

WASHINGTON DEPARTMENT OF REVENUE
NEW APPORTIONMENT METHOD AND MINIMUM NEXUS THRESHOLDS

In 2010 Washington changed the way businesses providing services or earning royalties apportion their taxable income between Washington and other states and countries. Along with this change, there are now two different nexus standards for B&O tax:

- For companies engaged in apportionable activities, which includes the classification service and other activities, “economic nexus” has been adopted. The definition of apportionable activities can be found in Washington rule, WAC 458-20-19401.
- For other business activities, such as retailing and wholesaling, nexus continues to be based on the business having a physical presence.

Effective June 1, 2010, the new law establishes minimum nexus thresholds for the B&O taxation of apportionable activities. If your business earns income from an apportionable B&O classification in another state or country and *meets one of the following thresholds*, you are eligible to apportion your income attributable to that state or country away from Washington.

- Pay business activities tax in the other state or country
- Have more than \$50,000 of property in the other state or country
- Have more than \$50,000 of payroll and third party compensation in the other state or country
- Have more than \$250,000 of gross income in the other state or country
- Have at least 25 percent of your total property, payroll or income in the other state or country

For 2010, the minimum nexus thresholds are based on the entire 2010 calendar year, but taxes are only due under the new thresholds from June 1, 2010, forward. Prior to this new apportionment method, businesses used separate accounting or a cost apportionment method to apportion gross income. *Effective June 1, 2010 you can no longer use the separate accounting method even when records are kept that allow for accurate segregation of in-state and out-of-state activities. The new economic nexus laws require businesses to use the new single-factor apportionment method on all apportionable activities.*

The new single-factor apportionment method is based solely on sales. The sales factor is determined by taking the apportionable income sourced to Washington during the tax year (numerator) and dividing by the apportionable income from worldwide sources during the tax year (denominator). However, the new apportionment law has a throw-out rule. *Under the throw-out rule, apportionable income is excluded from the denominator of the sales factor if both:*

1. The income is sourced to a state where the taxpayer is not subject to tax or the taxpayer does not have nexus and
2. At least some of the activity is performed in Washington.

Washington income

(Worldwide income) – (Throwout income)

Previous to June 1, 2010, services were sourced where the services were performed. Under the new method, services are sourced under a cascading method, with the first being where the purchaser receives the benefit of the service. Only if a test cannot be determined to be met, should the next test be applied. These tests are:

1. Where the purchaser receives the benefit of the services
2. If the benefit is received in multiple states, then where the benefit of the service is primarily received
3. Where the service was ordered
4. Where the billing statements or invoices are sent to the purchaser
5. Where the purchaser sends the payment from
6. The purchaser's address maintained in the seller's records
7. The seller's commercial domicile

Note that if a business performs activities that are subject to more than one apportionable tax classification, a separate apportionment factor must be calculated for each revenue stream.

If you are a service business located in Washington, these changes may reduce the amount of Washington tax you owe. However, keep in mind that you may be taxable in other states. The Department of Revenue website, <http://dor.wa.gov>, is a good source for further information. Our Business Support Services department can assist you in apportioning your income and/or preparing your Washington excise tax return. Please feel free to contact us if you have any questions on this or any other Department of Revenue issues.

This communication discusses plans or arrangements that may have as a significant purpose, although not the principal purpose, the avoidance of any tax imposed by the Internal Revenue Code. Circular 230, the IRS Standards of Practice requires us to disclose to you that any federal tax advice contained herein was intentionally written without the requisite formality and scope needed for use as protection against federal accuracy related tax reporting penalties, and therefore cannot be used for that purpose. Furthermore, while you are not prohibited from disclosing such federal tax treatment or tax structure to a third party, it is our understanding that our advice will not be used by you to promote, market or recommend to another party any matters addressed herein. Please contact us if you are in need of written federal tax advice designed to protect against the imposition of accuracy related penalties.