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In this article, Allen and Murphy discuss a new, updated Washington apportionment rule and review previous versions of the rule to better understand how and why the state made its changes.

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Washington's updated apportionment rule, Wash. Admin. Code section 458-20-19402 (rule 19402) for attributing¹ apportionable receipts uses a series of questions to determine whether the benefit of the service is received in the customer's market or some other customer business location. But before addressing the new rule, it is helpful to review the previous version of Wash. Admin. Code section 458-20-19402 (former rule) to better understand how and why the Department of Revenue made its changes.

Applying Washington's Former Rule

Washington imposes a business and occupation (B&O) tax "for the act or privilege of engaging in business" in the state.² 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."³ The B&O tax rate is determined by the nature of the business activity in which a taxpayer engages. Wash. Rev. Code section 82.04.290(2) imposes a tax on gross income from business activities not taxed elsewhere in the B&O tax framework. Known as the "service and other activities" B&O classification, this tax is imposed on a broad range of service activities, including many professional services provided to businesses and individual customers.

Businesses taxable in Washington and another state⁴ must use Washington's apportionment framework to determine which portion of their apportionable income is subject to B&O tax in Washington. Apportionable income is derived from a number of listed apportionable activities, including those subject to the "service and other activities" B&O classification.⁵

Washington apportions receipts from apportionable activities among states based on a cascading method.⁶ Under the first step in the cascading method, receipts are attributed to the state where the customer received the benefit of the taxpayer's service, which is determined by using specific information if available.⁷ When specific information is unavailable, a reasonable method of proportionally attributing receipts may be used.⁸ In most cases the DOR does not allow taxpayers to use

³ *Id.*

⁴ Wash. Rev. Code section 82.04.460(4)(b)(i).

⁵ Wash. Rev. Code section 82.04.460(4)(a).

⁶ Wash. Rev. Code section 82.04.462(3)(b), former Wash. Admin. Code section 458-20-19402(301) (Wash. Reg. 15-04-004, section 458-20-19402 (filed Jan. 22, 2015, eff. Feb. 22, 2015)). (Hereinafter citations to the former rule include the year 2010 and those to the current rule include the year 2024. Note that the emergency rule was created in 2010 with updates throughout the next few years, leading to the current version referenced here using 2010).

⁷ Wash. Admin. Code section 458-20-19402(301)(a)(i) (2010).

⁸ Wash. Admin. Code section 458-20-19402(301)(a)(ii) (2010).

¹ The DOR has used the term "attribution" rather than "sourcing" to distinguish this process from sourcing sales taxes.

² Wash. Rev. Code section 82.04.220.

the lower cascading steps.⁹ Most taxpayers will be required to use the first step in the hierarchy. On this point, the former rule stated:

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.¹⁰

Thus, for most taxpayers, receipts must be attributed to the state where the benefit of the service is received, using either specific information or a reasonable method of proportionally attributing receipts. “Where the benefit is received” is initially determined based on the type of service performed. The former rule categorized these services into four types:

- **Services related to real property:** If the taxpayer’s service relates to real property, the benefit is received — and receipts are attributed to — the real property’s location.¹¹ Examples of services in this category are architectural, surveying, appraising, and other similar services.¹²
- **Services related to tangible personal property:** If the taxpayer’s services relate to tangible personal property, the benefit is received where the tangible personal property is located or intended/expected to be located.¹³ Services in this category include inspecting and testing tangible personal

property, commissioned sales of tangible personal property, and other similar services.¹⁴

- **Services not related to real or tangible personal property, provided to a customer engaged in business, and related to the customer’s business activities:** If the taxpayer’s service does not relate to real or tangible personal property, is provided to a customer engaged in business, and *relates to the customer’s business activities*, then the benefit is received *where the customer’s related business activities occur*.¹⁵ Services that may fall into this category include developing a business plan and legal, accounting, and advertising services.¹⁶
- **Services not related to real or tangible personal property, provided to a customer not engaged in business, or unrelated to the customer’s business activities:** If the taxpayer’s service does not relate to real or tangible personal property and is either provided to a customer not engaged in business or unrelated to the customer’s business activities, then receipts are attributed to one of three locations. If the service requires the customer to be physically present, then the benefit is received where the customer is located when the service is performed.¹⁷ An example is a doctor’s exam or a haircut. If the service relates to a specific, known location, then the benefit is received at that location.¹⁸ An example is wedding planning. If neither category applies, then the default attribution location is the customer’s residence.¹⁹ An example is drafting a will.

⁹ Later cascading methods include attribution based on the state where the customer ordered the service, the state to which billing statements are sent to the customer, and the state from which the customer sends payment. If the taxpayer is unable to attribute receipts under any preceding method, receipts are attributed to its commercial domicile. See Wash. Rev. Code section 82.04.462(3)(b)(iii)-(vii) and Wash. Admin. Code section 458-20-19402(301)(b)-(g) (2010).

¹⁰ Wash. Admin. Code section 458-20-19402(301) (2010). This concept is retained in the new Wash. Admin. Code section 458-20-19402(302)(a), with non-substantive revisions that reflect changes in section numbering.

¹¹ Wash. Admin. Code section 458-20-19402(303)(a) (2010).

¹² *Id.* See Det. No. 21-0102, 41 WTD 396 (2022) (for an example of an online property tax payment service, which was deemed related to real property).

¹³ Wash. Admin. Code section 458-20-19402(303)(b) (2010).

¹⁴ Wash. Admin. Code section 458-20-19402(303)(b) and (304)(b) (2010). See *Walter Dorwin Teague Associates v. Department of Revenue*, 500 P.3d 190 (Wash. Ct. App. 2021) (holding that design services for airplane interiors were services related to tangible personal property).

¹⁵ Wash. Admin. Code section 458-20-19402(303)(c) (2010).

¹⁶ Wash. Admin. Code section 458-20-19402(303)(c), (304)(c) (2010). See *LendingTree LLC v. Department of Revenue*, 460 P.3d 640 (Wash. Ct. App. 2020) (holding that an online referral service was not related to real or tangible personal property, but instead to the customer’s business activities).

¹⁷ Wash. Admin. Code section 458-20-19402(303)(d)(i) (2010).

¹⁸ Wash. Admin. Code section 458-20-19402(303)(d)(ii) (2010).

¹⁹ Wash. Admin. Code section 458-20-19402(303)(d)(iii) (2010).

The third category of services is the focus of this article — that is, attributing receipts from services provided to a customer engaged in business and related to that customer’s business activities. We limited the discussion to this category because it is where the DOR has focused its most significant changes in new rule Wash. Admin. Code section 458-20-19402.²⁰ This part of the former rule states:

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*.²¹

Thus, to apply this part of the former rule, it is helpful to ask: Who is the customer?²² After identifying the customer, the next questions are: What is the customer’s most closely or directly related²³ business activity, and where does that business activity occur? It is useful to look at Example 17 in the former rule to understand how this works:

Debt Collector provides debt collection services to ABC. The benefit of Debt

Collector’s services *relates to ABC’s selling activity* in various states. It is reasonable to assume that where the debtors are located is the same as where ABC’s business activity occurred. If Debt Collector is able to attribute specific receipts to a specific debtor, then the *receipt is attributed to where the debtor is located*.²⁴

Here, the customer is ABC. The example states that the customer’s related activity (that is, most closely or directly related activity) is selling. Because the customer’s related activity is characterized as selling, it receives the benefit of the taxpayer’s services where that customer’s selling activity takes place — at the debtor’s location. This has the practical effect of attributing receipts to what we may call “the customer’s market.”

If the customer’s activity is not market-related, then the customer’s related activities will generally occur at its business location. Example 24 in the former rule illustrates this scenario:

Company A provides human resources services to Racko, Inc. which has three offices that use those services in Washington, Oregon, and Idaho. Racko sells widgets and has customers for its widgets in all 50 states. The benefit of the service performed by Company A is received at Racko’s locations in Washington, Oregon, and Idaho. Assuming that each office is approximately the same size and uses the services to approximately the same extent, then attributing 1/3 of the receipts to each of the states in which Racko has locations using the services is a reasonable method of proportionally attributing Company A’s receipts from Racko.

Although not explicitly stated in the example, the customer’s related business activity appears to be something like human resources management. Thus, the related activity is not most closely or directly related to selling, and receipts are attributed to states where the customer has business locations benefiting from the services.

²⁰Note, new Wash. Admin. Code section 458-20-19402 leaves intact the parts of old Wash. Admin. Code section 458-20-19402 addressing services related to real property and services provided to individuals not engaged in business. However, new Wash. Admin. Code section 458-20-19402 deletes parts addressing services related to tangible personal property under old rule 19402(303)(b) and combines that category with the new analysis discussed in this article. As a result, services related to tangible personal property are no longer attributed to the state where the property is located or intended/expected to be located. Instead, if those services are provided to a customer engaged in business, and relate to that customer’s business activities, they are attributed under new rule 19402(303)(c), based on where the customer receives the benefit of the service. Otherwise, the services are attributed under new rule 19402(303)(d). The DOR intends for this revision to reduce complexity by removing the potentially difficult determination of whether a service relates sufficiently to tangible personal property for old rule 19402(303)(b) to apply.

²¹Wash. Admin. Code section 458-20-19402(303)(c) (2010) (emphasis added).

²²“Customer” means a person or entity to whom the taxpayer makes a sale, grants the right to use intangible property, or renders services or from whom the taxpayer otherwise directly or indirectly receives gross income of the business.” Wash. Admin. Code section 458-20-19402(106)(e) (2010).

²³Wash. Admin. Code section 458-20-19402(303)(c) (2010) does not use the phrase “most closely or directly related activity.” However, the DOR has administered using these concepts. This fact was acknowledged and supported in *LendingTree LLC*, 460 P.3d 640, holding that an online referral service was not related to real or tangible personal property, but instead to the customer’s business activities that “most closely or directly relate to the services performed by LendingTree.” See also Washington State DOR, “LendingTree Decision — What Next?” (last visited June 24, 2024).

²⁴Wash. Admin. Code section 458-20-19402(303)(c) (2010), Example 24 (emphasis added).

Old Challenges

Now that we have reviewed the former rule’s analytical framework, we can discuss the challenge encountered when applying that framework. The challenge was that taxpayers and the DOR often disagreed on what the customer’s most closely or directly related activity was, hence where that activity occurred (and therefore where receipts were attributed). The former rule provided examples that attempted to illustrate the analysis. The following table summarizes the examples in the former rule.

Former Rule 19402 Examples

Former Rule 19402 Examples	Taxpayer Service	Customer’s Related Activity	Attribution Location ^a
16	Product liability litigation services	Selling	Market
17	Debt collection	Selling	Market
18	Debt collection ^b	Selling	Market
19	Training	Ethical behavior	Customer business location
20	Training ^c	Ethical behavior	Customer business location
21	Call center	Selling	Market
22	Internet advertising	Selling	Market
23	Newspaper advertising	Selling	Market
24	Human resources	Human resources management	Customer business location
25	Director services	General management (board of directors)	Customer business location

^aAlthough Wash. Admin. Code section 458-20-19402 (2010) often indicates the attribution location (*e.g.*, market), it does not always provide a reasonable method of proportionally attributing receipts. This will be discussed later.

^bSame as Example 17, with additional facts.

^cSame as Example 19, with additional facts.

Unfortunately, it was not always clear from these examples how the most closely or directly related activity was determined for each example in the table of former rule examples. For instance, it may not be intuitive that litigation services (Example 16 in the old rule) relate to a customer’s selling activity. Example 16 in the former rule stated:

Manufacturer hires Law Firm to defend Manufacturer in a class action product liability lawsuit involving Manufacturer’s Widgets. The benefit of Law Firm’s services *relates to Manufacturer’s widget selling activity* in various states. A reasonable method of proportionally attributing receipts in this case would be to attribute the receipts to the locations where the Manufacturer’s Widgets were delivered, which relates to Manufacturer’s business activities.²⁵

This example states that the customer’s related business activity is selling. However, it is not clear how this determination was made. A reasonable person might think litigation services involving a product liability case are most closely or directly related to a customer’s legal department activities, court appearances, or even design or manufacturing activities. While litigation services may be generally related to selling,²⁶ it is not apparent that they are most closely or directly related to selling, especially when compared with other customer activities.²⁷

Similarly, it may not be intuitive that debt collection services in Example 17 of the former rule are most closely or directly related to selling. Former Example 17 states:

Debt Collector provides debt collection services to ABC. The benefit of Debt

²⁵Wash. Admin. Code section 458-20-19402(303)(c) (2010), Example 16 (emphasis added).

²⁶One might extend this argument even further to assert that virtually everything a business does is “related to selling” its product or service.

²⁷Note that the result of this example is changed in the new Wash. Admin. Code section 458-20-19402, Example 32. The facts remain substantially the same, with the addition that the manufacturer’s principal place of business is in Washington. The new example concludes that the manufacturer’s customer receives the benefit of the service at the customer’s business location, which under the facts provided is its principal place of business in Washington.

Collector's services *relates to ABC's selling activity* in various states. It is reasonable to assume that where the debtors are located is the same as where ABC's business activity occurred. If Debt Collector is able to attribute specific receipts to a specific debtor, then the receipt is attributed to where the debtor is located.²⁸

This example stated that the customer's related business activity is selling, but it is unclear how this determination was made. A reasonable person might think debt collection services are most closely or directly related to a customer's accounting activities (such as accounts receivable collection) or broader finance department activities, rather than selling activities; debt collection may occur long after a sale has been made, recorded in books and records, and reported for sales tax purposes.²⁹

Proposed Solution

In new rule 19402, Washington attempts to remove some of the uncertainty involved in determining what customer activities are most closely or directly related, and therefore where those business activities occur and to where receipts are attributed. The new rule states, in subsection (303)(c):

*A customer's related business activities will generally occur either in the customer's market or at the customer's business location(s).*³⁰

Thus, new rule 19402 starts by clearly stating the fundamental binary decision-making process for attributing receipts from services related to a customer's business activities. Receipts will be attributed to either the customer's market or to a nonmarket "business location(s)."

If the taxpayer is providing services related to the customer's activities in its market, the service receipts will be attributed to that market location. To

determine whether the taxpayer's service is related to the customer's activities in its market, new rule 19402 asks the service provider to determine if their services are:

- promoting the customer's products;
- engaging in or completing the customer's product sales;
- obtaining or facilitating amounts owed to the customer from the sale of its products; or
- establishing or maintaining the customer's market.³¹

If the taxpayer answers yes to any of those questions, then the customer's related business activities occur in the customer's market, and receipts are attributed to the corresponding market location. This analysis may be easier to apply because taxpayers have a better understanding of what services they provide, in contrast to guessing at the customer's related business activities. Having answered the four questions about its service, the taxpayer then has an answer to the question: Where does a customer receive the benefit of the service? If the taxpayer answers yes to any of these questions, then the receipts are attributed to that customer's market.

But if the taxpayer answers no to all four questions, receipts are attributed to the customer's business location(s). In new rule 19402, the customer's business locations are determined in a cascading hierarchy as follows:

- **Physically present:** If the taxpayer's service requires the customer to be physically present, then the customer's business location is where the customer is located when the taxpayer provides the service.
- **Specific, known business locations:** If the taxpayer's service does not require the customer to be physically present, and its service relates to specific, known business locations, then the customer's business locations are those specific, known business locations.

²⁸Wash. Admin. Code section 458-20-19402(303)(c) (2010), Example 17 (emphasis added).

²⁹This example remains in the new Wash. Admin. Code section 458-20-19402, Example 14, as an instance in which an activity is "obtaining or facilitating payment of amounts owed to the customer from the sale of its products." Under the new analytical framework, receipts from these activities are attributed to the customer's market.

³⁰Wash. Admin. Code section 458-20-19402(303)(c) (2024) (emphasis added).

³¹Wash. Admin. Code section 458-20-19402 (303)(c)(i)(A)-(D) (2024).

- **Principal place of business or commercial domicile:** If the steps above do not apply, then the customer's business location is its principal place of business or commercial domicile.³²

This cascading hierarchy for business location provides a definite answer for attributing receipts, with the last option being the customer's principal place of business or commercial domicile.

Washington's new analysis attempts to clarify the decision-making process for determining how to attribute receipts between market and business locations. The implicit assumption in new rule 19402 is that taxpayers and DOR personnel will be able to answer the four specific market questions more uniformly than they answer the two general questions of: What are the customer's related business activities? Where do they occur? Thus, the four questions are intended to put in place a more disciplined approach for determining where the benefit of the service is received.

Next Steps?

The new rule provides several examples of where the customer's related business activities occur in its market. While these examples provide helpful guidance, new rule 19402 does not elaborate on what method or data to use to attribute receipts within the customer's market in all instances. Taxpayers and the DOR will still need to agree on methods or data to be used to attribute to market or nonmarket business locations.

As such, if a taxpayer does not have specific information to identify where its customer received the benefit of the service, the rule may still provide a degree of uncertainty as to what is a "reasonable method of proportionally attributing receipts." For example, new rule 19402, Example 23, states:

Management Co. provides customer support services to Customer A. Customer A's only physical location is its office in State Z. Customer A makes sales throughout the United States. Per the contract between Management Co. and

Customer A, customer support services provided by Management Co. consist of operating a call center to handle Customer A's calls and emails related to services and sales. Management Co.'s customer support services are establishing and maintaining Customer A's market. Customer A receives the benefit of Management Co.'s service *in Customer A's market throughout the United States*.³³

While this example indicates that market attribution is appropriate throughout the United States, it is unclear what attribution method or data will be accepted by the DOR to perform the attribution. The following is a nonexclusive list of possible methods for sourcing to the market for this example:

- use customer sales data by state to reflect where the product is sold (to the extent available);
- use industry sales data for similar products to reflect sales percentage by state; or
- use relative population data among states.

As illustrated here, there may be multiple methods or sources of data for conducting attribution to the market. The DOR will likely prefer the more specific data where available (such as sales data), but after that, what data will be accepted is not necessarily clear. Thus, where there are multiple methods or data sources, the taxpayer and department personnel may continue to disagree.

To minimize disagreement, it would be helpful to have specific industry guidance proposing methods acceptable to the DOR. The department has provided this type of guidance for internet advertising services³⁴ and may consider providing more for other industries.

³³ Wash. Admin. Code section 458-20-19402(303)(c) (2024), Example 23 (emphasis added).

³⁴ The DOR provided specific industry guidance on what may constitute a "reasonable method of proportional attribution" in the context of receipts from internet advertising in its "Interim Statement Regarding the Attribution of Internet Advertising Receipts," issued June 22, 2017. That guidance is being taken off the DOR's website because it was largely incorporated into the new Wash. Admin. Code section 458-20-19402.

³² Wash. Admin. Code section 458-20-19402(303)(c)(ii), (iii)(A)-(C) (2024). Note that this analytical structure is very similar to new and old Wash. Admin. Code section 458-20-19402 (303)(d)(i)-(iii).

Conclusion

Washington's 2010 implementation of receipts attribution based on the benefit of the service has been challenging for the DOR and taxpayers to administer. The main challenge has involved subsection 303(c) of the former rule, addressing attribution of receipts from business services not related to real property or tangible personal property. The crux of the challenge is that taxpayers and the department have frequently disagreed about what the customer's related business activities are and where they occur.

Addressing this challenge, the DOR has created a new analytical framework in new rule 19402. This framework provides a series of questions to determine the customer's related business activities with more uniformity in the hope of reducing controversy and uncertainty in tax reporting and auditing. Although there are other changes in the revised rule, we believe the one discussed here is the most significant. Businesses may want to evaluate their current attribution methods implemented under the former rule in preparation for the annual apportionment reconciliation due later this year on October 31. It might make sense to freshen up apportionment methods, given the implementation of the new rule. ■



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