

Attributing Gross Income from Apportionable Activities

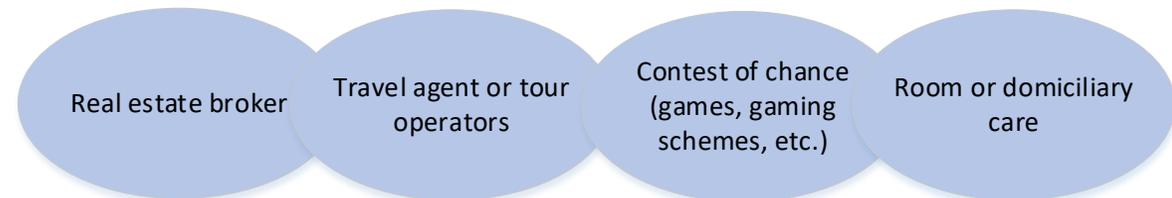
*FOR DEPARTMENT OF REVENUE
BUSINESS ADVISORY COUNCIL*

SEPTEMBER 21, 2020



What is Apportionment?

- **Apportionment**, for tax purposes, refers to the formulary allocation to a taxing state the share of a person's income that corresponds to its business activity in that taxing state.
- Since 2010, Washington uses a single sales/receipts factor apportionment formula.
 - For WA B&O tax purposes, any person earning income from apportionable activities that are taxable in WA and also taxable in another state would need to apportion their gross income following the WA apportionment formula.
 - **Apportionable activities** include, but are not limited to, income reportable under the service and other activities (S/O) B&O tax classification.

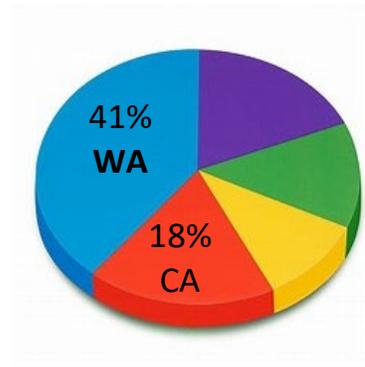
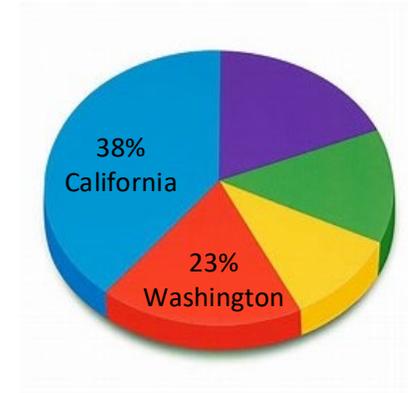


How to Apportion to Washington?

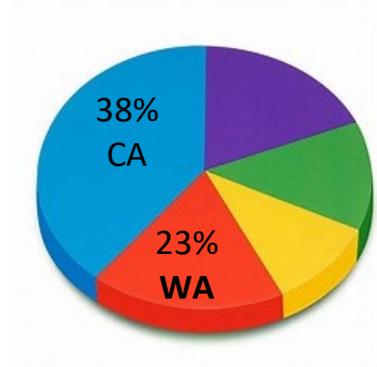
Taxable income = Apportionable income X Receipts factor*

NOTE*: Separate receipts factor for each apportionable B&O tax classification.

For example, a real estate brokerage office might provide both title insurance and real estate brokerage services.



Real estate brokerage



Title insurance

Receipts Factor

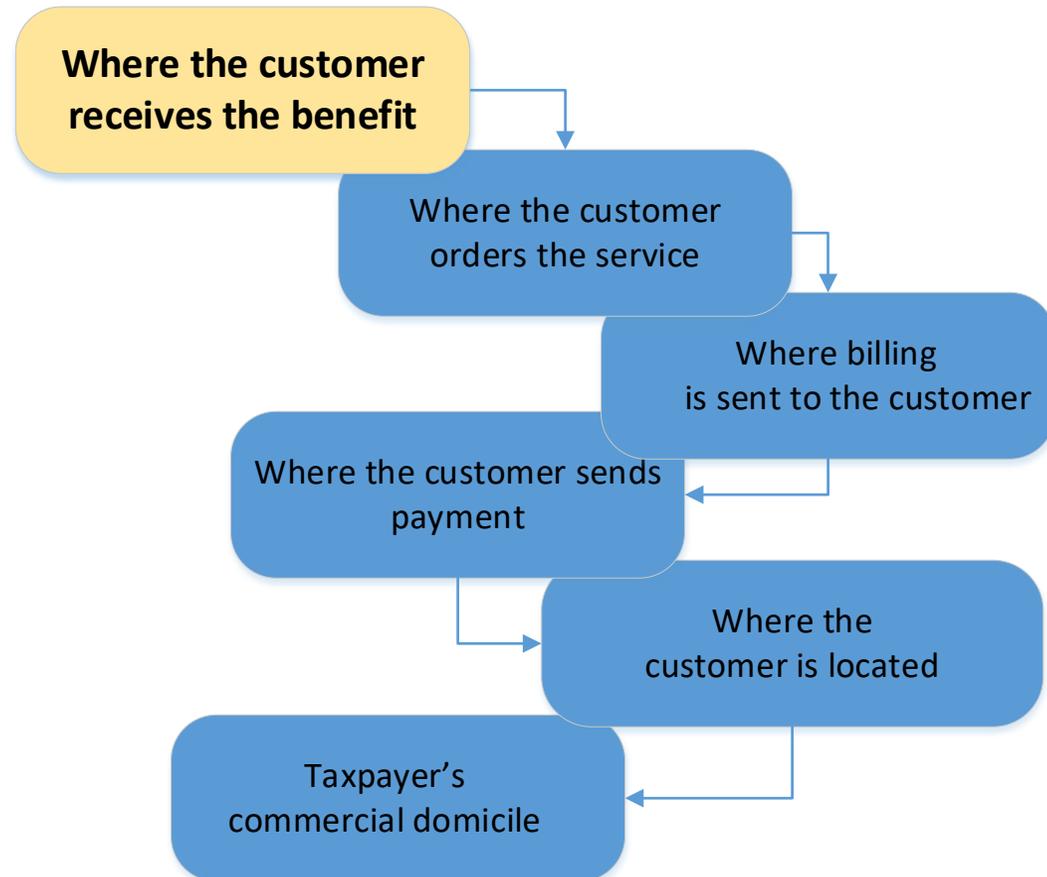
Receipts factor

Total gross income
attributable to WA

$$\text{Receipts factor} = \frac{\text{Washington apportionable receipts}}{\text{Worldwide apportionable receipts} - \text{throwout income}}$$

Gross Income Attributable to WA

- Washington law provides that gross income attributable to this state (or WA apportionable receipts) is determined in a cascading order, as follows ➡
- WAC 458-20-19402 ([Rule 19402](#)) explains how to determine where customer received the benefit of the taxpayer's service



Benefit of Service Received

Related to real property

⇒ where the real property is located



Related to tangible personal property

⇒ where customer's principal use of TPP occurs



Related to customer business activity

⇒ where customer's related business activity occurs



Related to non-business customer or activity

⇒ (i) where customer must be present in order to receive the service; (ii) specific, known location(s); (iii) where customer resides



Customer's Related Business Activity

- **Example 1:** HR Co., a human resource company, provides payroll services to a business with employees at three office locations in Washington, Oregon, and Idaho.

The business' (customer's) related business activity is its human resource activities.

The business received the benefit of the HR Co.'s services at its three office locations.

- **Example 2:** Advertising Co., an advertising company, provides advertising services to online retail businesses.

The retail business' (customer's) related activities are the product marketing, promotion activities.

The business receives the benefit of Advertising Co.'s services at its market locations.

Customer's Market Location

- **Example 2:** Advertising Co., an advertising company, provides advertising services to online retail businesses.

The retail business' (customer's) related activities are the product marketing, promotion activities.

The business receives the benefit of Advertising Co.'s services at its market locations.

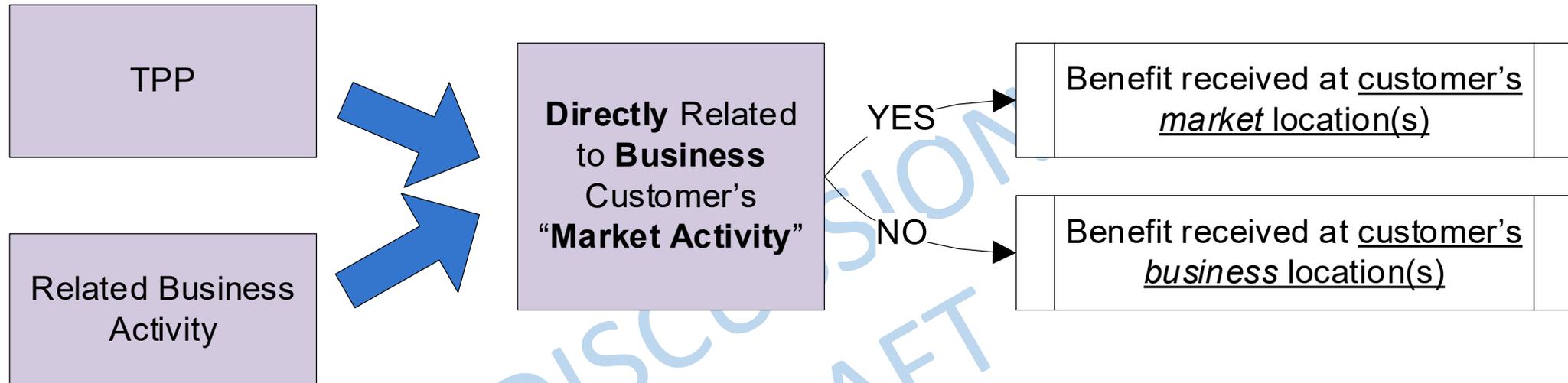
- Assuming a retail business sells regionally only (e.g. WA and OR only), the market location would be limited to WA and OR
- Assuming another retail business sells nationally, the market location would be U.S.

See the Department's [Interim Statement Regarding the Attribution of Internet Advertising Receipts](#)

Revising Attribution Rule

- Customer related business activities ...
 - Taxpayers & the Department often apply the rule differently from situation to situation; and
 - As result, we often do not agree
- September 2018
 - Opened Rule 19402 and held a CR-101 public meeting without a rule draft to seek public input
 - Clarify how to determine customer's related business activities
 - Clarify how to reasonably determine the amount of gross income attributable in this state
- March 2019
 - Sought feedback from a small group of stakeholders on a proposed clarifying framework
- September 2019
 - Further discussed and solicited feedback on how to refine the proposed clarifying framework

Proposed Clarifying Framework

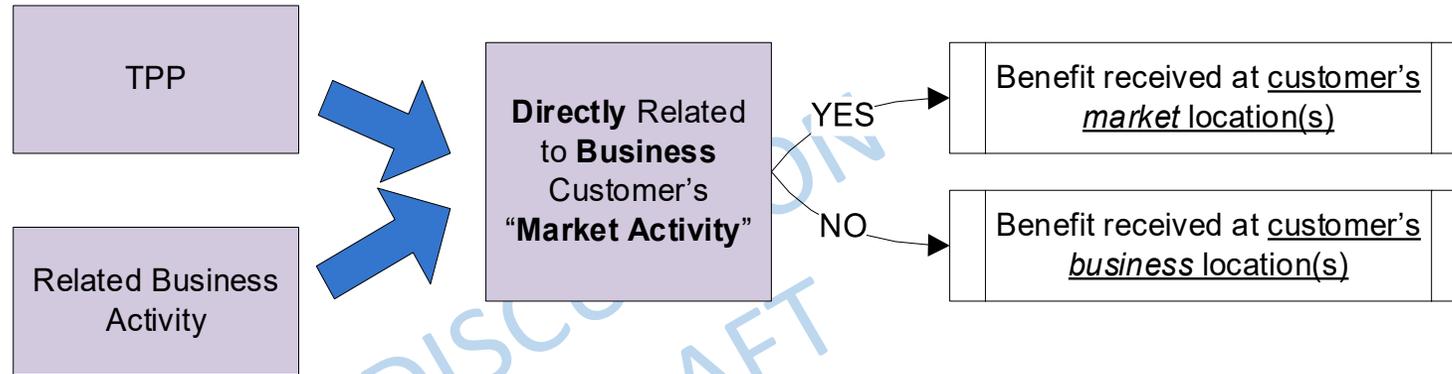


Market Activity:

Most closely or directly...

1. Is TP service PROMOTING customer products?
2. Is TP service ENGAGING IN or COMPLETING customer product sales?
3. Is TP service ESTABLISHING or MAINTAINING customer market?

Proposed Clarifying Framework (cont.)



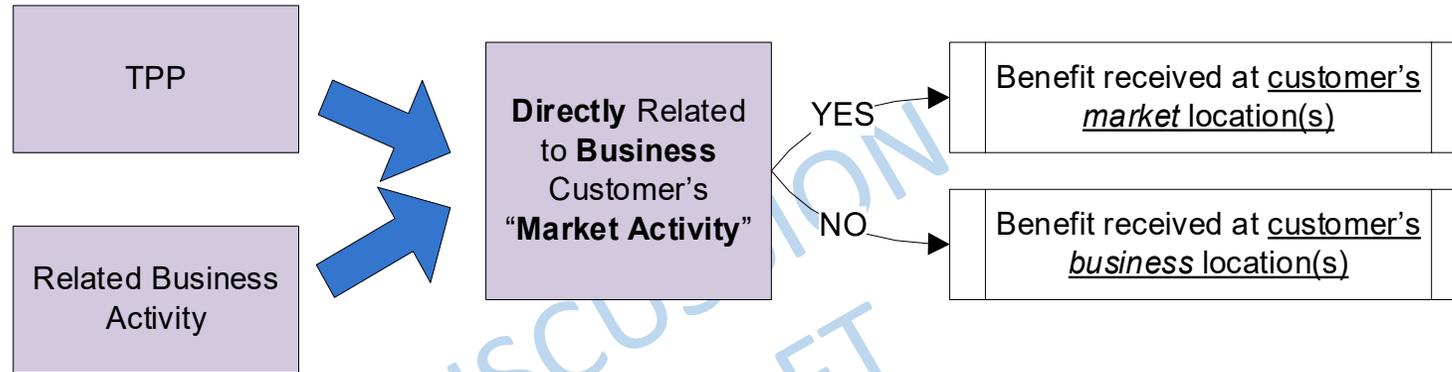
Market Activity:

Most closely or directly...

1. Is TP service PROMOTING customer products?
2. Is TP service ENGAGING IN or COMPLETING customer product sales?
3. Is TP service ESTABLISHING or MAINTAINING customer market?

- **Example 1:** HR Co., a human resource company, provides payroll services to a business with employees at three office locations in Washington, Oregon, and Idaho.

Proposed Clarifying Framework (cont.)



Market Activity:

Most closely or directly...

1. Is TP service PROMOTING customer products?
2. Is TP service ENGAGING IN or COMPLETING customer product sales?
3. Is TP service ESTABLISHING or MAINTAINING customer market?

- **Example 2:** Advertising Co., an advertising company, provides advertising services to online retail businesses. Some retailers sell locally; some retailers sell nationally.

Where We Are ...

Status Update

*Process for amending the
apportionment rule?*

*Reforming apportionment
reconciliation?*

Summary

- Resume and redo CR-101 with a rule draft in the near future
- Welcome continued stakeholder feedback, including but not limited to:
 - Apportionment reconciliation
 - Proposed clarifying framework
 - Other concerns...
- Continue working toward a mutual goal of:
 - Simplifying the current approach;
 - Making it more administrable, sustainable, and consistent; and
 - Minimizing challenges or disputes

