

Cite as Det. No. 16-0244, 36 WTD 352 (2017)

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

In the Matter of the Petition for Refund of)	<u>D E T E R M I N A T I O N</u>
)	
)	No. 16-0244
)	
...)	Registration No. ...
)	

RULE 19402; RCW 82.04.462: B&O TAX – APPORTIONABLE INCOME – INTERNET ADVERTISING – REASONABLE METHOD OF PROPORTIONALLY ATTRIBUTING RECEIPTS. For attributing internet advertising receipts, it is appropriate to use the relative population in the customer’s internet user market as a reasonable method of proportionally attributing the benefit of the taxpayer’s services because the internet user population accurately reflects the customer’s internet user market, and it is in this market that the customer’s related business activities occur. Using general population over internet user population does not capture the nature of its customers’ internet user market and, therefore, is not a reasonable method of proportionally attributing receipts because it does not accurately reflect the market.

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.

Eckholm, T.R.O. – An out-of-state company that generates revenue from digital media programmatic ad buying (classified as internet advertising services) objects to the [Department of Revenue’s (Department)] use of internet user population, rather than general population, to represent the relative population in its customers’ market in proportionally attributing its Washington receipts. . . . The taxpayer’s petition is . . . denied in part.¹

ISSUES

[Under RCW 82.04.462(3)(b) and WAC 458-20-19402(303), did the Department properly use internet user population data to represent the relative population in the customers’ market for purposes of determining where customers receive the benefit of taxpayer’s internet advertising services?]

...

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

FINDINGS OF FACT

[Taxpayer] is an out-of-state company that generates revenue from digital media programmatic ad buying – software-driven technology that automates the purchase of data driven, targeted ads, displayed primarily on a webpage (though display may include other mobile touch points).² The taxpayer's customers include a wide variety of businesses that offer goods or services for sale, and the taxpayer's services enable its customers' ads to be viewed at a multitude of websites across the U.S. The taxpayer generally described its services as internet advertising services.

The [Department's] Compliance Division became aware of the taxpayer's activities and mailed the taxpayer an inquiry letter requesting that the taxpayer complete a Washington Business Activities Questionnaire [(Questionnaire)] for the period of June 2010 through December 2014 (assessment period). The taxpayer returned the [Questionnaire] and registered with the Department. The taxpayer's representative contacted the Compliance Division revenue agent and indicated that the taxpayer met the economic nexus thresholds and would collect the requested information. Subsequently, the taxpayer representative provided the revenue agent with total gross income for the assessment period, taxes due, and the apportioned income methodology applied. The taxpayer did not have actual data of the location where the internet advertising and sales occurred (such as IP addresses) so it used U.S. Census Bureau general population data in order to proportionally attribute Washington receipts. The revenue agent and the taxpayer's representative engaged in discussions regarding the method of attributing the taxpayer's Washington receipts. Following these discussions, the Department issued an assessment against the taxpayer for the period June 1, 2010, through December 31, 2014, in the total amount of \$. . . , using internet user population data to attribute income rather than the general population data suggested by the taxpayer.³

The taxpayer paid the assessment except for amounts of delinquency penalty, assessment penalty, and interest, applicable to Quarters 3 and 4, 2014, which is the period during which the computation of the taxes due was placed on hold pending the discussions of the attribution method.

The taxpayer sought review of the assessment, asserting that its use of general population data as opposed to internet user population data is a reasonable method of proportionally attributing its Washington receipts and is consistent with Rule 19402(304)(c), Example 22, [which is] specifically related to internet advertising services. The taxpayer asserts that the general population data is reliable and more complete than the available internet user population data, which requires proportional estimates for certain years. In addition, the taxpayer asserts that Department records indicate general population data has been accepted by the Department in the past in attributing other taxpayers' receipts from internet advertising services. The taxpayer also requested waiver of penalties and interest applicable to Quarters 3 and 4, 2014.

² . . .

³ Document No. . . . , issued on July 14, 2015, included assessments of service and other activities [B&O] tax of \$. . . , a delinquent payment penalty of \$. . . , an assessment penalty of \$. . . , an unregistered business penalty of \$. . . , and interest of \$. . . , for a total amount of \$

ANALYSIS

RCW 82.04.220 imposes a tax upon every person for the act or privilege of engaging in business in Washington. RCW 82.04.290(2) states that persons engaged in any business activity, other than or in addition to those for which a specific rate is provided in chapter 82.04 RCW, are taxable under the service and other activities business and occupation (B&O) tax classification upon gross income from such business. Gross income from advertising services is subject to the service and other activities B&O tax. WAC 458-20-218.

“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, the taxpayer provides advertising services, which are taxable under RCW 82.04.290. Therefore, the taxpayer was engaged in “apportionable activities” in Washington and earned “apportionable income.” The taxpayer is also taxable in other states; therefore, the income the 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 82.04.462(1), (3)(a). The statute provides a series of cascading rules for purposes of determining which state to attribute gross income. RCW 82.04.462(3)(b).

Rule 19402 is the Department’s rule implementing RCW 82.04.462. Rule 19402(301) explains how to attribute apportionable receipts and provides that the Department expects most taxpayers will be able to attribute apportionable receipts to the location where the customer received the benefit of the taxpayer’s service, because either the taxpayer will know where the benefit is actually received or a “reasonable method of proportionally attributing receipts” will generally be available. Rule 19402(301)(a)(i). “Reasonable method of proportionally attributing” means “a method of determining where the benefit of an activity is received and where the receipts are attributed that is uniform, consistent, and accurately reflects the market, and does not distort the taxpayer’s market.” Rule 19402(106)(f).

Rule 19402(303) explains how to determine where a taxpayer’s customer receives the benefit of the taxpayer’s service in attributing apportionable receipts under Rule 19402(301)(a). Rule 19402(303)(a) and (b) address situations where the taxpayer’s service relates to real property or tangible personal property, and subsection (c) addresses the situation here, as follows:

If 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 is received where the customer's related business activities occur. The following is a nonexclusive list of business related services:

- (i) Developing a business management plan;
- (ii) Commission sales (other than sales of real or tangible personal property);
- (iii) Debt collection services;

- (iv) Legal and accounting services not specific to real or tangible personal property;
- (v) Advertising services; and
- (vi) [Theater] presentations.

Rule 19402(303)(c) (emphasis added.)

Rule 19402(303)(c)(v) specifically identifies advertising services as a type of service that relates to a customer's business activities. In addition, applying the criteria of Rule 19402(303)(c) to the taxpayer's internet advertising services also illustrates they are encompassed by Rule 19402(303)(c). [T]he taxpayer's services (internet advertising services) do not relate to real or tangible personal property, its services are provided to customers engaged in business (offering products or services for sale), and the taxpayer's services relate to the customers' business activities (selling their products or services over the internet). [T]herefore, [under] Rule 19402(303)(c), the benefit of the taxpayer's internet advertising services is received by its customer where the customer's related business activities occur – the location where it sells its products or service over the internet.

Because of the nature of the taxpayer's internet advertising services provided via programmatic ad buying, the taxpayer indicated it was not able to identify the actual location where its customers' ads were placed (e.g., IP addresses) and agrees with the Compliance Division that a reasonable method of proportionally attributing receipts should be applied, [as directed in] Rule 19402(301)(a)(i) & (303). Where the taxpayer and the Compliance Division differ is in determining the attribution method to be applied.

The taxpayer asserts that the use of the U.S. Census Bureau general population data is a reasonable method to proportionally attribute Washington receipts because it is reliable and more complete than the internet user population data. The Compliance Division chose to use internet user population data because the customers' advertising and selling occurred over the internet, and the internet user data would more accurately reflect the location of the customers' online sales. In the absence of evidence of the actual location of the customers' internet sales, we agree with the Compliance Division and find that the internet user population data is the best evidence of the location of those sales because it is reasonable to infer from that evidence that the internet user location is the location where the sale occurred.

The use of internet user population data as a reasonable method of proportionally attributing the benefit of the taxpayer's services is also consistent with Rule 19402(304)(c), Example 22, cited by both the taxpayer and the Compliance Division.

Rule 19402(304) contains examples of the application of the benefit of service analysis and reasonable methods of proportionally attributing receipts. Rule 19402(304)(c) includes an example specific to internet advertising services:

Example 22. Taxpayer provides internet advertising services to national retail chains, regional businesses, businesses with a single location, and businesses that operate solely over the Internet. Generally, the benefit of the advertising services is received where the customer's related business activities occur. Depending on what products or services are

being provided by Taxpayer's customers, the use of relative population in the customer's market may be a reasonable method of proportionally attributing the benefit of Taxpayer's services.

Rule 19402(304)(c), Example 22.

Both the taxpayer and the Compliance Division agree that Example 22 is useful in determining the reasonable method of proportionally attributing the benefit of the taxpayer's internet advertising services. Example 22 applies Rule 19402(303)(c) in stating that “[generally], the benefit of the advertising services is received where the customer's related business activities occur.” As in the taxpayer's case, it is not uncommon that an internet advertising service provider will be unable to identify the actual location of where the customer's related business activities – online sales – occur. Example 22 then states that “the use of *relative population in the customer's market* may be a reasonable method of proportionally attributing the benefit of Taxpayer's services.” (Emphasis added.)

A “[r]easonable method of proportionally attributing” means “a method of determining where the benefit of an activity is received and where the receipts are attributed that is uniform, consistent, and accurately reflects the market, and does not distort the taxpayer's market.” Rule 19402(106)(f). Here, the taxpayer's customers' market is limited to internet users and the taxpayer's services assist its customers in reaching the most relevant internet user market. [A]pplying Example 22, it is appropriate to use the relative population in *the customer's internet user market* as a reasonable method of proportionally attributing the benefit of the taxpayer's services because the internet user population accurately reflects the customer's internet user market, and it is in this market that the customer's related business activities occur. The taxpayer's preference of using general population over internet user population does not capture the nature of its customers' internet user market and, therefore, is not a reasonable method of proportionally attributing receipts because it does not accurately reflect the market. It is not reasonable to disregard the nature of the internet user market in determining where the taxpayer's customers' related business activities occur, particularly in light of the lack of actual evidence of where the sales occurred.⁴

Consistent with Rule 19402(303)(c) and Rule 19402(304)(c), Example 22, the Compliance Division appropriately used internet user population data as a reasonable method of proportionally [attributing] the taxpayer's Washington receipts. Such method accurately reflects the customer's internet user market and the location where the customer receives the benefit of the taxpayer's services – where the customer's internet sales occur.

In regards to the taxpayer's assertion that Department records indicate that general population data has been accepted by the Department in the past in attributing other taxpayers' receipts from internet advertising services, the Department is prohibited under RCW 82.32.330 from discussing the particulars of one taxpayer's situation with another taxpayer. *See* Det. No. 93-016, 13 WTD

⁴ The Department's guidance on its webpage also advises the use of internet usage data in employing a reasonable method of proportionally attributing internet advertising receipts. *See* “Economic Nexus and Apportionment Questions and Answers,” regarding “Attributing Income,” <http://dor.wa.gov/content/findtaxesandrates/bandotax/economicnexusqna.aspx> (last accessed July 22, 2016).

170, 177-179 (1993). In any event, the facts and circumstances that may have informed the choice of the method of attributing another taxpayer's income are unknown and not helpful here. The taxpayer's petition is denied as to this issue.

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DECISION AND DISPOSITION

The taxpayer's petition is . . . denied in part.

Dated this 3rd day of August, 2016.