income from a foreign jurisdiction as “throw-out” income increases Washington tax liability.

RCW 82.04.462(3)(c) provides:

Gross income of the business from engaging in an apportionable activity must be excluded from the denominator of the receipts factor if, in respect to such activity, at least some of the activity is performed in this state, and the gross income is attributable under (b) of this subsection (3) to a state in which the taxpayer is not taxable.

(Emphasis added.) WAC 458-20-19402, which explains the exclusion from the denominator “throw-out income,” states:

(403) **Throw-out income.** Throw-out income includes all apportionable receipts attributed to states where the taxpayer:

(a) Is not taxable (see subsection (106) of this rule); and

(b) At least part of the activity of the taxpayer related to the throw-out income is performed in Washington.

(Emphasis provided.) In this case, any administrative activities performed in a Washington office “related to the throw-out income” qualifies as an activity performed in Washington. Thus, the test is whether the Washington activity is “related to” the income earned in foreign jurisdictions.

Taxpayer complains that the amount of administrative work performed in Washington was minimal. . . .

In this case, Taxpayer has not produced a log or diary, or any other records to indicate that Member did not engage in activities [in Washington] in support of its activities outside the state of Washington. Therefore, we find that TAA’s conclusion that Taxpayer performed Washington activities in support of its out-of-state aircraft certifications was appropriate.

Therefore, we hold that the term “business activity” must be read broadly to include “all activities” engaged related to the activities that produce income. Such activities necessarily include administrative activities such as scheduling, developing travel plans, billing, filing, [and] taking phone calls relative to the business. Absent record-keeping as to the activities performed in Member’s home office, we must conclude that Member’s activities were in support of all of the contracts that involved aircraft certifications in foreign jurisdictions.

We hold that TAA’s calculations of throw-out income were reasonable.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 18th day of July 2016.