

Washington's B&O Tax Apportionment

The stealth refund opportunity for professional service businesses.

BY JOE HABERZETLE

WASHINGTON-BASED professional service providers with clients located outside the state are likely aware by now that significant changes were made to the state's business and occupation (B&O) tax apportionment rules in 2010. Under these revised rules, B&O tax on receipts from non-Washington customers are often sharply reduced. However, what many businesses may overlook, or remain unaware of, is that these rules may substantially reduce the B&O tax on sales to Washington-based companies as well, resulting in a significant potential refund opportunity. Before you start celebrating, there are a few things you need to know.

BACKGROUND.

BEFORE JUNE 2010, it was difficult for professional service businesses — including lawyers, accountants, management and technology consultants, architects, engineers and others — to determine how much of their receipts from customers outside of the state were properly subject to B&O tax. The state required using a complex cost apportionment method that was byzantine, often misunderstood and difficult to apply.

The central concept of the 2010 law change is that receipts from services are now taxed based on *where the customer receives the benefit of the service*. For example, consider a Seattle law firm that does work for a California client. In general, revenue from that work would not be subject to B&O tax under the new law because the client receives the benefit where it is located — in this case, California. The impact, which was anticipated by the new law's proponents, is to shift part of the burden of the B&O tax away from Washington-based service providers and onto

out-of-state companies that have a substantial Washington customer base.

BEWARE THE "THROW-OUT" RULE.

UNFORTUNATELY, THE LAW CHANGE contains provisions that add considerable complexity to its operation. Foremost among these is a "throw-out rule," which is best illustrated by this example: If our hypothetical Seattle law firm does work for California clients but neither files there nor has a taxable presence (defined in the following paragraph), then receipts from California work must be spread pro rata among states where the firm *does* file taxes or have such a presence. The ostensible purpose of the throw-out rule is to avoid a situation in which a company has receipts that are not being taxed by any jurisdiction. More information on the throw-out rule can be found on the Washington State Department of Revenue website (dor.wa.gov).

For this purpose, a "taxable presence" is determined using the same rules Washington applies to decide whether a non-Washington business is subject to B&O tax. For states or foreign countries in which a business does not file tax returns, it must generally have at least \$267,000 in annual receipts from customers in the state — or at least 25 percent of its total receipts there — in order to avoid paying B&O tax on at least some portion of those receipts.

OPPORTUNITY KNOCKS.

THE WAY THE Washington Department of Revenue interprets the apportionment law also creates a significant opportunity for Washington-based service providers. This opportunity lies in how the department evaluates

where the benefit of certain services is received.

If the benefit of the service is "internal" to the client (that is, services that help it run its business and operate more efficiently), the benefit is deemed to be received where those operations occur. On the other hand, if the benefit of the service is "external" — think services that help the client market its products or interact with its customers more effectively — the benefit is deemed to be received by the client where *its customers* are located. If the client is a company that markets its products nationally or globally, this can result in just a tiny portion of those receipts being attributed to Washington, even if the client is a Washington-headquartered company.

The statutory limitation period on B&O tax refunds is four years, plus the current calendar year. Although refunds may no longer be available for taxes paid in 2010, professional service businesses should be able to obtain refunds of any overpaid B&O taxes from January 2011 to the present by amending the relevant returns or submitting a written refund claim to the Department of Revenue.

Tax apportionment is a complex subject. We urge you to contact your tax services provider for assistance in obtaining a refund.

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